ALFA LAVAL AB

Moderator: Tom Erixon
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OPERATOR: This is Conference # 1855447

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

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

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

Tom Erixon: Good morning, and welcome to our second quarter earnings call. Let me as always start with a few introductory comments, and then we'll run through the presentation.

First, if you look back a quarter or so, the situation for the second quarter looked relatively complicated. We were unclear about the stability of the supply chains and we were unclear about how the demand situation would develop in the quarter. With the second quarter behind us, we felt we came out fairly well. The supply chain issues were largely resolved quite early in the quarter. Our delivery on time was restored. And in fact, despite lower factory volumes and challenging environment, we had a net-net productivity improvement in our operation system, which is somewhat unusual given the circumstances and the volume development.

On the demand side, at the end of the day, we had, obviously, a weaker demand in the quarter, but it came in more or less around our main scenario for how we're looking at the market outlook way back then. So – and since then, we feel that markets have stabilized somewhat on a lower level, and we will revert to that in our outlook statement later on.

Under these circumstances, we felt the margin development was positive in the quarter and increased to 17.2 percent. Clearly, the fact that we entered into an early – cost reduction program focusing on flexible solutions, implementing them quickly, led to cost savings effect of more than SEK 300 million in the quarter, above and beyond what we indicated to you in the first quarter review.

Going forward, we think the break on all of the activities and work time reductions that were implemented are not sustainable for the long term. Obviously, we will gradually return to a more normal way of operating in the second half with the effect that the cost savings would decrease during the year. At the same time, we will review a number of areas where we see long-term structural demand weakness and go back to the normal tool box on making the necessary adjustments where we feel so being necessary.

So in summary, we feel we're in a good position at this point in time. We've been going through a 3-year investment program in our infrastructure, in the product and technology areas. On top of that, our balance sheet has strengthened considerably over the first half this year with strong cash flow in the quarter and a cash net position of almost SEK 9 billion. So we feel we are well set to handle the challenges ahead of us.

And with that, let's go to the key figures. First half and the second quarter specifically. As you can see, relatively stable versus last year. We came into the year with a strong and significant order backlog and that provided certainly a good stability in the invoicing in the quarter. Still, the order backlog is reasonably strong and remains a good cushion also into the second half of the year.

On a divisional level, the Food & Water Division, as expected, was perhaps the most stable of our divisions with good performance across the board. We had variations in demand across various end markets, where certainly the wastewater area and the biotech area was strong in the quarter whereas, for example, the brewery segment was for obvious reasons, relatively weak.

We also saw, to a degree, larger projects slow or being delayed in the quarter, whereas the service business performed well not surprisingly given that most of the food and beverage plants around the world are operating at a normal level. We had a good development on the cost situation. We had very low cost of quality in the quarter. It was a clean operating quarter for the Food & Water Division. And that provided for good margin expansion in the second quarter.

Moving on to the Energy Division. In general, we had a good demand in our core energy efficiency-related businesses in particularly the HVAC sector where refrigeration was relatively stable in the quarter. And on top of that, we converted a fair amount of larger projects in the quarter, perhaps to a slightly better degree than we would have expected. So the firm bookings on the large side of the project scale was OK.

Parts of the hydrocarbon chain is obviously weak, it was weak already when we moved into the second quarter. So the drop in terms of order intake for the upstream oil and gas was not very meaningful, whereas part of the downstream business has continued on a reasonable level, including both the transportation side, where we had some important gas orders but also down on the petrochemical side. So all in all, that provided for a decent quarter. We certainly saw, though, effects of shutdowns at customer sites that impacted our service business considerably. We had a much weaker order intake on the service side in the quarter. And we were pleased under those circumstances that despite the lower invoicing, a lower in-for-out and a slightly lower service business, we managed to keep the margins stable at 16 percent, supported by good cost control.

The Marine Division certainly faced market conditions that were complicated. Yard contracting has continued on a very low level. The fleet utilization around the world is low. And the ability to perform certain service and repair

works has been hampered by the safety concerns. Consequently, market we're certainly providing a lot of headwind order intake in the quarter in those circumstances held up fairly well at SEK 3 billion. It was stable versus Q2 last year, but I remind you that the Q2 last year was comparatively a weak quarter in terms of order intake. So sequentially, we saw a downturn.

But I'd like to remind you that when we compare sequentially with Q1, we had a positive currency revaluation effect on the order book amounting to SEK 700 million. So although it is a considerable decline sequentially, part of that is actually pure currency. So you should be aware of that.

The margin improved somewhat versus Q1, but not to the 2019 level. There are some specific effects related to mix, and there are some currency effect that we also had in Q1 that we guided you for in Q2 as well. That is the main 2 drivers behind the margin decline from last year. Other than that, the margin development in the Marine Division has been relatively stable compared to last year. Moving on to the service then. After a period of growth and a successful implementation of a number of activities in the service organization, the order intake for service in Q2 was weak.

