

Expected downswing, recovery to follow...

SKF India reported dismal numbers for Q1FY21 as manufacturing activities were disrupted across the value chain. Tracking this, production was halted for more than 50 days at SKF. June saw some green shoots but it was short-lived on account of regional lockdowns. Revenue for the quarter was at ₹ 301.2 crore, down 61.2% YoY (vs. I-direct estimate of ₹ 351 crore). During the quarter, SKF won some significant orders for rotating equipment performance offerings. Performance for the quarter reflects production loss of more than 50 days. Gross margins stayed stable at 39% vs. 39.7% YoY. However, negative operating impaired the operating performance, as SKF posted EBITDA loss of ₹ 60 lakh. Employee cost fell 11.8% YoY while other expenses declined 50.5% in Q1FY21. Tracking its operating performance, SKF ended the quarter with a loss of ₹ 25 lakh. Other income came in at ₹ 15.3 crore while there was a tax reversal of ₹ 8 lakh during the quarter.

Underutilisation of capacity to impact margin in FY21E...

The pandemic induced lockdown halted production for more than 50 days, resulting in underutilisation of manufacturing capacity and unabsorbed fixed overheads. We expect margins for FY21E to get impacted by the same, stay at 10.5% in FY21E and return to 14% in FY22E. Further return to normalcy is expected by Q4FY21E. Fate of the auto segment continues to depend upon the revival of the domestic auto sector. Taking cognisance from the current economic scenario, we expect a revenue decline of 25.8%, 10% for manufacturing, trading segments, respectively, for FY21E whereas we expect these segments to grow 28%, 25%, respectively, in FY22E. Overall, we expect FY20–22E revenues to grow at a CAGR of 3.1%.

Expanding roots into REP & remanufacturing...

Through rotating equipment performance (REP) and remanufacturing services, SKF is expanding and shifting towards a circular business model. Recently, by leveraging digital collaborations, it won significant orders for REP offerings in industrial sector. Going ahead, this new performance-based business model is expected to augur well for SKF in future. Foray into remanufacturing would also bring additional revenue for it with minimal costs as no capex needs to be incurred. Thus, this would arrest fall in capacity utilisation and provide a good opportunity for SKF, going ahead.

Valuation & Outlook

Recovery, particularly in auto segment, is still hazy in terms of velocity and magnitude. The real impact of Covid-19 and recovery thereafter can only be known going ahead. Thus, short-term demand disruptions are expected to curtail topline and margins thereon. We expect FY21E revenues to decline by 16%. Currently, the stock is trading at 25.6x FY22E earnings. We believe the stock is fairly valued at the current price. We maintain our **HOLD** rating on the stock with a target price of ₹ 1490/share at 25x FY22E earnings.

Key Financial Summary

	FY18	FY19	FY20	FY21E	FY22E	CAGR FY20-22E
Revenue (₹crore)	2,750	3,035	2,842	2,400	3,023	3.1
EBITDA (₹crore)	435	486	349	251	423	10.0
EBITDA margin	15.8	16.0	12.3	10.5	14.0	
Net Profit (₹crore)	295.9	335.8	289.0	162.8	295.0	1.0
EPS (₹)	57.6	67.9	58.5	32.9	59.7	
P/E (x)	25.9	22.0	25.6	45.4	25.1	
EV/EBITDA (x)	15.5	14.2	19.4	29.0	17.1	
RoCE (%)	23.7	29.4	20.3	16.1	25.3	
RoE (%)	16.1	19.8	15.2	12.0	18.9	

Source: Company, ICICI Direct Research

SKF

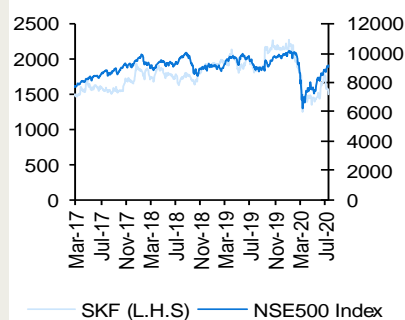
Particulars

Particular	Amount
Market Capitalization	7,391
Total Debt (FY 20) (₹crore)	0
Cash and Inv (FY 20) (₹crore)	618
EV (FY 20) (₹crore)	6,773
52 week H/L (₹) (BSE)	2313 /1237
Equity capital (₹crore)	49.4
Face value (₹)	10

Key Highlights

- Production halted for more than 50 days
- SKF won significant orders for Rotating Equipment Performance offerings
- Maintain HOLD rating on stock with target price of ₹ 1490 per share

