

ALFA LAVAL AB

Moderator: Tom Erixon
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OPERATOR: This is Conference #: 8959035

Operator: Good day, and thank you for standing by. Welcome to the Alfa Laval Q1 Earnings Call. (Operator Instructions) Please be advised today's call is being recorded. I'll now hand the call over to your speaker today, Tom Erixon. Please go ahead.

Tom Erixon: Thank you, and welcome to the Q1 earnings call. As always, I'll start with a couple of introductory comments before moving into the presentation.

First, order intake was very strong at SEK 13.3 billion, a new all-time high. Demand was good all over the place. But of course, it was especially firm in the Food & Water division with an exceptional organic growth rate of 40 percent in the quarter.

Margins were overall stable on a group level at just above 17 percent despite some variations between divisions. As indicated in previous quarters, the operating environment is complex and some quarterly volatility is to be expected. And indeed, we had some of that polarity on the divisional level in Q1.

Finally, as you know, we signed an agreement to acquire Desmet, an engineering firm complementing Alfa Laval in important growth areas of vegetable oil and biofuels. We expect to close the transaction mid-2022 and add approximately SEK 4 billion at around the double-digit market starting from there.

So with that, let's go to the key figures. As you've seen, our organic growth was strong and solid in Q1 at a rate of 20 percent. You should be aware that, of course, we have a slightly higher share of price growth in the numbers than we traditionally have had. So we would estimate that the price effect in the quarter is maybe in the area of around 5 percent. And the volume component, somewhere in the neighborhood of 15 percent for your reference.

Sales is going slower than orders related to the disturbances in the supply chain worsening to a degree. Before, in earlier quarters, we've indicated to you that we were lagging in deliveries approximately around SEK 150 million. Now, in this quarter, we estimate that lag to be in the order of SEK 600 million. And consequently, with some effects on sales cost ratio and also in terms of the gross profit from the operations. With that said, profit grew in line with invoicing for the quarter.

Then going on divisional level, starting with the Food & Water division. As I already indicated, we had an exceptional quarter in the division with a total order intake at SEK 5.7 billion with clearly strong demand across all of the end markets of the division, partly the exceptional order intake was driven by large SEK 700 million brewery order that was booked in the quarter. But even without the large order, we would have been way over 20 percent in the organic growth rate and at SEK 5 billion, it would still have been the all-time high for the division by far.

Sales increased, but the supply chain challenges affected invoicing negatively with an increase of the backlog, the late deliveries. In fact, the supply chain challenges are somewhat bigger in Food & Water and to a degree, Marine, compared to the Energy division as a whole.

The margin was stable in the quarter. We had positive volume effects and negative mix effects. And those two pretty much balanced out in the quarter.

Now in this context, a few extra comments on the Desmet acquisition. We were excited to announce the acquisition a few weeks ago. The strategic rationale for us is to take a further step in building our (Palomares) position in

the energy transition and biofuels is one of several tools that are important for us in our offer towards a decarbonized planet.

Combined with Alfa Laval's know-how, we have a complete engineering know-how and product coverage, feedstock to final product. So we will become a very strong company in this area. Our intention is to continue to operate the Desmet brand within the Alfa Laval portfolio of offering. And with that, we believe that we are well positioned for a dynamic and growing sector going forward.

The running rate of Desmet, we estimate to be in terms of invoicing in the order of magnitude of around SEK 4 billion per year. And we expect that the margin, leaving out then the synergies or other improvement areas that we may do, currently would be at approximately 10 percent, which mirrors fairly where Alfa Laval is currently in our engineering business in food systems.

Then on to the Energy division. We had a positive demand trend that continued related to the energy transition as a whole. Energy efficiency solutions are the main driver in the growth but we also had some early signs and bookings within the hydrogen market. And we also see a recovery in the gas sector related to LNG, whereas the traditional oil upstream, downstream remain on a fairly depressed level.

The supply chain is relatively stable in the Energy division with invoicing growing pretty much as expected and pretty much in line with the order intake growth.

The margin improved significantly in the quarter, supported by volume and also some revaluation effects on the inventory. Going forward, pricing effects should partly compensate for the future absence of further revaluations.

As I have indicated to you throughout the quarters, there are many moving components in the results of the group and on the division and here, you have some of those ingredients.

Then moving on to the Marine division. Despite cancellations of part of the Russian order book amounting to around SEK 500 million, the net orders in

the quarter were still on a stable level with a small growth which indicates an underlying sound market demand.

Sales were stable, but supply chain challenges affected the shipments in the quarter, not least in relation to our Chinese supply chain, where we have substantial industrial activities, we are being challenged by lockdowns, and this will likely continue in Q2.