Although Food & Water was positive, partly related to customers being in full operation and partly related to a range of new service agreements being signed in the quarter. The Energy Division and the Marine Division saw negative consequences in terms of customer shutdowns, utilizations and difficulties to visit customers at their site. The effects on our service business with this respect, it is probably temporarily not a structural change in terms of how our service business will go, how fast it comes up – comes back is obviously related to the ability for our customers to come back to normal operations and normal customer visits.

Going to orders received. As indicated, relatively stable versus Q2 '19 and a decline versus Q1 '20 with the currency effects in mind. If I just sketch out and summarize the divisions – Food & Water, relatively stable; energy, some segments performing well, some energy-related segments less well, so all in all, a flattish situation; and the Marine Division with the headwinds they have, probably at the bottom of the cycle, not so much further down to go in that

area. So all around we feel that the demand situation is stabilizing on a low level. The question on the recovery rate is something we will come back to later.

The regional perspective, again, Asia performed well. We were at 40 percent order intake of our total global order intake in Asia. And certainly, China has provided a strong backbone in the quarter and the first half year with nice growth rates compared to last year. Nordic regions were strong across the board, Eastern Europe continued on a high level, and for the first half, it is a very strong performance in the Eastern European region. Western European is OK, although affected somewhat by the weak marine order intake in the quarter and in the first half. North America had an OK quarter, but we have for some time been concerned about the underlying demand in the U.S. market. And it's still, although decent in the quarter, the one area where we perhaps have seen the biggest concern in terms of how it will develop going forward.

That takes us to the top 10 markets and obviously, the big development trend has been for a period of time, China closing in on the U.S. and right now on the 12-month running rate, China looks like it's closing in on the U.S. market relatively quickly and may turn into our biggest market as we move forward in the rest of this year.

You may also note that, in fact, all our Asian markets are growing compared to last year on the 12 months, which shows the resilience of the Asian economies in a difficult time. For the rest of the market, there is not much drama there.

Then finally, the margin developments. We had a good development in the quarter. It was what I normally call a clean quarter. We had no big mishaps, no big quality concerns. So things were moving through nicely despite a challenging market environment.

We also have positive effects from starting to phase out part of the cost that's been connected to our 3-year investment program. We have guided you on that before. Certainly, those cost reductions or slowing off, of investments in

OpEx and CapEx were visible in the quarter, as indicated. The organization performed well, both in terms of tackling the short-term fixed cost program that was implemented ahead of what we had communicated to you, but also ahead of our expectations for the quarter. And we had an operations team that, under very difficult circumstances, pushed through productivity and positive PPV programs despite the very challenging quarter, especially in the beginning.

So in summary, we were battle tested in the quarter. We stood our ground well. Customer service is OK, and we kept the company strong from both an operating perspective and a financial perspective.

And with that, I hand over to Jan.

Jan Allde: Thank you, Tom. So we'll switch and talk about sales. So we expected the invoicing to be lower than Q2 2019, and we realized sales of SEK 10.5 billion in Q2, which is 8 percent lower than last year. With regards to the Q3 sales, my outlook is as follows: considering the lower order backlog versus last year, especially in the Marine Division, I expect invoicing in Q3 2020 to be lower than the same quarter last year, but on about the same level as Q2 2020.

Then looking at the gross margin. We came in at about 50 basis points below Q2 of 2019. We had a slight positive capital sales service mix in the quarter. However, due to a negative product mix, primarily in the Marine Division, resulted in overall negative mix impact in the quarter. The load volume impact ended up positive as our factories were quick to adapt their cost structure to lower volumes, resulting in a positive productivity development in the quarter. The PPV metals impact was also positive, but on a similar level as last year. Finally, we did see a small negative FX impact in the gross profit margin in the quarter related to our marine operations in Norway.

Now over to my outlook for Q3. The starting point is the 35.6 percent gross profit margin reported in Q3 of last year. We do expect a positive capital sales service mix in the quarter, but also that the negative product mix in Marine will worsen in Q3 considering tough comparison with last year, giving an overall negative mix impact in the quarter. We expect a positive load volume

impact due to the continued good productivity levels in the operations in Q3. And finally, we anticipate a neutral PPV metals impact versus last year.

Then looking at the S&A development in the quarter. So the implementation of the cost reduction program has progressed well, and we saw a significant impact on S&A expenses in the quarter, generating savings of SEK 325 million or a reduction of 18 percent versus last year. The benefit of this program is that it has been quick to implement. It has protected our employees, and we have not incurred any restructuring cost. However, it is important to recognize it is temporary in nature.

As market demand is now perceived to have stabilized, we will stepwise return to more normal operating model and the effect of the cost reduction program will gradually decrease during the rest of 2020. My previous guidance of savings of approximately SEK 500 million to SEK 600 million for the full year 2020 remains but is likely to materialize in the upper end of that range.

