

## Holds ground on the back of auto sector...

SKF India reported relatively flattish numbers YoY whereas sequentially revenues jumped 133.4%, given a lower base in Q1 and swift recovery witnessed by the auto sector. Revenue for the quarter was at ₹ 703.2 crore, down 5.9% YoY (vs. I-direct estimate of ₹ 744.1 crore). Gross margins were at 37.2%, improving ~120 bps YoY while contracting ~180 bps QoQ as steel prices have recovered lately. SKF posted improved EBIDTA margin of 13.1% vs. 12.7% YoY, led by 3% & 2.4% decline in employee cost and other expenses YoY, respectively. Absolute EBIDTA declined 3.4%, coming in at ₹ 91.8 crore (vs. I-direct estimate of ₹ 96.4 crore) given lower sales. SKF ended the quarter with a PAT of ₹ 65 crore (vs. I-direct estimate of ₹ 61.5 crore), down 23.2% YoY. Decline in PAT was largely attributable to lower other income (₹ 7.8 crore in Q2FY21 vs. ₹ 23.2 crore in Q2FY20) as the company paid a special dividend of ₹ 130/share in July entailing a cash outflow of ₹ 641 crore, depleting the overall cash reserves of the company.

## Railway, auto, to aid topline in FY21E...

The auto segment is expected to keep up the ongoing momentum as PVs witnessed double digit growth in Q2. Further, SKF witnessed market share gains coupled with double digit growth in cars, trucks, 2-W & distribution segments led by pre-stocking demand for festive season. On the industrial side, infra linked segments like cement, metals, construction equipment are gaining traction whereas wind is sluggish on account of increase in prices & ceased capex by large players. Meanwhile, railway segment maintained its strong traction with SKF making progress in freight segment bearings.

## REP, remanufacturing: From capex to opex...

We believe REP and remanufacturing has a major role, going ahead as SKF aims at 20% (currently 5-7%) of topline to come from REP. Through rotating equipment performance (REP) and remanufacturing services, SKF is shifting towards an opex based model from a capex one. Foray into remanufacturing would also bring additional revenue for it with minimal costs as no capex needs to be incurred. Thus, this would arrest the fall in capacity utilisation and provide a good opportunity for SKF, going ahead.

## Valuation & Outlook

Taking cognisance of the recent auto numbers and management commentary, we expect a revenue decline of 20.5%, 8% for manufacturing, trading segments, respectively, for FY21E. In contrast, we expect these segments to grow 28%, 25%, respectively, in FY22E. Overall, we expect FY20-22E revenues to grow at a CAGR of 5.3% and FY21E revenues to decline 12%. Currently, the stock is trading at 25x FY22E earnings and, thus, leaves very little upside. We maintain our **HOLD** rating on the stock with a revised target price of ₹ 1615/share at 25x FY22E earnings.



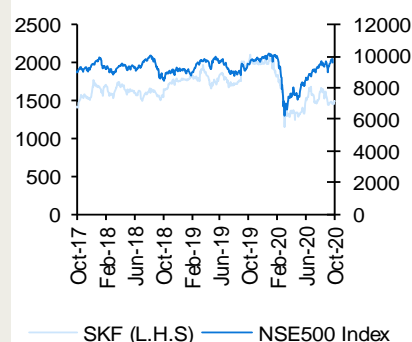
### Particulars

| Particular                    | Amount     |
|-------------------------------|------------|
| Market Capitalization         | 7,416      |
| Total Debt (FY 20) (₹crore)   | 0          |
| Cash and Inv (FY 20) (₹crore) | 618        |
| EV (FY 20) (₹crore)           | 6,798      |
| 52 week H/L (₹) (BSE)         | 2313 /1237 |
| Equity capital (₹crore)       | 49.4       |
| Face value (₹)                | 10         |

### Key Highlights

- Market share gains across auto OEMs, double digit growth in mobility
- Expect 12% revenue decline in FY21E
- Maintain HOLD rating on stock with target price of ₹ 1615/share