The margin dropped in the Marine division with several headwinds as a result. The mix was negative partly driven by the ballast water joint venture and the increasing share of invoicing. We also had deliveries of an old backlog priced at the old conditions. And we have earlier indicated to you that the group margins may be affected by approximately minus 0.5 percent as a whole. And this quarter, that was mainly affecting the Marine part of the business. In all, we are addressing the situation in the Marine division, but it will take a few quarters to sort out.

Then moving on to Service. We had a very strong service quarter with a new all-time high and a 16 percent organic growth rate. All three divisions had good development but it was unusually strong in the Marine division.

Note, when you look at the Marine numbers where, for the first time, the share of Service was 42 percent that, that mix was a little bit affected by the order calculation related to Russian orders. Consequently, the more normalized level would have been around 35 percent or so, which is slightly closer to, let's say, the historic average numbers. All in all, a good quarter for the Service business.

Returning to the overall or the intake situation. As I indicated, a new all-time high, supported by large orders, but certainly, the underlying demand trends was very positive. In fact, the large orders are a bit more than normal, but not dramatically. So if you want to get a feel for the pace, you could say that the one-off large brewery order that amounted to around SEK 700 million in the quarter was pretty much balanced out by the write-off of SEK 600 million of Russian-related orders. Those two taken out of the equation leads you to approximately the same level of orders that we actually accounted for in this

quarter, SEK 13.3 billion. If you add the Russian parts of it and just look at the gross order for the quarter, we were in fact close to SEK 14 billion.

The regional picture, of course, when you have this type of growth, the whole world grows very synchronized. We had a stable situation in China and a much stronger growth path in Southeast Asia than previous quarter. So all in all, Asia was positive. We had a very strong quarter in North America, especially in the U.S. with unusually high growth rates across the board.

Europe was good. Latin America was good. And in fact, even in Eastern Europe, with the big cancellations in Russia and the pausing of all new Russian orders, we are still ahead when it comes to the order intake in Eastern Europe as a whole, net-net.

So that is the situation in the market. Let me then in this context, give you some final comments on the Russia, Ukraine situation. We have earlier communicated that we are pausing new orders in Russia due to the complex situation and the sanctions. That decision remains in place for now. We canceled approximately SEK 600 million from the existing order books in Q1 due to the existing sanctions. We have also canceled SEK 200 million in signed but not booked orders in the quarter. So all in all, SEK 800 million, approximately corresponding to normal business year in Russia.

We made provisions of around SEK 330 million to cover for possible costs related to our contractual obligations in Russia. The net assets in Russia amount to only SEK 30 million. So impairment is a minor issue for us going forward. However, we do have 240 employees in Russia, and although we have started a personnel reduction in that process, we may have some restructuring costs related to the personnel situation in Russia, either in Q2 or as we find appropriate depending on when decisions are being made.

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

Jan Allde: Thank you, Tom. And as usual, we'll jump into the sales picture first. So we expect that invoicing in Q1 to be higher than the same quarter last year. We realized sales of SEK 10.6 billion, which is 18 percent higher than last year.

Please note that we had a positive FX translation impact on sales in Q1. Excluding this, sales were up 12 percent.

Invoicing was a bit lower than expected, especially in the Food & Water division due to the delayed shipment related to the worsening supply chain situation. We estimate this impact to be approximately SEK 600 million in Q1.

With regards to sales in Q2 outlook as follows. Considering the strong order backlog – or sorry, the increase in order backlog during last year also in the first quarter, I do expect invoice in Q2 to be higher than the same quarter last year.

Then we look at gross margin. So the gross profit margin in Q1 came in at 39.1 percent compared to 38.2 percent last year. The overall mix price impact was slightly negative primarily due to the execution of orders in the Marine and Energy division that was priced prior to the material cost increases.

We had a continued good load in capacity utilization in most of our factories during the quarter. The PPV metals impact was positive in the quarter, mainly because of the onetime inventory revaluation effect that compensated for higher raw material costs. The inventory revaluation effect primarily affected the Energy division. FX impact was slightly negative in the quarter. And finally, the acquisition of StormGeo had a positive impact on the gross profit margin.

Now when it comes to the outlook for Q2. The starting point is, of course, the 38.2 percent reported last year. We expect a slight positive capital sales service mix on a comparable basis. And we expect a continued good load in capacity utilization in our factories with exception of some sites in China impacted by the COVID lockdown situation there.

With regards to the PPV metals impact. As communicated during the CMD, we do expect that we can offset most of the cost inflation with price increases and material price hedges in place. However, part of the opening order backlog in 2022 primarily in Marine and Energy divisions was priced prior to the large material cost increases. And we expect this order backlog impact to

be more visible in the Q2 quarter as the offset from the inventory evaluation effect will be much smaller than in Q1. We do expect also a continued slight negative FX impact on the gross profit margin also in Q2.

