

Alfa Laval AB
Fourth Quarter Report
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Transcript

Speakers:

Tom Erixon

Fredrik Ekström

Welcome to Alfa Laval's Fourth Quarter Report. And we are in the newly inaugurated studio in Lund, so transmitting from here, first time. Hope all will work well. Together with me, I've got Fredrik Ekström, our CFO, and we will run through the normal presentation. You will lose us in picture during the actual presentation, and then we will be back in full picture as we move into the Q&A session.

I also want to alert to you that due to a bit of time pressure on the schedule today, we will have to run the Q&A a bit shorter. So at approximately 10:45, we will have to discontinue. So I hope you can have some understanding for that. And with that, as always, let me go to a couple of introductory comments.

Now, first, obviously as you've seen, demand remained strong in Q4, with record levels of order intake across several businesses. The outlook also remained positive overall. Secondly, the global supply chains continued to stabilise, with solid invoicing and improving cash flow in the quarter, especially towards the end.

Thirdly, the energy transition drives demand beyond normal growth rates and existing capacity limits. To support our customer base, we announced the largest investment decision in our history yesterday, amounting to 3.8 billion SEK. In balancing the decision between a weaker global economic outlook and supporting the global reduction of carbon emissions, the climate was the winner.

Finally, we charged 440 million SEK in the quarter. The earlier-announced restructuring program is progressing as planned, with changes in the marine division and the energy division. We have also provided for all our remaining exposures in Russia as the wind-down of our existing operations continued, as earlier announced. The decision in February 2022 was to stop all new orders, cancel all sanctioned contracts on the order book. The legal entity is gradually becoming non-operational as we move into 2023. And with that, let me go to the key figures.

Both order intake and invoicing grew in the fourth quarter, with approximately 15% organically. Sequentially, the growth was about 4% organically on order intake, slightly better than expected and guided. Earnings improved on the back of high invoicing, with some downward pressure on the margin. The main margin challenge was related to the specific businesses included in the restructuring activities.

Going then on the divisional level, starting with food and water, we had a good quarter overall, with good demand and exceptional invoicing. A few end markets, and China

specifically, were a bit weaker in the quarter. Margins held up well, supported by good performance in the engineering business, both regarding Desmet and our own food system, reaching double-digit profitability, both of them.

Going to the energy division, the strong demand in the invoicing trend continued in the quarter, supported by several applications related to the energy transition. The margin decrease compared to last year was mainly due to the business unit, Welded, now being restructured.

The cancellation of the Russian order book and the earlier softness in the fossil investment cycle created significant utilisation and load issues in business unit Welded, improved order intake in Q4, and the planned actions and restructuring is presumably improving the situation during 2023.

The marine division had a very strong demand and a record quarter in terms of order intake, supported across most of the portfolio, both in applications related to sustainable shipping and the more traditional offshore business. Specifically, demand improved for cargo pumping in late December, with improved factory load expected from Q3 2023 and onwards.

The margin improved sequentially in the marine division due to mix and volume, but we still have some work to do during the first half of 2023. As indicated before, the second half of 2022 and the first half of 2023 is likely the bottom of this cycle when it comes to the margin development.

Moving on to service, it grew to record levels and beyond our expectations. The trend was positive across all three visions. As said many times during the last six years, the work to strengthen our service offering is paying off. In addition, we may have an element of pent-up demand from the period of the pandemic, supporting the growth numbers even further.

Then on to the regional picture. All regions, including China as a whole, had a good development in the quarter. Russia is now removed from the comparison going forward, but even with Russia included in Q4 21, the numbers for Eastern Europe were still positive year on year.

A final comment on the order intake as a whole. If you consider the last three quarters, it puts us on a running rate of approximately 60 billion SEK on average when it comes to order intake. After hovering around 40 billion-plus in 2020 during the pandemic, the growth is exciting but also somewhat challenging.