### Price chart



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### Key Financial Summary

|                     | FY18  | FY19  | FY20  | FY21E | FY22E | CAGR FY20-22E |
|---------------------|-------|-------|-------|-------|-------|---------------|
| Revenue (₹crore)    | 2,750 | 3,035 | 2,842 | 2,503 | 3,154 | 5.3           |
| EBITDA (₹crore)     | 435   | 486   | 349   | 262   | 457   | 14.4          |
| EBITDA margin       | 15.8  | 16.0  | 12.3  | 10.5  | 14.5  |               |
| Net Profit (₹crore) | 295.9 | 335.8 | 289.0 | 170.5 | 319.5 | 5.2           |
| EPS (₹)             | 57.6  | 67.9  | 58.5  | 34.5  | 64.6  |               |
| P/E (x)             | 26.0  | 22.1  | 25.7  | 43.5  | 23.2  |               |
| EV/EBITDA (x)       | 15.5  | 14.2  | 19.5  | 27.9  | 15.8  |               |
| RoCE (%)            | 23.7  | 29.4  | 20.3  | 16.8  | 26.9  |               |
| RoE (%)             | 16.1  | 19.8  | 15.2  | 12.5  | 20.1  |               |

Source: Company, ICICI Direct Research

Exhibit 1: Variance Analysis

|                             | Q2FY21 | Q2FY21E | Q2FY20 | YoY (%) | Q1FY21 | QoQ (%)  | Comments   |
|-----------------------------|--------|---------|--------|---------|--------|----------|--|
| Income from Operation       | 703.2  | 744.1   | 747.2  | (5.9)   | 301.2  | 133.4    | Topline recovered on a sequential basis tracking swift recovery in auto segment  |
| Other Income                | 7.8    | 5.0     | 23.2   | (66.5)  | 15.3   | (49.1)   | Other income was down as significant cash balance was used to pay out dividends  |
| Cost of material consumed   | 156.2  | 163.7   | 156.0  | 0.2     | 47.3   | 230.2    |  |
| Purchases of stock in trade | 174.0  | 312.5   | 336.6  | (48.3)  | 145.0  | 20.0     |  |
| Change in inventories       | 111.5  | -11.2   | -14.7  |         | -8.5   |          |  |
| Gross margins (%)           | 37.2   | 37.5    | 36.0   | 116 bps | 39.0   | -176 bps | GMs improved YoY but contracted ~176 bps sequentially as a result of variance in input prices & product mix  |
| Employee cost               | 57.9   | 62.1    | 59.6   | (3.0)   | 56.7   | 2.0      | Employee cost remained relatively stable   |
| Other expenditure           | 111.9  | 120.5   | 114.7  | (2.4)   | 61.3   | 82.6     |  |
| EBITDA                      | 91.8   | 96.4    | 95.0   | (3.4)   | -0.6   | NA       | EBITDA came in broadly in line with our estimates recovering from a loss in Q1   |
| EBITDA Margin (%)           | 13.1   | 13.0    | 12.7   | 34 bps  | -0.2   | 1327 bps | Operating margins improved led by decline in other expenses & employee costs   |
| Depreciation                | 14.5   | 15.0    | 14.1   | 2.7     | 14.5   | 0.3      |  |
| Interest                    | 0.8    | 1.0     | 2.5    |         | 0.5    |          |  |
| PBT                         | 84.3   | 85.4    | 101.6  | (17.1)  | -0.3   | NA       |  |
| Taxes                       | 19.3   | 23.9    | 17.0   | 13.2    | -0.1   | NA       |  |
| PAT                         | 65.0   | 61.5    | 84.6   | (23.2)  | -0.2   | NA       | Decline in PAT largely attributable to lower other income (₹7.8 crore in Q2FY 21 vs. ₹23.2 crore in Q2FY 20) as the company paid special dividend of ₹130/share in July entailing cash outflow of ₹641 crore, depleting overall cash reserves of the company |