Looking at the key figures. As commented in my previous slide, S&A expenses were reduced by 18 percent in Q2 versus last year. And in percent of sales, S&A expenses decreased from 15.6 percent in Q2 2019 to 13.8 percent in Q2 2020, with a direct impact on the overall profitability of the company.

R&D expenses decreased by 5 percent versus last year on a comparable basis due to the overall reduced activity level in the company during Q2. Net other cost and income in Q2 2019 included a gain of SEK 196 million from the divestment of a air heat exchanger business. Excluding this, net other cost and income showed an increase of SEK 54 million in Q2 versus last year, which is mainly explained by an increase in royalties paid to our ballast water joint venture partner in the Marine Division.

Financial net, excluding FX impact, was minus SEK 51 million in Q2, which is same level as last year, and the FX gains and losses amounted to a positive SEK 191 million, giving a total financial net of positive SEK 140 million. The tax rate came in at 24.6 percent in the quarter, slightly lower than our guidance of 26 percent. EPS was down 9 percent versus last year, partly

explained by the extraordinary income last year from the sale of the air heat exchanger business discussed earlier.

Then moving over to the cash flow statement. So cash flow from operating activities was SEK 2.8 billion in the second quarter, which represents an increase of SEK 2.2 billion versus same quarter last year. This increase was primarily driven by a reduction in working capital as this has been a major focus area during the quarter.

Investing activities included CapEx investment of SEK 192 million in Q2 and SEK 399 million for the first 6 months of 2020, which represents a reduction of 34 percent versus last year as the wave 1 of the footprint program was completed at the end of last year, and as we have further prioritized our CapEx decisions. Our CapEx guidance of SEK 1 billion for the full year 2020 remains.

Financial net paid, excluding FX impact, was minus SEK 44 million, again, similar level as last year. And the net realized FX gains amounted to SEK 18 million in the quarter, giving a total financial net paid of minus SEK 26 million. This means that our total cash flow in Q2 came in at SEK 2.6 billion, which has considerably increased versus last year, very important for us to ensure our strong liquidity position during these turbulent times.

And that leads us to our net debt position. So considering our strong cash flow generation during the first half of 2020, we have made a considerable reduction in our net debt position, which now stands at SEK 5.3 billion, including lease liabilities of SEK 2.5 billion. This should be compared to a total net debt position of SEK 8.2 billion at the end of 2019.

Our net debt-to-EBITDA ratio now stands at 0.58, and excluding the lease liabilities at 0.3. This means that our net debt-to-EBITDA ratio is now at a level below the one before the acquisition of Framo in 2014.

From a capital structure, we have refinanced the loan with the Swedish Export Credit of USD 136 million, that matured in June 2020, with a term loan with SEB and Nordea of SEK 2 billion that will mature in December 2021.

Then looking at the FX impact on EBITA. So the transaction FX effect on EBITA in the quarter was positive SEK 90 million, while the translation impact was a negative SEK 30 million, giving a total positive FX impact on EBITA of SEK 60 million in the quarter. Please note that this FX analysis does not include FX impact caused by revaluation of balance sheet items in foreign currency.

Looking at the projection for full year 2020, we expect a positive transaction impact of approximately SEK 440 million and a negative translation effect of SEK 180 million in total, a positive FX impact of around SEK 260 million.

Then looking at the order backlog at the end of June, so we had a total order backlog now at SEK 21.9 billion, which is about 10 percent lower than the same period last year. However, it's about 3 percent higher than at the end of 2019. The book-to-bill ratio in the quarter was 0.93 percent, and the order backlog now represents approximately 5.7 months of LTM sales.

For shipment in the second half of 2020, the backlog amounts to SEK 12.1 billion, a reduction of SEK 1.4 billion compared to the same time last year. The majority of this reduction is related to the Marine Division.

And this then leads us into the sales bridge for the full year 2020. So the year-to-date sales is SEK 21 billion. And as stated in the previous slide, the backlog for delivery during the current year is SEK 12.1 billion, which leads to a subtotal of SEK 33.1 billion. On top of that, you will, of course, need to make your estimates on price, change in in-for-out orders and FX translation impact. Please note that our estimated FX translation impact for the full year 2020, given the current FX rates, is estimated to be negative SEK 900 million.

And by that, I hand back to you, Tom, for outlook statement.

Tom Erixon: Thank you. Some short words or background first. We feel that we've gone over the last quarter from a pandemic crisis situation to more of a normal business cycle downturn. And at this point in time, we don't see it moving strongly in either direction. We interpret it as we are at the lower point of the business cycle downturn. And that's most likely where we will remain in the third quarter.

There are a bit too many red flags in the macroeconomic scenario for us to be very optimistic about general economic upturn quickly. And let me remind you that we are still facing situations of trade wars that we have been debating for the last 2 years. Budget deficit problems are increasing and unemployment as well.