Customer service remains the priority for us, resulting in higher than normal operating costs. If demand remains stable, we should gradually resolve the imbalances in our supply chain as we move into 2024. And with those comments, I hand over to Fredrik for some further financial details.

Fredrik Ekström

Thank you, Tom, and good morning. During quarter four, we have delivered a record amount to our customers, in part due to the improving supply chains and in part due to the high backlog and order intake we've had over the last 12 months.

Sales closed at an all-time high of 16.5 billion in the quarter and 52.1 billion for the year. The gross profit has in most business units had a good development in the quarter. Our pricing initiatives have offset a good part of the inflationary pressure, and the overall margin also reflects a positive mix in capital sales.

Invoice backlog with orders taken prior to 2022 and low factory loads in business unit welded heat exchangers and marine pumping systems affect the margin negatively. The underlying negative contributions are being addressed through the restructuring programme that Tom mentioned in his introduction.

Sales and administration expenses were 2.1 billion during the fourth quarter and 7.9 billion during 2022. The full year corresponds to a 15% of net sales. If you exclude currency effects and acquisitions, sales and administration expenses increased approximately 10%. That increase shows a return to normal levels after the pandemic years.

The cost for research and development during the fourth quarter corresponded to 3% of sales, an increase that marks a return to pre-pandemic levels and increased innovation ambition. Earnings per share were at 10.89 by the end of the year compared to 11.38 the year before, and corresponding adjusted EPS numbers are 12.78 versus 12.98.

Q4 sales of 16.5 billion represents a growth of 41% compared to last year, of which 14% was organic growth, 11% currency related and a final 16% related to acquisitions, where Desmet contributed with 1.9 billion. Service sales constituted 28% of the Group's net invoicing in the fourth quarter and 30% for the full year.

In summary, a solid sales quarter that saw the first, even if modest, reduction of backlog in quite some time. Summarising 2022, sales reached 52.1 billion, which is 27%

better than 2021, of which 11% was organic, 10% currency and 7% structural, of which Desmet represents 2.5 billion SEK.

It has been a turbulent year, with continued supply disruptions, capacity imbalances, lockdowns, rising inflation, rising interest rates and continued uncertainty driven by the Russia-Ukraine war. Given this, it is reassuring that the demand from our customers remains strong and prioritised.

Sales in quarter four yielded an adjusted EBITDA of 2.5 billion, corresponding to 27% growth, of which 6% was currency related. That yielded a margin of 15.3%, which was diluted by FX, with 0.6%, and structure-driven dilution of 0.5%. The overall margin reflects that our pricing initiatives to a considerable extent have offset inflationary pressures and a positive impact from capital sales mix. The low factory loads and backlog orders taken prior to 2022 are affecting the margin negatively. Adjusted EBITDA for the year ended at 8.2 billion, which is 16% higher than 2021, with a currency component of 5%. Finally, adjusted EBITDA margin for the year of 15.8%, which is in line with expectations.

From a cash flow perspective, the increasing EBITDA contribution is materially offset by working capital movements. Record-high sales have increased accounts receivable with 2.1 billion and decreased the balance of advanced payments as sales are recognised, with a heavy impact in quarter four and for the year.

Supply chain disruptions have eased towards the end of the year. However, COVID lockdowns in China and the war in Ukraine have created uncertainty that continues to persist in high inventory levels. Initiatives to reduce and optimise have already been started and will continue during quarter one 2023. Nevertheless, the cash flow is impacted negatively with 3.1 billion on a full year basis.

Cash flow from operating activities in quarter four amounted to 1.7 billion and 3.3 billion for the year. Capex of 1.9 billion were primarily allocated to capacity-increasing initiatives, and acquisitions to the tune of 3.7 billion included Desmet at 3.4 billion, Scanjet at 237 million and BunkerMetric, 13 million, closing quarter four and the year with a positive cash flow and free cash flow. We are increasing our capex guidance to 2.5 billion to 3 billion SEK per year over the next three to four years in order to capture growth opportunities in the area of energy transition and service.