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 | 2,400.4 | 2,503.4 | 4.1      | 3,022.6 | 3,153.6 | 4.2      |
| EBITDA            | 485.9   | 349.5   | 250.8   | 261.6   | 4.1      | 423.2   | 457.3   | 7.5      |
| EBITDA Margin (%) | 16.0    | 12.3    | 10.5    | 10.5    | 0 bps    | 14.0    | 14.5    | -50 bps  |
| PAT               | 335.8   | 289.0   | 162.8   | 170.5   | 4.5      | 295.0   | 319.5   | 7.7      |
| EPS (₹)           | 67.9    | 58.5    | 32.9    | 34.5    | 4.5      | 59.7    | 64.6    | 7.7      |

Source: Company, ICICI Direct Research

### Conference call takeaways

- Domestic sales grew 11% during the quarter. The management iterated that their primary focus remains the domestic business
- The auto sector is growing faster than expected. However, need to be cautious in terms of sustainability of growth
- Maintains capex guidance of ₹ 150 crore annually
- SKF is making strides in bearings for freight segment of railway
- Total 95% of auto segment is localised whereas 35% is for industrial. The company aims to improve its localised content for industrial. However, this would take time as feasibility is a deterrent in many cases

### Sales mix

Q2FY21: Auto - 43%, Industrial - 50%, Exports - 7%

H1FY21: Auto - 40%, Industrial - 53%, Exports - 7%

Manufacturing: - 57%, Traded - 43%

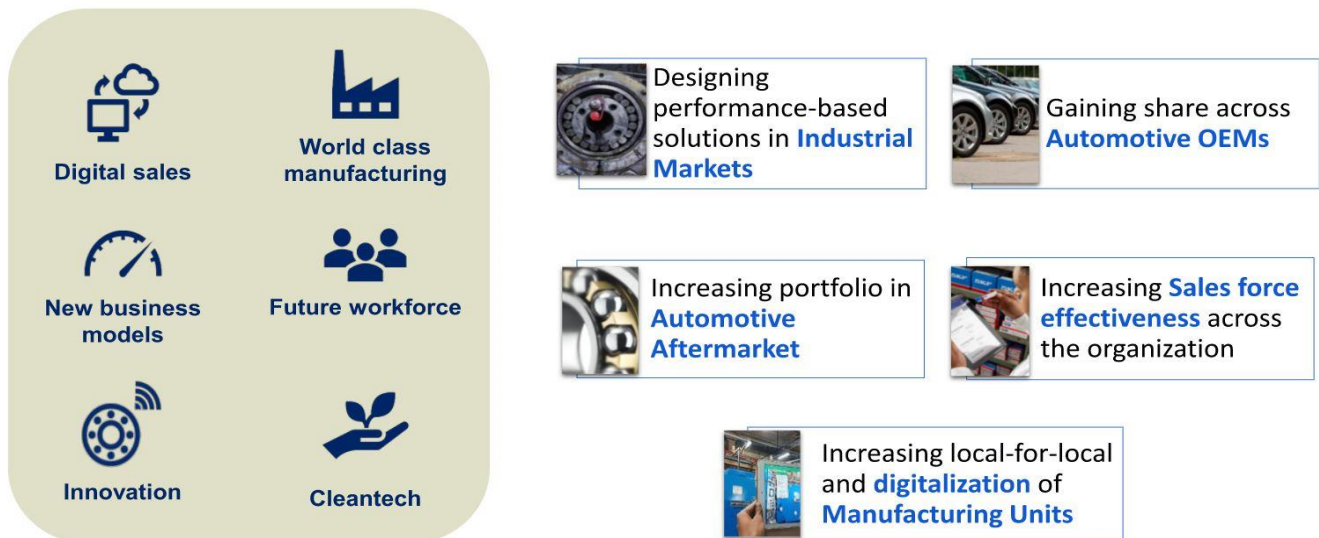
### Q2 segmental performance

Auto - 15%, Industrial - 7%, Export - 50%+

### Exhibit 3: SKF's strategy



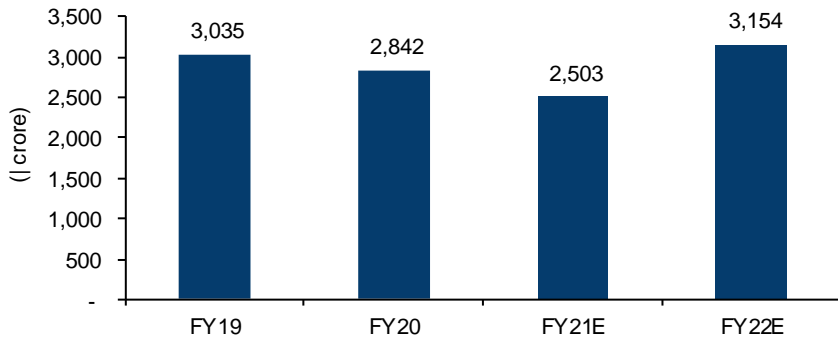
## SKF India Strategy



Source: Company, ICICI Direct Research

### Financial story in charts

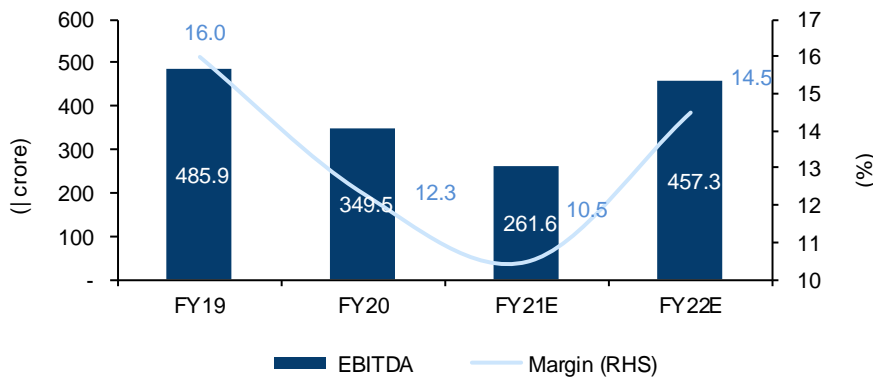
Exhibit 4: Revenue trend (consolidated)



We expect gradual recovery in H2FY21E, whereas overall FY21E to be down by 16%

Source: Company, ICICI Direct Research

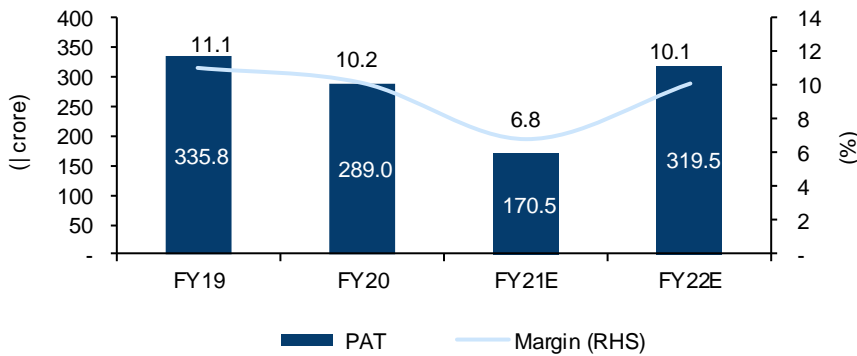
Exhibit 5: EBITDA and EBITDA margin trend