So in that scenario, our main strategy is to continue to keep costs under good control, although, we will be gradually returning to a bit of a normal operating mode in the company gradually in the second half. That means that we also have to selectively compensate for this by adjusting our businesses as needed structurally to the demand situation that we will face. And we have some natural opportunities to do that as part of our footprint programs where we have already prepared for such things, and there are some additional measures that will be considered during the second half.

The outlook, consequently, for us is that we expect demand to be somewhat lower in Q3 compared to Q2. And on a division level, the Food & Water is expected to be somewhat lower, Energy Division to be somewhat lower and the Marine Division to be somewhat higher.

And that summarizes the outlook statement, then we are open for questions. Thank you. Do we have an operator then?

Operator: Ladies and gentlemen, we now begin the question-and-answer session. As a reminder, if you wish to a question, please press "star" "1" on your telephone.

We have the first question from the line of Klas Bergelind from Citi.

Klas Bergelind: Tom and Jan, it's Klas from Citi. So first, on the cost actions, very strong execution. But just a question for you Jan, when you say SEK 500 million to SEK 600 million for the year upper end, SEK 600 million. So is it SEK 600 million less, what you did this quarter, it's around SEK 275 million for the rest of the year, just so we get that right? And is the full program of SEK 1 billion impact, so is the rest to hit next year? And for you, Tom, on the same topic, you talked about likely longer-term actions in weaker areas. So where do you see that need, I will start there?

Jan Allde: No, you understood it correctly. So as we said, we expect to go back to a more – I would say, gradually return to a normal operation level. That means, of course, since this cost-saving program have been, as I said, a flexible and temporary in nature. We expect also that the cost-saving program will gradually have a smaller effect for – during the second half of the year.

Tom Erixon: Yes. Regarding the structural, I want to be a bit cautious here because, as you know, we prefer to make sure that we have an internal communication and rollout program before we are communicating externally. The one area that is clear, though, and has been communicated before is the fact that we are completing the transition from Copenhagen to Krakow when it comes to our Decanter factory. And that was delayed due to a high level of demand during a period of time. Krakow is now fully up and running, and we are in a full swing to complete that transition with a year's delay.

But for good reasons, we kept Copenhagen up, and they've done a wonderful job in making sure we could keep the customer service going during this high demand period. There will be some other areas that are being evaluated and addressed. We don't foresee at this point in time, a large restructuring program, that's not what we see in the cards right now. We have relatively good opportunities to work with temporary labor with adjustments, where we don't necessarily have high restructuring costs. So right now, there may be, obviously, I'm not excluding anything, but it is not a major restructuring program/charge around the corner.

Klas Bergelind: OK. Very clear. Then my second one is on services. Orders are growing more than sales. And I appreciate and understand book-to-bill is not always in balance on the service side. But I guess, services will see a bit more pressure into the second half. But on orders, could you help us some with exit rates on services in June and into July? How quickly did you come back there as we were opening up and got more access?

Tom Erixon: The speed of recovery, I will leave a little bit open. I mean, we don't see a real structural change in our service business as a result of this. But it's also clear that they are in areas where we have customers that are not operating,

obviously, it will be 0 until they are. I think a good example of that is the cruise industry, which is obviously affecting our Marine Division to take one example. And part of the repair works that require people to fly with different nationalities to different destinations, and that will also be hampered for a period of time. So I don't think that the whole issue will disappear in a couple of months. But I think maybe that the immediate impact in Q1 was perhaps slightly elevated compared to what we should expect.

Klas Bergelind: OK. My very final one is on Marine and the mix, which is linked to lower sales of Pumping Systems and environmental. Jan, when do we start to comp out on this? So asking this given that Pumping systems orders are quite solid, has been for 2 quarters. So what is the book-to-bill now in Pumping systems? And then what is the lead time? So at current demand, when can mix start to improve in Marine? I know it's forward-looking, but yes, you see what I'm trying to get into.

Jan Allde: Yes. I would say we try to be fairly transparent on this, as we came into 2020, saying that the order book that we carried with us from Pumping System was lower than the same period in end of '18. So that is, of course, one aspect. We have, though, seen a pretty good and stable order intake on the pumping system. I think the second element, of course, is the mix in the environmental side, which I would say is what I'm referring to when I say that we would have tough comps in Q3.

Klas Bergelind: OK. So pumping system is – Pumping System has been down year-over-year, correct, in revenues?

Jan Allde: Again, I would say the pumping system from the volume point of view has been OK. So for – I think the big mix impact that I was referring to is more on the environmental side Klas.

Operator: The next question came from the line of Madhvendra Singh from BofA.