In quarter four, we have also quantified and charged two comparison distortion items in cost provisions. The first one

related to the restructuring programme covering marine division and business unit welded heat exchangers, as communicated in the last earnings call. The programme will address capacity imbalances in the supplier organisation and reposition for future business. A restructuring charge of 367 million has been charged in the fourth quarter, and we expect a payback in approximately two years. The second one relates to Russia, as Tom has already explained.

The closing backlog in quarter four shows the first modest reduction of a historically large backlog, with a book-to-bill in the period of 0.96. The acquisitions of Desmet and Scanjet increased the backlog with 5.7 billion at the time of acquisitions. Excluding currency effects and adjusted for acquisitions, the order backlog was 30% higher than the year before.

On to some guidance. As mentioned before, capex guidance will increase to 2.5 billion to 3 billion per year. Currency impact is expected to be positive based on currency rates for closing of 2022. Amortisation of step-up values continues, with a modest increase in 2023, to start declining in 2024, with current structure. Tax rate guidance remains in the span of 24% to 26%. The board of directors proposes a dividend of 6 crowns per share, equal to the dividend of last year and to be voted on at the upcoming ARGUMENT.

And then a final guidance. We, going forward, are going to change the way we report our divisional numbers, going from EBIT to adjusted EBITDA level, this to simplify how we communicate with the market. Below follows a conversion in anticipation of the quarter one report, where we will implement this change. And with that, I hand back to Tom for some closing comments.

Tom Erixon

All right. Thank you, Fredrik. And then to the outlook statement. And let me first say that, of course, we are acutely aware of the concerns on the macroeconomic situation in the years to come. We see how the business downcycle is affecting many parts of businesses on the consumer side. On the industrial side, we still haven't seen those effects and we haven't seen them Alfa Laval's end market.

So in that perspective, we see an unchanged situation as we move into Q2, sequentially compared to Q4, on the Group as a whole. We may see some variations between end segments and divisions. Specifically, in the energy segment, we expect an unchanged demand. In the food and water division, we may see somewhat better conditions. And

in the marine division, after an all-time high and super strong situation in Q4, we may see somewhat of softer market conditions coming into Q1. And so with that, we are happy to take questions.

Operator

Ladies and gentlemen, at this time, we'll begin the question and answer session. Anyone who wishes to ask a question may press star followed by one on their touchtone telephone. If you wish to remove yourself from the question queue, you may press star followed by two. If you are using speaker equipment today, please lift the handset before making your selections. Anyone who has a question may press star followed by one at this time. In the interests of time, please limit yourself to only one question. One moment for the first question, please. The first question is with Gustaf Schwerin with Handelsbanken. Please go ahead.

Gustaf Schwerin

Yes, hello. Thank you. Gustaf with Handelsbanken. On the strong marine orders in Q4, how much do you think the alternative fuel contracting explains the organic step-up year over year? How many of the capable vessels in contracting are actually installing the additional equipment, do you believe? And maybe also on the pumping systems, were you surprised about the timing of the large orders, are you getting a feeling that the tanker ordering is really picking up here? Thank you.

Tom Erixon

Yes, the trend is clear towards multi-fuel solutions. I don't have the percentage numbers exactly on my hand, but the trend is going in that direction. It does impact us positively, as we've indicated several times, so you're correct in your assumption. It is a contributing factor to this. But all in all, we see a pretty strong demand across the board. So it was not a unique feature in the Gulf story for the quarter, but it is certainly pointing in the right direction. And I remind you that this is also part of replacing the old historic order backlog, specifically for boilers that we are now moving into, related to new orders and multi-fuel and so forth.

On the cargo pumping, as I tend to say, every quarter is a surprise. The lead times on those orders in terms of dialogue with customers tend to be very short. So we've been cautious in anticipating anything. And in fact, the main part of the orders came in second half of December. So in that sense, it was a good ending on the quarter. We knew that there was good demand out there in the pipeline, and so it was good for us to see.