Price chart



Research Analyst

 Chirag Shah
shah.chirag@icicisecurities.com

 Adil Khan
adil.khan@icicisecurities.com

Exhibit 1: Variance Analysis

Year	Q1FY21	Q1FY21E	Q1FY20	'oY (%)	Q4FY20	QoQ (%)	Comments
Income from Operation	301.2	351.0	776.8	(61.2)	610.2	(50.6)	Lockdown, manufacturing shutdown & supply chain disruptions impacted topline
Other Income	15.3	15.0	17.2	(11.0)	46.4	(67.1)	
Cost of material consumed	47.3	82.5	165.6	(71.4)	146.1	(67.6)	
Purchases of stock in trade	145.0	140.4	299.5	(51.6)	290.1	(50.0)	
Change in inventories	-8.5	-3.5	3.7		-56.3		
Gross margins (%)	39.0	37.5	39.7	-69 bps	37.8	121 bps	Gross margins remained stable
Employee cost	56.7	57.9	64.3	(11.8)	58.1	(2.4)	Employee cost declined on account of loss more than 50 production days
Other expenditure	61.3	87.7	123.7	(50.5)	110.4	(44.5)	
EBITDA	-0.6	-14.0	120.0	(100.5)	61.9	(101.0)	SKF reported an EBITDA loss on account of negative operating leverage
EBITDA Margin (%)	-0.2	-4.0	15.4	566 bps	10.1	1035 bps	
Depreciation	14.5	14.0	13.9	4.4	14.7	(1.3)	
Interest	0.5	2.1	2.6		1.8		
PBT	-0.3	-15.1	120.7	(100.3)	91.8	(100.4)	
Taxes	-0.1	0.0	42.7	(100.2)	16.5	(100.5)	
PAT	-0.2	-15.1	77.9	(100.3)	75.3	(100.3)	Net loss on account of transmission of negative operating leverage

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

	FY19	FY20	FY21E			FY22E		
(₹Crore)	Actual	Actual	Old	New	% Change	Old	New	% Change
Revenue	3,034.5	2,841.6	2,732.0	2,400.4	(13.8)	2,802.9	3,022.6	7.3
EBITDA	485.9	349.5	314.2	250.8	(25.3)	356.0	423.2	15.9
EBITDA Margin (%)	16.0	12.3	11.5	10.5	105 bps	12.7	14.0	-130 bps
PAT	335.8	289.0	244.4	162.8	(50.2)	272.2	295.0	7.7
EPS (₹)	67.9	58.5	49.4	32.9	(50.1)	55.1	59.7	7.7

Source: Company, ICICI Direct Research

Annual Report Takeaways

- SKF's FY20 annual report is based on the theme of 'SKF Stronger', which signifies inherent strength and strategic objectives that add to the companies' agility
- In a year overshadowed by a global pandemic, the silver lining in the clouds for SKF was the acquisition of RecondOil. The company develops chemical filtration and rejuvenation process for industrial lubrication oil
- Tiding over the cyclical nature of business, SKF has been expanding its roots in REP & remanufacturing. This helps SKF to assist its customers to transition towards a circular economy
- Global bearing market size is estimated to reach US\$ 186.1 billion by 2025, registering a CAGR of 9.1% during the same period. Rising adoption of automation in manufacturing units, thrust by the Government's Make in India initiative and spending towards railways & metros will support demand for bearings
- Disruptions in supply and demand side on account of Covid-19 affected the performance in Q4FY20 & Q1FY21. However, SKF is confident of growth once the pandemic fades out
- SKF sees a revenue spike coming from precision bearings from aerospace and corresponding industries. Additionally, growth is expected in miniature bearings, which are used in industrial robots

Rotating Equipment Performance (REP)

REP is a service by SKF that offers extensive solutions to customers that enable customers to improve their rotating equipment performance.

Customer Benefits:

- Complete outsourcing of critical maintenance and operations to a single vendor
- Performance-based payment enabling better operational efficiency
- 100% availability of spares

Benefits for SKF:

- Transition to a circular economy.
- Expanding roots in services, thus reducing reliance on cyclical nature of industrial & automotive segment
- Long term performance based contracts ensuring revenue visibility
- Minimal capital requirement

Remanufacturing

Remanufacturing is the process of returning a used product to its original performance, with a warranty equivalent to, or better than, that of a newly manufactured product.