Madhvendra Singh: First question is a quick one. You had a big delta on the working capital side during the quarter. How quickly would you expect that to reverse and whether you would expect that to continue, this positive trend, for the rest of the year? Or would you expect a reversal and how quick? And secondly, just

following up on the backlog that you have, how comfortable are you with the levels? And do you see any issues in terms of book-to-bill and so on? And if you could talk, particularly the trends you are seeing in China, if you talk about the growth trends out of China, that will be great.

Jan Allde: Well, with regard to the first question on the working capital, if you've followed us these last 2, 3 years, we have grown this company fairly fast. And along with that, we have grown our working capital, to a level which historically is at a fairly high level. We have worked with a high focus now to bring down the working capital levels to more, let's say, normalized level. We had, of course, fears that we – as we went into this corona situation, we could run into problem. That's why we've had a high focus on this topic. We've gone through the period so far, I think, in a good way. We will, of course, keep a continued high focus on this point.

When it comes to the order backlog, as I said, we had a backlog now, which represents approximately 6 months of sales. We haven't had any significant cancellations or postponement in backlog. So we feel that backlog is solid.

Madhvendra Singh: So is it fair to assume on working capital question that you wouldn't really expect a major reversal in the working capital trends going forward?

Jan Allde: Well, it's always very tricky to provide some kind of outlook statement on cash flow and working capital. I'm just saying that the working capital levels have been elevated as we've grown the company fast as sales have now stabilized on a lower level. Naturally, you do also see working capital coming down. And the second point, as I said, we've had a very high focus on this, considering the challenging time that we've gone through here.

Madhvendra Singh: May I ask a question on Marine Division as well. It seems like this division has bottomed out in terms of growth rather the pressure on the growth. What is driving the stabilization at this point, especially if you talk about whether it is the cruises or other segments, which are still weak, so – but still, you are seeing demand actually kind of bottoming out. So what is driving this, let's say, Marine Division's bottoming out here?

Tom Erixon: I think the big issue in our Marine Division is that the new contracting amounts for only a portion of our orders. Part of the – the big part of the Environmental business is driven by retrofits in the existing fleet. So that is not so dependent on the contracting side, although part of the sales goes there. The service business, although somewhat depressed.

Obviously, the majority of the world merchant fleet is sailing as normal and needs spares and service as normal. So there certainly is a continuation of that business. We have partly an offshore business that is booked on the marine side, and that has also booked a number of orders in the quarter. So even leaving aside the new contracting, there is some stability in the division coming from those areas.

If you look at the contracting side, although the numbers are depressed, it also is so that in terms of the ships that are being booked today and contracted today, the ship mix in terms of what is attractive for us in terms of our business opportunity per vessel is relatively positive. So while the overall number is depressed, the specific target segments for us are not as weak as the total market. But of course, we prefer to see a very different number there anyway.

Operator: The next question came from the line of Johan Eliason from Kepler.

Johan Eliason: This is Johan at Kepler Cheuvreux. Congrats to good performance during this quarter. Staying on the marine side, I was just wondering, we've obviously seen some sort of delays in shipyard deliveries because of lockdowns, et cetera. But I think we are getting some signals as well that customers want to postpone deliveries even further, primarily, obviously, in the cruise segment, but are you seeing that also in other segments?

Tom Erixon: No, it hasn't been – it hasn't been a big factor for us. I think in general, our reflection on the quarter was less than expected, especially on the retrofit side, we were, of course, seriously concerned in the beginning of the quarter of the ability for ships to dock and all that. So I think given the turbulence that comes by nature with a sailing fleet with limitations to as how they can actually dock and enter harbors, I think the development was relatively good.

Johan Eliason: OK. And then just shortly on your outlook statement by division. You said Food & Water and Marine are somewhat down, and Energy is somewhat higher, if I understood you correctly, what's the reason for energy being...

Tom Erixon: Marine is somewhat higher – sorry, marine is somewhat higher and Energy and Food, somewhat lower. I hope...

Johan Eliason: No, it might be my mistake. So OK Marine is somewhat higher. And the reason for that 1 being somewhat higher, are you seeing some big orders in the pipeline there or what's the situation?

Tom Erixon: Well, it's not really a big order. It's – there certainly are some larger orders potentially out in the market. We see specific segments where we expect demand to be decent such as gas carriers and a couple of other vessel types. So it's not all doom and gloom in the marine market, but we just feel that when we look at the pipeline that we have, the fact that the quarter wasn't super strong.

We simply have some optimism for where the market is moving on a low level at the moment. And I remind you that the order intake for the second quarter in the Marine is not, when you compare historically, particularly high, whereas on the Food & Water side, we are on a high level and have continued on a high level. So I think there's some reflections on where we were in the Q2 numbers, that affects the way we look at the outlook from going forward.

Johan Eliason: OK. And then finally, just on the environmental systems, I guess we can skip scrubber talks for some time with the current spreads. But on the ballast water, what's your understanding of your market share right now? Is it sort of at your 40 percent level you have in many other product areas or what are we talking about, do you think?