Gustaf Schwerin

Okay, thank you.

Operator

The next question is from the line of Nancy Ni with Goldman Sachs. Please go ahead.

Nancy Ni Hi. Great. Thank you very much for taking my question. I just wanted to go back to your capex announcement. So I know you mentioned this is driven by strong energy demand, but I'm wondering, is this backed by current orders or future expected market developments? And I guess on the back of that, given that you're doing this, how much room is there left for M&A or cash distribution?

Tom Erixon Well, let's start with dividend policy. The dividend policy is not expected to change in any way. We have a guidance on that when it comes to share of net profit. So that has not been the debate. I think, for M&A, our balance sheet remains strong. So I think the aspects on M&A is less about the balance sheet and more about the fact that, of course, it's got to be attractive acquisition targets in order to compete with our organic opportunities. And so the bar is set high at the moment.

When it comes to the capex, obviously there is a lead time in implementing the changes. We have an unusually accelerated process for implementing the programme, so we will be far into completing a lot of this as we reach the end of 2024. So in that sense, of course, it's future order, but we are not making these type of capital allocations without a tight dialogue with customers and expectations on the market.

Nancy Ni Great, thanks. Maybe just going back to your first answer, will you be revisiting your buybacks anytime soon then?

Tom Erixon Well, in hindsight, I think maybe we should have made a different call, but we were looking at an overloaded balance sheet at the time and not a clear pipeline on M&A either. So we wanted to show that we were diligent when it came to how we look at that cash and our balance sheet build-up. As we see it now, I think buybacks will be far into the future, before we are back in that situation again.

Nancy Ni Very clear. Thank you.

Operator The next question comes from the line of Massimiliano Severi with Credit Suisse. Please go ahead.

Massimiliano Severi Yes, hi. Thanks for taking my question. My question would be on the sequential improvement of margins in marine, even if from a relatively low base. I was wondering if you could comment on the moving parts, whether it was FX hedges improving, price cost issues on boilers improving or the operating leverage on tankers. So what got better in Q4 versus Q3? Thank you.

Tom Erixon Yes, it's a relevant question. I think as I said last time, when it's bad, it's sometimes not as bad as good, and when it's

good, it's not always as good as it looks. There are moving parts in this. I think we are not out of the trough. That's what I want to be clear about. We have a couple of quarters now when we are remaining to work with low load on cargo pumping, and we will be in transition when it comes to the restructuring, and we do have elements of the order book left to deal with from the old pricing. So structurally, it has not changed.

What has changed is that I think the demand situation has certainly accelerated. The mix has been, in the quarter, going favourably. The service growth is bigger than expected and stronger than expected. And all in all, I think we are progressing on the cost side in a good way. So I think what you should interpret, the margin development sequentially, is that I think we have it under control. We know where the problems are. We feel confident we have a way forward in 2023.

And so for me, it was more a sign of that we are in a level from which we can build the future platform, and that's okay. We may have some up-and-down variations in the next two quarters or so, but 8% last quarter was probably as bad as it possibly could get.

Massimiliano Severi

Clear. Thank you.

Operator

The next question insurance from the line of Max Yates with Morgan Stanley. Please go ahead.

Max Yates

Thank you. Just my question was around the services business. So you've obviously seen very strong services growth this year, 15%, even stronger in Q4. So I just wanted to understand. Could you maybe help us understand a little bit what's happening here? Is this more a case of price than volume? Is this disproportionate to one division rather than another? Is it your own internal initiatives coming through? Or do you think you're broadly growing in line with customer activity levels? I'm just trying to understand a little bit better the moving parts behind what looks like a very strong number.

Tom Erixon

Yes. I think there might be a small element of pent-up demand that is coming through in 2022. I don't think it's a big cyclical element. But we see in the marine division that onboard services, for example, was obviously down during a period of time. It's catching up. We also have a situation where a lot of the ship owners are in good profits. Freight rates are, generally speaking, good, and so there is a big eagerness to keep the vessels in good shape at this moment. So there are some factors here that is supporting an underlying service volume that is better.