Now looking at the S&A expense development. So our S&A expenses were up 11 percent in Q1 on a comparable basis. This increase is reflecting the overall high business activity in the company, the inflationary pressure, but also that we have selectively adding resources in both our current businesses with high growth but also in some of our more long-term business development areas. We expect to gradually offset the increase in S&A costs by increasing sales volumes as we execute on the large order backlog.

The EBITDA margin came in at 17.1 percent, same as last year despite major challenges in the supply chain with decreased material and freight costs as well as larger negative impact on sales caused by delayed shipments. The cost inflation was compensated by price increases as well as positive volume and revaluation effects, as earlier explained.

Then looking at some of the key figures. So on a comparable basis, S&A expenses were up 11 percent and R&D expenses were up 3 percent versus last year, reflecting the overall higher business activity in the company. Excluding comparison – items, primarily the provision taken this quarter related to Russia of SEK 327 million, net other cost and income was up SEK 38 million versus last year, which is entirely explained by the higher royalty costs paid to our PureBallast joint venture partner in Marine.

Financial net, excluding FX impact, was a negative SEK 53 million in Q1 versus SEK 48 million last year. The FX gains losses were positive SEK 38 million in this quarter versus a positive SEK 191 million last year, giving a total finance net of minus SEK 50 million in Q1 this year versus a positive finance net of SEK 143 million last year. The main reason for the FX impacts in Q1 and last year were revaluation of local cash positions in foreign currencies.

The tax rate was 36 percent in the quarter, in line with our guidance. Net income, and it was slightly lower than last year, primarily due to the

provisions related to Russia this quarter, but also due to the positive FX impact on finance net last year.

Then looking at the cash flow in the quarter. Cash flow from operating activities was SEK 767 million in Q1, slightly lower than last year. The increase in working capital of SEK 937 million was mainly due to an increase in inventories, partly offset by increasing customer advances. The inventory increase was primarily driven by the volume growth, but also due to the global supply chain disruptions. The operating working capital as a percent of sales is now running approximately 2 percent to 3 percent higher than a more normalized level.

Investing activities included capital investment of SEK 274 million, only about the same level as last year. We do expect the CapEx levels to gradually increase in the coming quarters to support our organic growth as per previously guided.

Financial net paid, excluding FX impact, was negative SEK 24 million versus a negative SEK 26 million last year. Realized FX gain losses in the quarter amounted to negative SEK 46 million, giving a total finance net paid of negative SEK 70 million. This means our total cash flow in Q1 came in at SEK 424 million.

We have bought back 1.7 million of shares in the company during Q1 and 5.8 million shares since we started the share buyback program last year. This represents 1.4 percent of total number of shares outstanding at a value of SEK 1.9 billion. The Board will ask for a new mandate from the AGM to continue the share buyback program until the next AGM in 2023. However, even under the assumption that the mandate is given from the AGM, we will wait to initiate the share purchases for some time considering the recent acquisitions.

Finally, our net debt position at the end of March stands at SEK 6.5 billion, with a net debt-to-EBITDA ratio of 0.79.

Then looking at FX. So the transaction effect on EBITDA in the quarter was a negative SEK 40 million, and the translation impact was a positive SEK 80

million, giving a total net positive FX impact on EBITDA of SEK 40 million in the quarter.

Looking at the projection for full year 2022, we expect a negative FX transaction impact of approximately SEK 150 million, primarily as our average euro hedge rate for 2022 is lower than last year. On the other hand, if the closing rate at the end of March remains, we would expect a positive translation impact that would more than offset the negative transaction impact for the full year '22.

And that leads us to the order backlog. So at the end of March, we had a total order backlog of SEK 26.6 billion, which is 11 percent higher than at year-end 2021 on a comparable basis due to a positive book-to-bill ratio of 1.25 in the quarter. The order backlog now represents 7.5 months of LTM sales. And for shipments in the remaining part of '22, the backlog amounts to SEK 17.3 billion, an increase of SEK 2.8 billion compared to the same time last year.

And that leads me to the sales bridge then for the full year. So starting with the sales in Q1, which was SEK 10.6 billion and then the backlog for shipment in the remaining part of this year is SEK 17.3 billion, adding up to SEK 27.9 billion. On top of that, you will need to make your estimate on change infra-out orders and FX translation impact.

For your reference, the level of infra-out orders during Q2 to Q4 '21 was SEK 17.4 billion. In regards to the FX impact, it is, of course, quite uncertain. However, using the closing rate at the end of March, the estimated FX impact in 2022 would be approximately SEK 1.5 billion positive.

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

Tom Erixon: Thank you. Then regarding the outlook, let me first say that the market demand and market situation in Q1 was very strong. The underlying market conditions are expected to remain relatively unchanged in Q2. If I start with the divisional part of it, we expect the demand in the Marine division to increase compared to Q1.