Tom Erixon: I would hesitate to give a firm answer to that. But what I'd like you to keep in mind is that there are 2 competing technical solutions: one chemical solution, where we are not participating; and one UV-based technology, where we are very strong. So it's not a 50-50 split. I mean, I think the UV technology has the largest share but when you count market shares for the global market,

you need to chop off a significant part of the market before you start to look at the area where we are competing.

In the area where we are competing, I think we've been coming out well. It's been, as you know, some 50 competitors in the race from the very beginning, and we've got a good market position on the retrofit, but we have also been able to capture a fair amount of orders on the new build.

So all in all, it played out well. We have at times done retrofit on competing systems that have malfunctioned at the ships as well. So I think the technical level of our solution and the fact that it absolutely needs to work or else you may face some dramatic fines when you enter foreign waters, has made shipowners be a little bit cautious in terms of what systems they put on board

I would say we are – if you eliminate the chemical systems, we are on about normal market share levels compared to the rest of our marine business, which may be a bit better than we were hoping for looking back some 2 years when the race of competitors look fairly broad.

Johan Eliason: OK. Good. And then finally, I don't know if you can say something, but obviously, having talked to Pasi at Valmet. He is very intent on stopping you getting the 2/3 majority for a cross-border merger at the AGM. What's your view on the situation right now?

Tom Erixon: Well, it hasn't really – it is as expected. We obviously made our offer to all the shareholders, but specifically to 85 percent of the shareholders, we think it's a fair offer. It's a full valued offer. And at the moment, there is no other offer on the table. So I'm hopeful that the shareholders will come to a positive conclusion as we enter into the offering period in the mid-August. And that's where we are on the situation, and I hope we will find a good solution.

Operator: The next question came from the line of Mattias Holmberg from DNB.

Mattias Holmberg: Mattias Holmberg from DNB here. When you say that the market demand at this point is perceived stabilized and that you expect a step-wise increase, do you mean that sort of the Q2 sales was a low watermark and that you expect

an increase going forward from this level or am I reading too much into this comment?

Tom Erixon: Yes. I'm not sure I took the word stepwise increase in my mouth. We – if anything, I think I'll comment on the macroeconomic scenario is that from an industrial point of view, we feel we are at the bottom of the cycle, and we are not overly optimistic as to how we will go short-term in the coming quarters. So I think we see more of a stability situation than a gradual improvement at this point in time. If I'm wrong, I'd be very happy.

Mattias Holmberg: Also to Jan, regarding your comment on FX, where you said that the figures on the slide does not include any balance sheet FX revaluation. Did you have any such revaluations that impacted Q2 earnings, please?

Jan Allde: Well, we had really large such revaluation effects in Q1 and as we guided, we had some impact also in Q2, but much smaller than what we saw in Q1.

Mattias Holmberg: And you do not to quantify this?

Jan Allde: No. Because they are not material.

Operator: The next question came from line from Sebastian Kuenne from RBC.

Sebastian Kuenne: Yes question one would be on the energy side. You mentioned strong invoicing. And I was wondering if that is for projects that dragged from Q1 into Q2 or projects that you were thinking of delivering in Q3 and that shifted in Q2? That would be my first question.

Then on Marine, could you maybe be a bit more specific on what order volumes come from refurbishment of ships and what comes from the new build sites at the moment, we'll put the ratio roughly, so we get a better picture and can use the Clarksons data a bit more effectively?

And then on Food & Water, compared to the other businesses, this was kind of most in line, the strong beat, but Food & Water was in line. And I was wondering whether you now see maybe a more better recovery or better

demand from the food processing industries that would lead to some growth maybe in the second half, what is your view there on the food side?

Tom Erixon: All right. On the Energy division, I may not have been crystal clear in my comments. The large order pipeline was affecting order intake positively only. We always have a pipeline of projects that are discussed, negotiated signed and waiting for down payment, moving into a quarter. And that conversion into firm orders was relatively strong for the larger projects in Energy division. And that was actually an opposite situation in the Food & Water division at that quarter. So I thought it was a significant development that may not fully repeat itself in Q3. Hence, the outlook statement for the energy division.

In terms of the invoicing, the invoicing was not particularly fast. If anything, it was perhaps on the low side given the order backlog in the division. So we were pleased with the margin development that tends to go a little bit with the invoicing level otherwise. But actually, the margin went the other way due to several factors in the quarter. So for the Energy Division, that was quite good, and we are moving into Q3 with a good order backlog. So situation is under control.

On the Marine division, I'm – we have – you could – there is in the appendix, the Marine division's industry split in the presentation. And there, you will find the share split in terms of marine world trade and fleet capacity, which is basically new built, about 30 percent of the order intake service, about 26 percent of order intake. The offshore side and land-based power about 10 percent. And then we have various retrofits. And to a degree, there is some small new build in those numbers, too. But the environmental aspects of legislation and fuel cost is about 1/3 or 34 percent of the order intake.