But you're also correct that, of course, and this is an issue when you look at our numbers and anybody's numbers at this point in time, with big currency swings and an inflation that is affecting cost but also prices, the volume analysis is a bit different than it has been historically. So there is clearly a price element on the service business that you need to take into account. I'm not going to throw a specific number. There are variations, depending on service scopes and so forth that affect these numbers. But I think you can safely assume that 5%-plus is probably... Somewhere north of that are price adjustments, if you want to think about the volume side.

Max Yates

Okay.

Tom Erixon

I think what is good from our point, and let me just finish off by saying that when we look at all the service scopes, whether it is service works, spare parts, whatever, the trend is pretty similar across the board. So I think it's a fairly broad-based service growth trend we are looking at, at the moment.

Max Yates

Okay. Helpful. And just...

Tom Erixon

Sorry, go ahead.

Max Yates

If I can have a quick follow-up just on the energy margin. And I understand you completely said when we went into this year that 21% was not where... It was too high and not where it should be. We've obviously exited this year at a bit lower, closer to 16%. We're averaging 18% at the full year, 18.3% at the full year. So I just wanted to get a sense of when you look at the energy margin, I feel like this quarter is maybe a bit lower than where it should be normally, but is that 18% the right level that we should think about in aggregate? I'm just trying to understand a bit how to think about what you would view as a more normalised margin for your energy business, going forward.

Tom Erixon

Yes. And as you know, I don't like to guide you when it comes to your margin assumptions. But what I would say is that the fairly big difference between the 18% and the current level is related to a financially nonperforming unit. So everything else being... So I would say, if I look at the rest of our portfolio, margin development has been relatively stable over the last... Well, at least the last year, and maybe even a bit beyond that. So the movements that we see are, generally speaking, related to business unit welded and the big under-capacity and low utilisation level that we faced coming into 2022.

Max Yates

Could you just help me understand, so what is it about

welded heat exchangers that mean they're particularly weaker? Is it some kind of change in customers? I don't fully... I don't know enough about them to know exactly what drives that.

Tom Erixon

Right. And I will take that as a... Because we're a bit under time pressure, so I will take that as the last question from you. But if you look at our energy division, the welded applications are the ones that are by far most exposed to the fossil industry. That's the main application for business unit welded. And prior to 2022, we already entered a lower demand cycle from the fossil industry, and so we saw that.

Then one of the major countries, as you well know, when it comes to the fossil side is Russia. And consequently, we had a big order portfolio related to Russia. And that was all cancelled and scrapped, both the formal order book and the signed contracts that were not formally booked. So in fact, we wrote off a very significant amount of orders in February last year, and that left us with a number of units with exceptionally low capacity utilisation. So that is the operational problem for this year.

The strategic decision though that you are well aware of since a couple of years back is that we have a view that the fossil side will follow as another cycle or so, but moving toward 2030, probably this is going to be a very minor part of our business portfolio overall. And what we can transit in the existing portfolio from fossil to green is probably, one way or another, slowly but surely evaporating from our portfolio. And that transition from fossil to green is also work that is being done now, also related to some cost and implementation changes. So that is why that unit specifically is experiencing the situation much, much worse than the rest of our business portfolio.

Max Yates

Great. Thank you.

Operator

The next question comes from the line of Weier with UBS. Please go ahead.

Sven Weier

Yes, morning. It's Sven from UBS. The first one is on food and water. Tom, I was wondering if you could give some more granularity, because the comments you made on the dairy/brewery was a bit weaker. And you said, at the same time, Q1 is going to be a bit better in food. Is that driven by a recovery in those two, or would you expect the brewery and dairy to stay a bit softer than the other areas?