Now let me guide you in the fact that in Q1, we canceled approximately SEK 500 million of orders in the Marine division. We don't expect that to repeat. And consequently, you could also consider the guidance being somewhat the same or somewhat better compared to the underlying conditions in Q1.

So for the Energy division, we had a very solid market in Q1. We expect market conditions to remain unchanged, positive. And consequently, our expectations are on that level for the Energy division.

For the Food & Water division, the outlook is a little bit challenging. The SEK 5.7 billion is a nonrepeat. We grew 40 percent organically compared to the year before. So sequentially, we do not believe that we will repeat the level that we had. We believe in demand in the Food & Water that is lower. With that said, we think that the underlying market conditions in the Food & Water market will remain good and solid. However, you have to consider the Q1 numbers, a little bit exceptional compared to even good market conditions.

So all in all, that leads to an outlook for the group that is somewhat lower than in Q1. And I just advise you to consider the Food & Water outlook a bit in the context of an exceptional Q1.

So with that, we are ready for questions.

Operator: We will now the question-and-answer session. (Operator Instructions) We'll now take our first question. Please go ahead. Your line is open.

Klas Bergelind: It's Klas from Citi. So first, on the one-timers, if you could help us with the positive revaluation effect in Energy. I guess it's around SEK 180 million. And then on the margin in Marine, you're talking about higher costs linked to StormGeo.

I'm trying to understand what the clean Marine margin was and also how we should think about the margin going forward? I think Jan, you were alluding to that the backlog margin could be weaker quarter-on-quarter in both Marine and in Energy. And I'm trying to sort of gauge whether we can dip below the 10 percent level in Marine in the second quarter.

Tom Erixon: Let me give some overall comments. I think there is a limit to how much we should dissect the various components in the P&L. There are big positives and big negatives in the quarter. I would say like this, I think the underlying margins in the Energy division are somewhat lower than the one we posted. The underlying business conditions and margins in the Marine are possibly a little bit better with a lot of headwinds hitting the results the quarter at the same time. So I wouldn't overdo the consequences of those.

You have to remember, when you look at the Energy division that while there are positive effects, there are also negative effects. We are not getting – and this is true for the group, we are not getting the invoicing that we should. We are not getting the gross margin out that we should. We are tying up profits in inventory. That should be in the P&L in the quarter. We are dealing with increased costs in a situation where the pricing implementations always are going to lag a bit compared to the underlying inflationary process.

So when you think about the development of the group, it's a little bit too simplistic to sort of – to pull out an inventory reval position. We think it's prudent to note that it's there. We are fully aware of that. But we are also in the process of implementing measurements in order to manage our P&L going forward. So maybe that's not the full detailed answer that you would like to hear, but that's a little bit where we are.

Klas Bergelind: All right. OK. So my second one is on the cancellation in Marine in Russia. And if I back out the growth on the pie chart, I can see that the pumping systems saw it. So is this linked? Was this a sort of a pumping system related business?

Tom Erixon: It's a good question. It wasn't. It's different things. The – in the shipping sector, of course, these are not orders booked in Russia. These are orders booked in Korea for Korean yards, but with Russian owners, and consequently, they're canceled out. Whether those ships will be built, owned by somebody else in the end, then let's see. But as it stands right now, it is canceled out.

The new contracting of the product tankers is, at the moment, very low. And one speculation around it is that it's the one ship class with by far most dominant stainless steel components. And consequently, with the current stainless steel and nickel prices, the cost and the concerns among shipowners has to place new orders for product tanks has been modest. And so that is a small amount. It's not related to Russia.

Klas Bergelind: Yes. All right. My third one is on the guidance. I'm getting a lot of questions on this. So when you say somewhat lower, just to understand you in the right way, are you guiding from the SEK 13.9 billion? Or are you guiding from the SEK 13.2 billion, underlying – back the...

Tom Erixon: We're guiding from the SEK 13.3 billion.

Klas Bergelind: SEK 13.3 billion, I meant. OK. All right. So somewhat lower from the SEK 13.3 billion, OK? So that means that you are guiding for sort of maybe more Russia. Sort of, obviously – yes, we will have more Russia weakness, but from the SEK 13.3 billion...

Tom Erixon: No, I think – I guess what we're saying is that when we book our largest order in history for SEK 700 million and we, at the same time, have an exceptional order cancellation that is a wash around SEK 600 million, we think the SEK 13.3 billion is a fair representation of the underlying market demand, new one. And that still leaves Food & Water with an exceptionally high situation. We think we are not at the full repeat on that. So consequently, we are a little bit cautious as to – but the – we are not necessarily seeing that we see weak market conditions in here, too.