So there, you have more or less – that number is somewhat overstated due to that there are some new build that is also installing environmental systems. But the large part is – it's probably fair to say about 1/3 if is shoot from the hip here. So those are the numbers. And we publish those as every at every quarterly report. So they may be helpful for you in that guidance.

Question number 3 was Food & Water and where it's going in the second half. I mean, we indicated a somewhat weaker third quarter. We don't typically give a fourth quarter forecast. So we'll get back to that. I think what will decide the Food & Water number is to what degree larger projects are moving through or not moving through. And they were a bit slow in the beginning of this year.

We haven't come to a different conclusion for the second half, specifically. But our guidance in terms of the third quarter is not driven by a general downturn of activities other than very specific areas like brewery that is negatively hit by the pandemic. But otherwise, in general, terms will look reasonably favorably on the Food & Water market in – at least in the medium perspective.

Sebastian Kuenne: So growth could be possible for the year?

Tom Erixon: I will not exclude neither decline or upsides on the numbers that we are discussing, but you're not going to get me to comment further than that.

Operator: The next question came from the line from Sven Weier from UBS.

Sven Weier: The first one is also a question on the food side. The beverage exposure that you have in food, was beer, the only weak spot or also some other beverage segments? And when you talk to your brewer clients, how do you see them proceeding? I mean, is the pipeline generally OK and those orders are going to come through once we have a proper vaccine and people come back or do you see structural changes here on the brewery side happening? That's the first one.

Tom Erixon: Yes. I mean, the other main beverage sector that we are involved in on the food side, that is the driver is the dairy industry. And the dairy industry in the first half and certainly the second quarter came through stronger than expected. There are – there has been some market turbulence in the dairy segment, not least in the U.S. And so we had some concerns moving into the second quarter on that area, it hasn't been a growth area in the first half of the year, but it's been on a relatively stable and high level coming in from a good

2019 so that has been, so far, a positive development for us given what we believed.

The brewery side, I mean, it's a good question. I would just first frame it by saying it is not the major share of our Food & Water. So the implications of those numbers are not huge. But if you dissect our brewery business a little bit and take away the service component, which is probably around average compared to the rest or average plus compared to many other applications that we have, the – there's been a period of consolidation in the market and largely we feel that process has been completed in any case. So large production facility mergers and installations are fewer and far in between at this point in time.

The other – and that's regardless of the corona situation. The one area that is affected short-term and has been gradually more important is the craft brewery side where we see bankruptcies and smaller craft brewers that are simply not getting their beers out to the pubs and places where people buy them. So and we think that will also create a bit of an overhang when it comes to second-hand equipment and other things that are going to be available in the market. So we are on that part of our business on a much lower level than we've been in the past.

The last part of our brewer business is mainly driven by product diversification among the large brewers. And there are flavored beers there dealcoholization processes and a number of changes that require additional equipment installed in existing breweries, that business will probably, to a degree, continue irrespective of this. So there are variations on the theme. But clearly, it will be difficult for the brewery industry as such to create a clear growth path for us in the quarters to come.

Sven Weier: OK. So that sounds like 1 of the structural areas you mentioned earlier in the conversation that might need some attention, I guess, right? It sounds like, if anything, a very slow recovery on that end.

Tom Erixon: It probably is. But again, a lot of the product range is shared into other segments as well. So it's not a huge aspect, but in principle, yes, you're right.

Sven Weier: And then secondly, a follow-up on Neles. I mean given Valmet's action, I mean, do you intend to have a conversation with them or to find a compromise or you basically intend to treat them like every other shareholder of Neles, and there is no conversation planned here to find a solution?

Tom Erixon: No. There's no negotiation path at this point in time. We've made an offer to 100 percent of the shareholders, and we will await the response, and then we have to take it from there.

Sven Weier: OK. And then lastly, just a housekeeping one. Obviously, you mentioned there were no cancellations in the backlog to a large degree. I was just wondering if you also took orders out voluntarily where you could see some issues or is that also tiny?

Tom Erixon: No, it's been relatively – there's always a small we don't bother you with the small adds and back and forth on the order backlog. But the movement – the extraordinary movements have basically not been there. We were clearly concerned as we came into the quarter we came out without any major deviations, and we didn't adjust manually either from our side. So it's been intact and solid, and we feel good about the order backlog as it stands.

Operator: The next question...

Tom Erixon: We go for last question at this point, maybe?

Operator: OK, sir. The next question comes from the line of Lars Brorson from Barclays.