Tom Erixon

Well, we're going to have a huge challenge in brewery in Q1. I think we booked... Was it in Q2 we booked the large order? Sorry, my mistake. But we're going to have a

comparison distortion on brewery this year since we booked a 700 million SEK order in the last year. So comparative numbers will be a challenge. But no, I don't see it so much as a specific end segment. Overall, the trend is positive.

I think the open issue is how we will see the China development in this year. That is, I think, the strategic theme. We had a bit of a weakening tendency in China, as I said a number of times, from third quarter onwards last year. And we will need to see now what happens with the business sentiment and the development in China after the COVID situation now is dealt with. So I think if we see a structural upside on food and water above and beyond what we've been experiencing recently, I think China is the place to look for.

Sven Weier

Understood. And if I may just quickly follow up on what you've said on the marine services earlier, more forward looking, if we look into this year, we obviously have the IMO regulation on EEXI, CII potentially taking out some older capacity, which is maybe a bit more service active for you. But at the same time, the fleet is growing on the container side. Have you formed an opinion yet, how that could turn out for you overall, net positive, net negative or too early to say?

Tom Erixon

No, I think in principle, this is a net positive. You are right that the expectations on scrapping going forward will accelerate. We've actually been, I think, in 2022 on a historic low when it comes to scrapping good freight rates. Ships coming to end of life were still worthwhile to keep on the seas. So I think, all in all, we have to expect that no matter what, we will see an increased scrapping, and certainly related to the environmental regulation, this will be an acceleration. So all in all, I think this is good for the planet, it's good for our business.

And the service, we're not particularly concerned on impact on service. I don't feel that the age of the fleet is the determining factor on this. The service intervals are rather regular, and I don't see that the age profile on the fleet has a major impact on how the service will go in 2023.

Sven Weier

Okay. Thanks, Tom.

Operator

The next question is from the line of Klas Bergelind with Citi. Please go ahead.

Klas Bergelind

Thank you. Hi, Tom and Fredrik. First, on the new investment ramp, it's a big step up, great to see, obviously underpins the strong outlook. We know growth out there is broad-based. But is there, Tom, any particular area across

heat pumps, carbon capture, data centre, hydrogen and so forth that explains adding more capacity? Because we obviously have the IRA, Europe is being stressed, want to do their own IRA. I just want to understand the incremental a little bit better.

Tom Erixon

Yes, I think the IRA discussion is a little bit overdone. I think the US decision is, generally speaking, good for industry. We are operating within US as well as outside. So I think from a trade point of view, I think we should take it a bit easy. And it's good news, generally speaking, what the Americans have done, and then, of course, there are some practical challenges on that.

On the investment programme, for various reasons, we don't want to be too detailed. But it's clear that heat pump demand with key global key accounts is an important part of our investment decision.

Klas Bergelind

Okay. No, that's good. And just a question for you, Fredrik. The Desmet, we knew that half of the annual sales would be recognised this quarter and that this should normalise as you integrate it into Alfa, that the revenue recognition won't be as conservative going forward. How will that change now, going forward? Is that already in the first quarter we should normalise? Or just help us a little bit about the phasing there now into the first.

Fredrik Ekström

Yes, there will be a normalisation that will continue during the year. We won't make any major changes, simply because we are occupied with the integration of Desmet on a more structural level and obviously on a business level. So the financial part will happen during the year, but you will see, towards the end of the year, a more normalised percentage of completion, in line with the Alfa Laval standards.

Klas Bergelind

Okay, that's perfect. A very, very quick final one on food and water, Tom. It's a solid underlying margin. Can I just ask if you had any impact from China? This was the division that saw most of the pressure during the second quarter during the lockdown, and now we have the sick leaves as they open up. We hear that from others. Did this impact revenues or margin in December for food and water?

Tom Erixon

Not too much. We managed to operate reasonably well in China. So while we certainly did have there the infection rate that was astronomical from December 1 to January 15, about, all in all, we managed the situation quite well. So I don't think there's big rebounds on that from a delivery point of view.

Klas Bergelind Thank you.