Klas Bergelind: OK. Very clear. A very quick final one on the 5 percent price increase. This is obviously new orders, new backlog. We see issues with nickel, with titanium and so forth. You're pretty much hedged for the year. But thinking about the end of the year and into 2023, when you feel you need to increase prices further to compensate for the new cost inflation that we've seen in those areas?

Tom Erixon: Well, price increases are implemented gradually. We did – this year, we did the normal in January. We have a second round in May. We will wait to see

where we are as we move into the second half. Last year, I think we had three price increases through the year.

So the – we are monitoring it and hedges and things like that doesn't play into that. I mean we are looking at the underlying market conditions and pricing ourselves accordingly. We have delays in implementing new prices in a way. So hedges help us in the transition period. But of course, any new hedges are signed on the new level. So we need to adjust to the actual market conditions and that's what we're trying to do.

Operator: We'll now take our next question.

Male: I just wondered, I appreciate you don't want to go into too much detail on the Marine margin. But is it fair to say that proportionally the much bigger impact was raw materials? Or when we think about it relative to ballast water and StormGeo?

I guess the reason I asked is because I didn't think this was a year where we delivered a lot more ballast water equipment and I guess we've been consolidating StormGeo for a few quarters now. So I was just trying to understand, is the biggest of those three changes, the raw materials, is that a fair assumption?

Jan Allde: I would actually say that it's the increase on the royalties on the PureBallast volume. That is the single largest, but not significantly higher than the order backlog impact.

Male: OK. And I mean just when we think about kind of the proportional increase perhaps in kind of PureBallast as a percentage of the business? I mean, my understanding at least I thought that we kind of maybe had 300 million, 400 million higher ballast water deliveries this year versus last year, but perhaps I'm wrong on that? Or are there kind of any – is it the order of magnitude that's wrong? Or is it the fact that there's some additional costs, which we're not thinking about?

Jan Allde: I mean as Tom was saying, there's a lot of moving parts impacting the profitability in this quarter and certainly Marine. I guess we are just guiding

you and say, the two largest impact is the order backlog impact and the impact from the royalties on the PureBallast, but you also have some other effects. FX is one.

The SG&A ratio was a bit higher this quarter because the invoicing was a bit stuck in the sales channel this quarter. So there's a multitude of, let's say, items impacted profitability on the Marine side. But the two single one – largest one is the order backlog impact. And as I said, the payment of the royalties on the PureBallast.

Male: OK. And then just the second question, obviously, I mean, you've talked about kind of quite substantial sort of volatility between the divisions, which is completely understandable given the environment.

But I just wanted to at least get a kind of rough idea of when we think about Energy margins going forward, is it conceivable that we have a couple of quarters that look kind of somewhat similar to what we've just seen in Marine? Or do we think kind of the magnitude of the impact in Energy will be kind of a lot less than that, partially because we don't have the ballast water impact?

I'm just trying to understand when we talk about kind of Marine could be in – sorry, Energy could be impacted over the next couple of quarters. I mean, are we talking about kind of 300, 400 basis point swings? Or would it likely be less than that? Just any guidance on kind of how big that impact from raw materials in the backlog could be for Energy would be really helpful over the next couple of quarters?

Tom Erixon: Yes. I mean we are certainly not looking at the green scenario for the end there. We felt we had an underlying reasonably good development in the Energy division in the quarter. We have reasonable up until the latest Chinese – I should say, with some reservations in China regarding lockdowns and our ability to run our manufacturing systems in the right way over there. But as we speak today, we are still in reasonable condition when it comes to the supply chain in the new division.

And assuming we can keep that up in China, I think we have good and steady demand situation for profitable parts of our business in the Energy division. And consequently, we feel relatively good about it. But of course, when you look at the situation, you have the historical profitability of the Energy division not being on 21.7 percent.

So you should expect that to move towards – in the direction of the historical at least. And you should probably expect that we are doing something about the Marine business at the same time to make sure that we don't – we are not in full repeat.

So I don't want to – we are not typically giving detailed result guidance here, and we will not do that either. But we think we have a reasonable margin outlook for the group.

Male: OK. And maybe just a very quick sort of housekeeping question, just around the Desmet deal. I mean, obviously, when you close it and report, I'm sure we'll sort of see the cost of the acquisition, but would you be able to help us with kind of how to think about sort of multiple of sort of EV sales? Is it similar to your own? Is it lower than your own, given the margin just in terms of updating our numbers with at least the right numbers for when that acquisition comes through, that would be helpful.

Tom Erixon: We will come back, of course, with some further details on the Desmet acquisition. It's been initially since it's very dynamic. You got initially just the sales number for last year, which is significantly lower than the running rate of the business.

The way – and since it is a project business, you should and we do expect a little bit more volatility in those numbers that you have in the traditional product business. But the numbers are approximately a running rate of SEK 4 billion. The order book and the current order intake is on a somewhat higher level than that.