Customer Benefits:

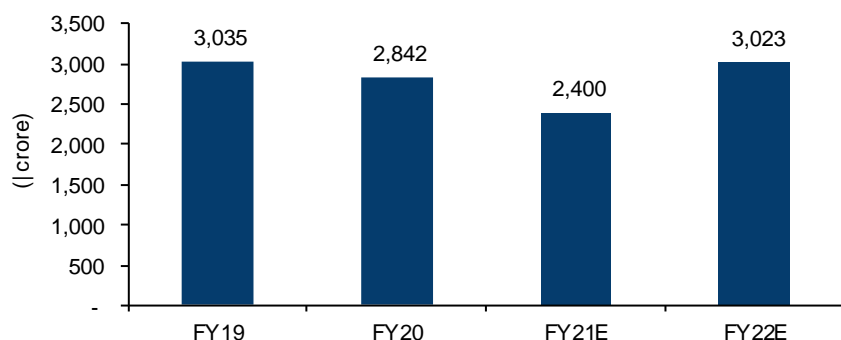
- Integrated engineering solutions
- Increased profits
- Increases machine up-time
- Reduced OPEX and maintenance costs

Benefits for SKF:

- Shorter remanufacturing cycle when compared to product life cycle
- Lower cost of remanufacturing on account of negligible Rmat costs, thus lower capital requirement
- Minimal costs as the machinery required to produce new bearings are used for remanufacturing as well

Financial story in charts

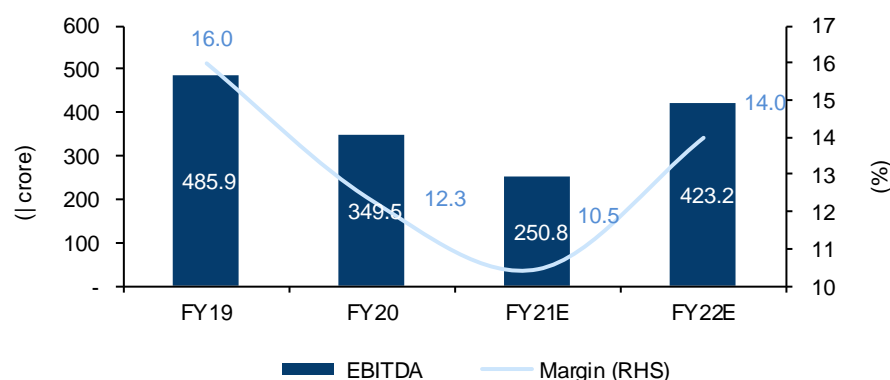
Exhibit 3: Revenue trend (consolidated)



Source: Company, ICICI Direct Research

We expect H1FY21E to be a washout with gradual recovery in H2FY21E. Hence, we expect 26% growth in FY22E

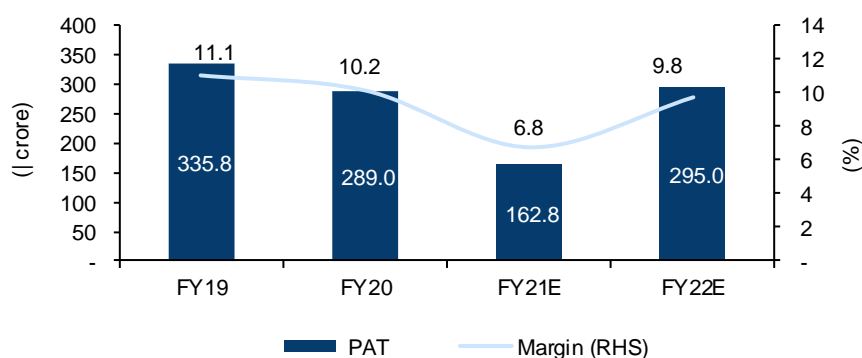
Exhibit 4: EBITDA and EBITDA margin trend



Source: Company, ICICI Direct Research

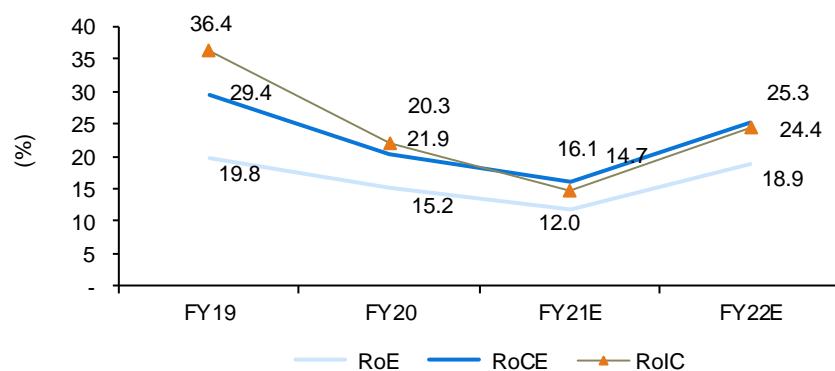
Negative operating leverage affected EBITDA margins