Tom Erixon And then demand in market, we will see.

Klas Bergelind Yes. Thank you.

Tom Erixon Thank you, Klas.

Operator The next question is from the line of Johan Eliason with Kepler Cheuvreux. Please go ahead.

Johan Eliason Yes, hi. Just a minor question on your guidance on PPA amortisation related to Desmet. In your guidance there, what have you assumed for Desmet, going forward? And then the step-down in 24, is that mainly related to Framo, or is there something else as well?

Fredrik Ekström Well, it's the normal aging of the step-up values or the price purchase allocation, as you want to see it. So what we see is that a lot of the companies that we've acquired over the last ten years are starting to fall out of that amortisation, and therefore, you see the drop in 2024. 2023 is still sort of propped up by Desmet. And of course, how we have done that evaluation of what is step-up value and what is goodwill, well, that's an internal one.

Johan Eliason Okay, thank you.

Operator The next question is from the line of Andreas Koski with BNP Paribas Exane. Please go ahead.

Andreas Koski Thank you, and good morning. So I want to come back to your capex guidance. You will invest almost 10 billion SEK over the next three years. What impact will this have on your production capacity or sales capacity, and what kind of payback time should we expect on the investment?

Tom Erixon Well, it's a very good question, and there are obviously some concerns in terms of the degree of transparency we do on everything here. But let's say that we communicated the decision. We already, as you can see, this year... Last year, we were at about 2 billion SEK in capex implemented, that is charged to us, paid out. And that's the issue with adding capacity, that the decision has a lead time until it's completed.

So I think when we reach the 2 billion where we... And we're probably not going to be all that far away from that also in 2023, although we are upping it, it takes some time for us. But in the annual terms, we are running at high capacity and it allows us the continuous expansion and growth story that we are in.

But I'm not going to give you a finite number as to where we

will be, capacity production wise, three years from now, but this assures that we continue to grow at a good level in some of our core businesses. And that was the first question. And the second question was...

Fredrik Ekström

Was the payback.

Tom Erixon

Was the payback. Let's see. But let's put it like this. Typically speaking, when we are evaluating investment proposals, the payback times in manufacture that we tend to look at, that's somewhere around six years. If it's ten years, it's going to be a lot of sustainability-related issues for us to go ahead. So you should assume that when we look at our internal rate of return and payback numbers, those are typically the ones that we are looking at. Then sometimes it's a bit better and sometimes marginally worse, but around there.

What I would say on this one though is that we are, in this package specifically, relatively equipment heavy, which is a good thing. We have earlier worked with footprint investments where we had a reasonably high share of real estate versus equipment, and obviously that's not a good mix for payback. So in this sense, we can now... And that's why we're expanding in existing sites, so that we, as much as possible, can optimise the share of equipment. It's faster for us to implement, and the payback is somewhat better.

Andreas Koski

Okay, thank you. I think when you launched the bigger capex programme four years ago, I think you mentioned at the Capital Markets Day that those returns on capital employed on those core organic growth initiatives normally were about 50%. So you expect quite good returns also on the investment that you plan to do now, I guess.

Tom Erixon

Your memory is very good.

Andreas Koski

Yes, thank you. Then my second question is on the backlog. It's now standing at 37 billion. If you look at the composition on when the backlog is going to be delivered, it's around 35% of the backlog that will be delivered later than 2023. And if you look at the backlog composition in previous years, it was closer to 20% to 25% of the backlog that would be delivered later than next year. What is explaining this change? Is it the specific business segment end market or have we seen lead times growing across many different areas?

Fredrik Ekström

I would say that in general, we have an increase in lead times, but I would also say that... I would remind that for the year, we had a book-to-bill of 1.12, which means we have been building backlog during 2022. And certainly, the

backlog that was built during quarter four certainly then falls into the category of spilling over into 2024, and I think that's more what you see in your backlog analysis.

Andreas Koski

Okay.