We and they independently have worked on our margins in the engineering business for a number of years, and we actually found that we've done

approximately the same progress over the last 4 years. So they are, as we are in our Food Systems business on just about, let's call it, double-digit profitability numbers. So that's about where the margin will be pre any synergies.

Now we obviously do expect to see synergies, although we will operate to a degree independently from each other even as they join us initially. There has to be some assumptions on synergies in the business, enhancing the margins somewhat.

The acquisition is subject – price is subject to the usual adjustments on balance sheets and other things. So there isn't a specific price on that. But let's say that in order of magnitude, we are looking at something like between EUR 340 million and EUR 360 million. That's about where it's going to be. So you can run your multiple evaluation from that.

Obviously, and I've seen some speculations in it prior, that is a multiple that is lower than Alfa Laval's multiple by far, even after today's share price development. And it should be, as it reflects an appropriate multiple for an engineering business. So that's my language around it.

Operator: We'll now take our next question.

Sven Weier: It's Sven from UBS. The first one is on the food division. And Tom, you already spoke about the demand strength even if you strip out the big ticket and probably is going to be relatively stable on that level then going forward, ex the big ticket.

I was just wondering, do you see a kind of a common denominator and the strength on the food side that keeps the food companies investing despite high food price inflation, maybe some consumers starting to trade down? Do you see any common driver here? That's the first one.

Tom Erixon: It's – the analysis on the numbers is complicated when we look at the huge volatility. We obviously came in way higher in food than we expected. And

we've actually been at this during a couple of earnings calls. If you remember that we looked at, especially in fluid handling, a very high order intake.

And there has been speculation on our part and on your part to a degree, if there are preordering behaviors due to expected price increases and whatnot. And we've been cautious in outlook based on is the preordering behaviors or what is that we are seeing. We are typically not that much off when it comes to judging the pace of the business. And we've been wrong every time.

It's – and when we look at the growth numbers we had in Q1, they are strong numbers from last year. It's not a recovery number. It is on top of – if you remember, last quarter, we talked about the 8.5 percent annual organic growth pace of the Food & Water division in 2016. And that's the numbers we are off. We are way above our growth targets for 5 years running, and then we go 40 percent up from there. I'm a little bit surprised.

In terms of what is it in macro that is influencing this. It could be that there is a bit of redundancy built up on the back of concerns about supply chains. But I still don't know if that's really what we see because normally, CapEx decisions take some time to come through and hit our books.

One area that we definitely see is in the biotech sector, where the investments into regional production capacities is very clearly driving biotech demand across all three regions. And I think that is a clear situation.

I think the question on vegetable oil is still out there because the impact of the Ukraine, Russia conflict may be relatively large when it comes to availability of veg oil. And consequently, that may drive some capacity investments in other regions of the world. We haven't seen that yet.

So brewery is what it is. Dairy was firm. Protein has already started the growth journey based on alternative proteins. So we see some positive effects on that. Biofuel will continue to be an important part of long-term growth for us.

So it's a good situation. I think the 57 is a silly number, if you want it as a trend number. But going back to where we were last year and extrapolate from

there is probably a better basis than the Q1 numbers, but it is a strong situation.

And I have to say that I think also some of the work that we've done over the years in our sales team, in our product teams is bearing fruit. And of course, the invoicing is affected by difficulties in the supply chain for highly technical products. So if we can get into a bit of a catch-up mode for the Food & Water division for the remainder of the year, that's obviously a potential positive effect.

Sven Weier: OK. Understood.

Tom Erixon: (Inaudible) sorry.

Sven Weier: No, that's fine. I appreciate that. The second one was a follow-up on the revaluation. A more technical question, why is the effect so big in Energy and not so relevant in the other two divisions?

Tom Erixon: Well, because we – here's the pros and cons. The supply chain for heat exchanger has a very high share of metals being part of the cost structure. The value add in our own organization is relatively, compared to the others, low and the amount of metal sourced is very, very high compared to component sourcing in the other divisions. So the mix of what we buy into the Energy division is very different from the other two.

That has a positive and a negative, if you like. The positive is we are controlling the supply chain better. The availability of the raw material is relatively more stable than components in other areas, and that's a plus. The negative is that we get a clearer effect on the revaluations, of course, both positive and negative. Now this quarter, it was a positive. But in reality, what happens in the books, of course, is that there are new standard costings and we need to upgrade the entire costing system and consequently, the pricing, and there's a bit of lag on that as well.

So that's why the effect come stronger on the Energy division, but it's also the area where we have the most active work when it comes to repricing given the clear connectivity between metals prices and final products.

Sven Weier: And my final question, and sorry for belaboring the point here on the Marine margin. I understand all the moving parts that you mentioned that were more negative this quarter. What I'm still surprised about is the magnitude of the sudden sequential drop, right, from like 16 in Q4 to just over 10. So why is such abrupt kind of falling off the cliff? What makes it so severe?