Exhibit 5: PAT and margins trend



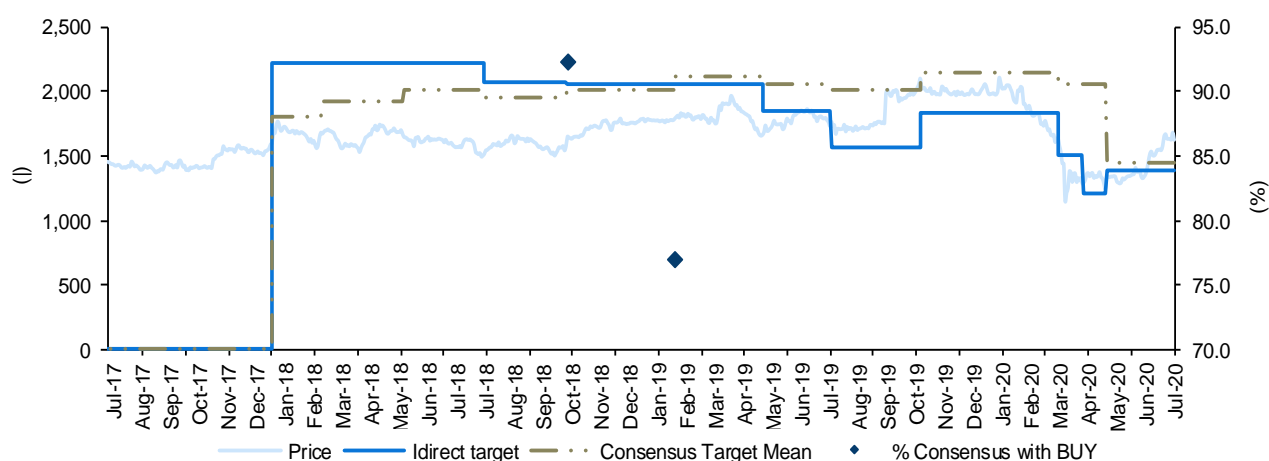
Source: Company, ICICI Direct Research

Exhibit 6: RoE and RoCE trend



Source: Company, ICICI Direct Research

Exhibit 7: Recommendation History vs. Consensus



Source: Bloomberg, Company, ICICI Direct Research

Exhibit 8: Top 10 Shareholders

Rank	Investor Name	Filing Date	% O/S	Position (%)	Change
1	Skf Ab	31-Mar-20	45.9	22.67m	0.00m
2	Hdfc Small Cap Fund	31-Mar-20	9.3	4.57m	4.57m
3	Hdfc Asset Management	31-May-20	9.1	4.49m	0.00m
4	Skf Uk Ltd	31-Mar-20	6.3	3.13m	0.00m
5	Sbi Funds Management	30-Jun-20	4.0	1.97m	0.00m
6	Mirae Asset Global I	31-May-20	3.1	1.55m	0.41m
7	Franklin Resources	31-May-20	2.2	1.10m	0.02m
8	Mirae Asset Emerging	31-Mar-20	2.2	1.10m	1.10m
9	Uti Asset Management	31-May-20	2.1	1.05m	0.00m
10	Dsp Blackrock Invest	31-May-20	1.3	0.66m	(0.39)m

Source: Reuters, ICICI Direct Research

Exhibit 9: Shareholding Pattern

(in %)	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20
Promoter	52.6	52.6	52.6	52.6	52.6
FII	8.0	8.1	7.7	7.3	7.8
DII	25.9	27.1	27.7	28.5	27.8
Others	13.5	12.3	12.0	11.6	11.8

Source: Company, ICICI Direct Research

Financial summary

Exhibit 10: Profit and loss statement					₹ crore
(₹Crore)	FY19	FY20	FY21E	FY22E	
Revenue	3,035	2,842	2,400	3,023	
Growth YoY (%)		-6%	-16%	26%	
Other Income	92	104	45	65	
Total Revenue	3,127	2,946	2,445	3,088	
Cost of materials consum	734	603	510	650	
Purchase of stock-in-trad	1,086	1,203	1,008	1,209	
Change in inventories	(44)	(16)	19	(30)	
Employee cost	258	240	228	272	
Other Expenses	514	462	384	499	
Total expenditure	2,549	2,492	2,150	2,599	
EBITDA	486	349	251	423	
Growth YoY (%)		-28%	-28%	69%	
Interest	8	9	8	8	
PBDT	571	444	288	480	
Depreciation	46	57	62	70	
Profit Before Tax	524	387	226	410	
Tax	188	98	63	115	
PAT	336	289	163	295	
Growth YoY (%)		-14%	-44%	81%	
EPS	68	58	33	60	