Lars Brorson: Tom, if I have 3, if I could do 3 quick ones. First of all, on the demand outlook, I'll give you credit for giving us a very granular demand outlook. Thank you for that. It's not an easy environment to do that. And so maybe with the risk of being slightly unfair, if I can press you a little bit on the divisional demand outlook in both Marine and in Energy. First of all, in Marine, can you help me a little bit with how big a part of, as you say, pent-up demand in services would explain somewhat higher demand in Q3, and

Can you talk a little bit about whether you feel that demand outlook is sustainable? I appreciate some bigger orders. I think you called out gas carriers and specialty vessels. But if you could talk a little bit about sustainability of that Marine development as we look further into the year and into next, if at all possible?

Tom Erixon: Yes. I don't think services has played a major role in our outlook statement. We are a little bit unsure as we indicated in the question earlier in terms of when we will be able to get back to full-service operation at least when it comes to that part that is driven by our ability to visit ships and to actually execute repair works and such.

There's also – the cycle tends to be in tough times, some shipowners reduce their spare parts inventories and the amount of spare ports that are delivered on ships, whereas when times are good and freight rates are good, some shipowners take the opportunity to stock up on spare parts.

So we see some cyclicality in terms of that pace. But that is obviously not sustainable. So I would expect that regardless of our abilities to do customer visits, we will gradually in this year, see some improvement in the service business for the marine side. But we haven't plugged it as a major factor in the Q3 outlook statement.

Lars Brorson: Do you feel that if IMO – sorry.

Tom Erixon: Yes. Go ahead.

Lars Brorson: I was just going to ask you, Tom, on that. Do you feel that, that IMO-driven boost to your service business, so the multifuel reconditioning work, et cetera, is that largely behind us or do you still feel that, that can continue to deliver some support to your service business going forward over the next few quarters?

Tom Erixon: I think we sort of came through a fair amount of the multifuel work at the end of the year and beginning of this year. So I don't think we will be – that was and I think we indicated that during the second half of last year as well that we would see a temporarily increase in the service business and service

installation business related to the multi-fuel. So we don't think that will return as such.

But I would still say that if you look at it structurally from our business, in new build opportunities and also in ongoing maintenance and service business for the existing multifuel solutions. There is – the overall scope of our service business, covering multi-fuels, but also increasingly covering our ballast water systems and our scrubber solutions, the overall service scope per ship is generally larger today than it was 2 years ago.

Lars Brorson: Clear. Secondly, can I ask briefly to the energy division. I mean, you called out the U.S. as 1 area that you're most concerned about. You're not the only one. I think we've heard that throughout this earnings season. I appreciate the headwinds you're facing in your upstream business there within energy, I think that's well known. Can you help us a little bit more about where you're concerned and whether you see more broad-based weakness in your hydrocarbon downstream business in the U.S. going forward?

Tom Erixon: Well, I think on the – as opposed to some other markets, I think the amount of the project delays also on the downstream side has been higher in the U.S. There's been projects that have been advanced that normally would go through that didn't go through in the U.S. So our when we've been looking at where we've been on our pipeline, in general, and I wouldn't limit this to hydrocarbons only, but the willingness to put firm CapEx on the table in the number of end-user industries has been limited.

And add to that, that there has been a pronounced problem of uptime or shutdowns, if you like, with certain customers areas in North America, including Canada, the situation for the OpEx driven and the CapEx business has been somewhat weak in the U.S. And we feel that this was actually a situation that started even in 2019. We had a very bullish outlook on the U.S. If you move back a couple of years that I think we were not alone in.

There was certainly a lot of perceived momentum in the U.S. economy at the time. It didn't quite materialize that way for us, not even in 2019. So for that reason, we have had the U.S. market a bit on an extra watch for a period of

time to understand where it's going. And certainly, in second quarter, was the first time that maybe came in a bit better than perhaps we expected, but we are not in the U.S. where we felt we should have been for some time now.

Lars Brorson: Clear. A quick third one, maybe just for Jan, if I can. Jan, you were very clear in calling out the impact from currency revaluation of Marine in Q1. The Norwegian krona has made a full upturn off the big move we saw in March. That's obviously the big reason for revaluing, particularly in Pumping systems. So it's not obvious to me why it would not be material in Q2 in the way that it was in Q1. So with the risk of pressing you a bit, I'm a little surprised you're not able to help us with some levels around the impact, marine?

Jan Allde: Yes. I – let me – I mean, if you look at the margin impact in Marine in Q1, we said that the FX impact in total was about 2 percent impact on the margin. I would say, if you look at Q2, it was about 1 percent. But that 1 percent doesn't necessarily – the bulk of that doesn't really come from the revaluation. It's more the fact that we have this dilution impact coming from the fact that we are sitting in hedge contracts that are lower than, sort of say, the prevail NOK USD rate.

Tom Erixon: All right. And with that, we'd like to thank you for listening in on the call. And if not before, we will meet up again 3 months from now. Thanks a lot.

Operator: That has conclude our conference for today. Thank you for participating. You may all disconnect.

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