Tom Erixon: Yes. It's – I think the – if you ask me, Marine came in a little bit weaker than we expected and Energy a little bit better than expected, if you want to put like that. And the Marine situation is, as Jan was on to, it's a number of headwinds at the same time. There is a negative ForEx that's sort of a one-off.

The backlog situation was weak for – compared to the pricing in the shipments that we had out. The mix overall, not only PureBallast, but it's also a quarter when let's say, the boiler side of it has a bigger part compared to the exhaust gas cleaning, which has been having an order book that's been out – delivered over a period of time. And so that has disappeared compared to – largely compared to last year.

So it's been a number of factors. Some – the one odd one is probably a one-off. There are some that we are working with – can work with. We thought the headwinds were a little bit too many at the same time for various reasons. So it was not an individual event. If we look on the various product lines, the variations are not that big in the underlying situation when it comes to market shares when it comes.

And then, of course, as Jan was on to, when we don't even deliver out the order book that we have then, of course, we sit a little bit with higher cost for new ventures in Marine that are not covered from a ratio point of view on the invoicing. So yes, it was – if you want to ask us if it was a good quarter, it was not. No. Can it get a little bit better next quarter? It could.

Sven Weier: Understood, Tom.

Operator: We will now take our next question. Please go ahead. Your line is open.

(Aurelio Calderon): It's (Aurelio Calderon) from Morgan Stanley. My first question is on the inflationary pressures that you've seen this quarter. I think you mentioned that you had a positive impact in sales number of around 5 percent. And you also mentioned that you compensate or sort of compensated inflationary pressures. I wonder if you could give us an indication of how much those pressures were in the quarter compared to that 5 percent pricing that you had?

Tom Erixon: It's a good quarter. It's a hard one to answer in all product groups, all geographies, all individual customer applications. And then on top of that part of the mix being priced in all, it's difficult for us to give you an appropriate guidance. But let me give you some reference point.

When we talked about what we needed to do from a price point of view, in October last year, we communicated that to you, I think, at the Q4 report, we estimated that we needed a price – based on conditions back then, 6 months ago, a price increase in the order of magnitude of 3 percent, 4 percent to compensate for the inflationary pressure overall. This quarter, we gave you the update that probably when you compare, we are probably rather at 5 percent, or 5 percent to 6 percent in pricing overall for the group. That is twice what we thought 6 months ago.

That still doesn't capture the full extent of price increases introduced in the beginning of Q1, and it still doesn't take height for the possible price increases that are due in May. And so you can see sort of where the numbers are running from the normal 1.5 percent or so to a pace of 3, 3-plus 6 months ago to 5, 6 at this point in time to – plus some additional is probably going to take us close to double digit. That will be my best guess at the moment.

(Aurelio Calderon): OK. And on the 6 million – SEK 600 million in sales that you couldn't deliver in the quarter, I wonder how much of an impact do you think that could pose to the – I think you mentioned SEK 17.3 billion of the backlog to be delivered this quarter. I'm assuming you're not working on the basis that you can make up those SEK 600 million through the year. Is that right? Or is that included in the SEK 17.3 billion to be delivered this year from backlog?

Jan Allde: Yes. I mean that's – it's a little bit hard to give a precise answer to you with the uncertainty we have on the whole, let's say, delivery side by – let's for it like this. I don't think that the situation is necessarily getting much better or much worse. So I would expect that it's going to be similar to what we have seen in Q2 – sorry, in Q1.

Tom Erixon: So the 17 is probably our best estimate.

Jan Allde: Yes.

(Aurelio Calderon): Yes. That's helpful.

Operator: We'll now take our next question. Please go ahead. Your line is open.

Sebastian Kuenne: Sebastian Kuenne from RBC. Just two remaining questions. On the asbestos litigation, could you give us an update what the situation is? And what the scale of impact would be if you do lose that low case?

And then on the Marine business, just to confirm, the order book cancellations that used for the SEK 600 million, that's actually an order intake cancellation, the way I understand it. So you reduced your Q1 order intake or you adjusted that by SEK 600 million in the order book. Maybe if you could confirm that? And then what is the remaining Russian risk that you have for your operations?

Tom Erixon: Yes, do you want to go?

Jan Allde: Yes. When it comes to the SEK 600 million, the way this is handled is that it's reversed as a negative order intake. So you reverse the backlog by booking negative order intake. And what Tom was saying is we are saying we are reversing SEK 600 million out of the order backlog. But then there was about SEK 200 million, that sort of say, we're booked and canceled in the same quarter, if you may.

Sebastian Kuenne: So, yes. So it's basically – yes, it's a reversal of SEK 600 million. So it's currently against the order intake. So we can address the Marine order intake for that number to see the run rate.