Source: Company, ICICI Direct Research

Exhibit 12: Balance sheet					₹ crore
(₹Crore)	FY19	FY20	FY21E	FY22E	
Share Capital	49.4	49.4	49.4	49.4	
Reserves & Surplus	1,648	1,856	1,312	1,508	
Netw orth	1,697	1,905	1,361	1,557	
Total Debt	90.0	-	45.0	45.0	
Other non-current liabilities	24.0	47.6	47.6	47.6	
Total Liabilities	1,810.9	1,952.9	1,453.7	1,649.8	
Gross Block	501	554	664	774	
Acc: Depreciation	217	240	302	372	
Net Block	284	352	363	402	
Capital WIP	62	41	70	100	
Investments	239	237	237	237	
Inventory	461	452	365	459	
Sundry debtors	521	436	368	463	
Cash and bank balances	603	618	166	202	
Other financial assets	97	275	275	275	
Other current assets	28	60	50	63	
Total Current Assets	1,711	1,840	1,224	1,462	
CL& Prov.	486	517	440	551	
Net Current Assets	1,225	1,324	784	911	
Total Assets	1,810.9	1,952.9	1,453.7	1,649.8	

Source: Company, ICICI Direct Research

Exhibit 11: Cash flow statement					₹ crore
(₹Crore)	FY19	FY20	FY21E	FY22E	
Profit after Tax	336	289	163	295	
Depreciation	46	57	62	70	
Interest	8	9	8	8	
Other income	(92)	(104)	(45)	(65)	
Prov for Taxation	188	98	63	115	
Cash Flow before WC changes	486	349	251	423	
Change in Working Capital	29	(83)	87	(91)	
Taxes Paid	(188)	(98)	(63)	(115)	
Cashflow from Operations	326	168	275	217	
(Purchase)/Sale of Fixed Asset	(80)	(104)	(102)	(140)	
(Purchase)/Sale of Investments	(1)	3	-	-	
Other Income	92	104	45	65	
Cashflow from Investing	11	3	(57)	(75)	
Issue/(Repayment of Debt)	5	(90)	45	-	
Changes in Minority Interest	-	-	-	-	
Changes in Netw orth	(397)	(81)	-	(0)	
Interest	(8)	(9)	(8)	(8)	
Dividend paid	(79)	-	(707)	(99)	
Cashflow from Financing	(479)	(180)	(670)	(107)	
Changes in Cash	(141)	(9)	(452)	35	
Opening Cash/Cash Equivalent	743	603	618	166	
Closing Cash/ Cash Equivalent	600	595	166	202	

*calculated, Source: Company, ICICI Direct Research

Exhibit 13: Key ratios					₹ crore
(Year-end March)	FY19	FY20	FY21E	FY22E	
Per share data (₹)					
EPS	67.9	58.5	32.9	59.7	
Cash EPS	77.3	70.0	45.4	73.9	
BV	343.2	385.4	275.3	315.0	
DPS	16.0	130.0	13.0	20.0	
Cash Per Share	44.0	48.5	61.0	75.2	
Operating Ratios (%)					
EBITDA Margin	16.0	12.3	10.5	14.0	
PBT / Net Sales	14.5	10.3	7.9	11.7	
PAT Margin	11.1	10.2	6.8	9.8	
Inventory days	55.5	58.0	55.5	55.5	
Debtor days	62.7	56.0	56.0	56.0	
Creditor days	55.3	64.7	64.7	64.7	
Return Ratios (%)					
RoE	19.8	15.2	12.0	18.9	
RoCE	29.4	20.3	16.1	25.3	
RoIC	36.4	21.9	14.7	24.4	
Valuation Ratios (x)					
P/E	22.0	25.6	45.4	25.1	
EV / EBITDA	14.2	19.4	29.0	17.1	
EV / Net Sales	2.3	2.4	3.0	2.4	
Market Cap / Sales	2.4	2.6	3.1	2.4	
Price to Book Value	4.4	3.9	5.4	4.7	
Solvency Ratios					
Debt/EBITDA	0.2	-	0.2	0.1	
Net Debt / Equity	-	-	-	-	
Current Ratio	3.3	3.0	2.2	2.2	
Quick Ratio	2.4	2.2	1.3	1.3	

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com

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