Tom Erixon

We may also have a bit of an effect on Desmet in the order book we bought, which is a project business with typically somewhat longer lead times.

Fredrik Ekström

Correct.

Tom Erixon

So that may affect the percentage split a little bit as well.

Fredrik Ekström

That's a valid point.

Andreas Koski

Yes, thank you.

Operator

The next question is from the line of John Kim with Deutsche Bank. Please go ahead.

John Kim

Good morning, everybody. Two questions, please. One, could you give us some colour and commentary on capacity? At the Capital Markets Day, you talked about capacity constraints in certain growth areas, and perhaps overstaffing, overcapacity in other areas. If you could just comment as to where you've seen improvements or growing constraints, qualitatively. Second question on inflation, wage inflation specifically. Do you have a view for this coming year or the quarters as to whether that's going to accelerate, and how should we think about that? Thank you.

Tom Erixon

Yes, the capacity balancing is, in my career, the most complicated I experienced in the sense that on the same day almost, we are making our biggest capex decision in our history, and at the same time, we are releasing approximately 5% of our employees from areas which are under change. So this transition from something to something else is very visible in our business overall. And it's a very happy story, but it's also a difficult one for many parts of our organisation where we have big changes happening as we speak. But of course, overall, it is a very good demand situation for the Group.

The general comment on capacity, I think, is in the marine division in general, we are quite well set when it comes to capacity. Although we're going high in some areas, we are quite well set. In food and water, if we look back, which is heavy on rotating, that has been actually a fairly heavy part of investments that we've done over the last few years. And there, depending on where demand goes, we may have somewhat of a better situation in 2023, but we certainly don't have a lot of slack in that. So utilisation levels are high, but at the moment reasonably balanced.

And the area over the last year, and moving into 23/24, which is most concerned when it comes to capacity utilisation is related to the energy division, and predominantly then the heat exchanger part of our business portfolio. So that's the view on the situation.

John Kim Okay, helpful. And can you pivot to the question on wage inflation, please?

Tom Erixon On wage inflation specifically?

John Kim Yes. Or how should we think about that? Where are you seeing pockets of...?

Tom Erixon Yes.

John Kim Stronger growth?

Tom Erixon Well, I think the jury is out, how this economy will cool down by the central banks. At the moment, the labour markets are still very strong. As you know, in the US, there are still more open positions than available labour. And so we are assuming, for 2023, a wage and salary inflation that is higher than normal. It's not all that new to us, because if you operated in India, China, in emerging markets, we are used to relatively high wage and salary inflation levels and we are trying to work with productivity and automation in the same way in those markets as in others, although the actual labour cost historically has been lower.

So it's not a... My main concern for 23 onwards is not related to wage and salary levels in terms of inflation. It is that we get some stability when it comes to currency situation, when it comes to commodities market and all that. And I think we're going to have to live with a shortage on the labour pool at least during 2023, and maybe onwards if the economy is not cooling more. And that would be my inflationary precaution. With that, we have time for one last question, so please.

Operator This last question is a follow-up from Massimiliano Severi with Credit Suisse. Please go ahead.

Massimiliano Severi Yes, hi. Just a quick follow-up for me, which is connected to what you were saying before. Clearly, the order book that you have in energy and food and water is quite large, and you are adding capacity. So I was wondering, if I think about the organic growth that we could see in 23 and 24, especially for these two businesses, how much can we expect this to be, given your plans and given you have a capacity utilisation already quite high?

Tom Erixon If you knew me better, you wouldn't ask the question. I will not guide you on the growth level. What I would say is that

we have a corporate growth target of 5%. We achieved that over the last few years. We are investing in capacity, which should give you an indication that we don't consider we are at the end of the growth journey. But when it comes to forecasting where we're going to be, I leave that in your knowledgeable hands.

And with that, I'd like to thank everybody. Sorry to cut it a bit short today. But you all have Johan's number, so if there are follow-up questions, he will be on standby. Thank you very much.

Fredrik Ekström

Thank you.