Jan Allde: Correct.

Sebastian Kuenne: And the remaining Russian risk?

Tom Erixon: It has the guidance in Marine.

Sebastian Kuenne: Yes. Yes, understood.

Jan Allde: Or litigation, we don't see a big issue on that. We've been handling the litigation for asbestos for, I don't know, how many years, 20 years. We have it under good control. It's a nonmaterial at this point in time.

Sebastian Kuenne: So you mentioned it in the report, but it's not an incremental news flow coming from there. Is that correct?

Jan Allde: It's been in the quarterly report for many quarters. If anything, I think you will see that there is a net reduction in other cases compared to previous quarters.

Sebastian Kuenne: Understood. And maybe a final question, just coming back to the stainless steel issue and the impact on Energy or rather on the group. Can you just confirm the revaluation effect in the Swedish krona between December and March? Maybe you explained it already, but I missed it. Just what's the jump in the – in your inventory in terms of valuation?

Tom Erixon: We're not commenting on the individual parts. We – and it's not to be transparent to unhelpful. I think we are compared to many being explicit about the revaluation effects but there are many moving parts in this. So the right conclusion when you are looking at the numbers is not to pull out a single one. It will lead you to the own conclusion. And consequently, we're just highlighting that it is a bit of an elevated effect, specifically in the quarter, but not more than that.

Sebastian Kuenne: But are we speaking 10 basis points effect or 100 or 200 basis points? I mean, what's the scale because we know that stainless steel is shooting through the roof. It's your biggest input costs for the group.

Tom Erixon: There are hedging contracts, there are reval positions, there are a number of issues. So I think you have to draw your conclusions.

Operator: We'll now take our next question. Please go ahead. Your line is open.

Female: I just had two quick ones. The first, I wanted to focus in more on Energy, and I was hoping you could talk a bit more about kind of the specific product line, the – market. In particular, I was thinking kind of heat pumps, how that's sort of progressed in the quarter given recent energy issues?

And then my second one is – I'm sorry if I missed it. I just wanted to confirm the royalties for PureBallast, is that a one-off? Or something that we should expect to continue?

Tom Erixon: All right. Let's start with the last one. The royalties has always been there, are there. It's based, as many of you know, on a joint venture set up, that's why we had royalty payments. So we are consolidating the full sales, and we are sharing the profit by ways of royalties. So we'd only consolidate half of the profitability. And that creates a margin erosion in the Marine division.

The only way these royalty payments will stop is if we have an agreement eventually with our joint venture partner or maybe acquiring their part. That is a theoretical possibility. At the moment, we will, of course, inform you. But as the retrofit period comes to an end and it becomes more of a Service business, that is a possible outcome down the road.

But as such, it has been there for years. It's just that our sales is elevated in the quarter on the back of very high order intake last year. And I remind you that this is the last year formally of the retrofit period. So probably towards the end of the year, we may start to run down those numbers a bit with less sales, also less royalty.

Now on the Energy efficiency, as you indicate, the demand situations remain very strong. Heat pumps is one. AC is another one. But the whole HVAC area, including larger heat exchanges for data centers and heat recovery projects is going very well. So demand is – remains strong.

Our challenge is to make sure that we are building capacity enough to manage the customer demand cycles. And as we indicated to you, we are elevating our

CapEx program this year, next year in order to handle the demand. So as long as our Chinese operations can run in a good way throughout this year, we are in a fairly good position to deliver as well.

And with that, we have an AGM. We would have loved to see there. I'm afraid we would probably not see so many of you there, but we need to be getting way.

So if there is the last question, we will take that quickly, and then we'll break.

Operator: Thank you. You do have one more question

Karl Bokvist: It's Karl Bokvist from ABG. Most of my questions have been answered. So just my final one is environmental sales in Marine seems to have been flat year-over-year. I'm just curious how we should think about timing of royalty payments compared to deliveries of the systems?

Tom Erixon: Do you know, Jan? Obviously, they come afterwards. But...

Jan Allde: Yes. I mean – so I mean, the royalty payments are based on the invoicing. So shipments invoicing and then we pay based on, so to say, a profit split, right? So naturally, they've had a strong order intake up through last year. And with good invoicing that's materializing now, that retrofit peak market, sort of say, retrofit cycle, so to say, have reached its...

Tom Erixon: I guess we'll lag on 1 quarter, right? So what we had paid out in Q1 is probably the Q4 invoicing, I suppose. We may need to get back to know for sure, but we can't pay royalties until we know what the profits are. So it is not a percentage of turnover. It is 50 percent of the profit. That's what it is. So I think we need to close the books before we actually make the payment. So my guess is we're lagging a quarter, but we can't confirm that. That's a good question. Thank you very much, and see you at the next call.

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

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