Margins to be impacted in FY21E owing to disrupted performance in Q1FY21

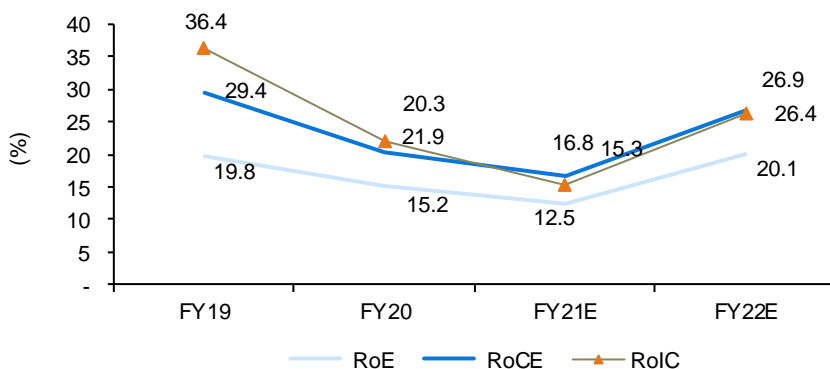
Source: Company, ICICI Direct Research

Exhibit 6: PAT and PAT margin trend



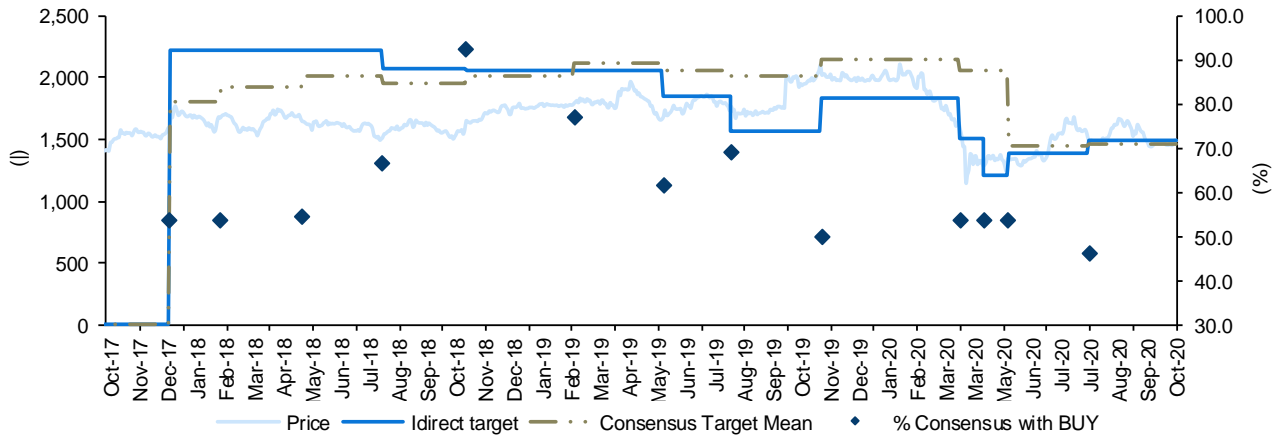
Source: Company, ICICI Direct Research

Exhibit 7: RoE and RoCE trend



Source: Company, ICICI Direct Research

Exhibit 8: Recommendation History vs. Consensus



Source: Bloomberg, Company, ICICI Direct Research

Exhibit 9: Top 10 Shareholders

| Rank | Investor Name        | Filing Date | % O/S | Position (%) | Change  |
|------|----------------------|-------------|-------|--------------|---------|
| 1    | Skf Ab               | 30-Jun-20   | 45.9  | 22.67m       | 0.00m   |
| 2    | Hdfc Small Cap Fund  | 30-Jun-20   | 8.9   | 4.39m        | (0.18)m |
| 3    | Hdfc Asset Managemen | 30-Sep-20   | 8.4   | 4.16m        | (0.11)m |
| 4    | Skf Uk Ltd           | 30-Jun-20   | 6.3   | 3.13m        | 0.00m   |
| 5    | Sbi Funds Management | 30-Sep-20   | 4.0   | 1.99m        | 0.03m   |
| 6    | Mirae Asset Global I | 30-Sep-20   | 3.3   | 1.62m        | 0.08m   |
| 7    | Franklin Resources   | 30-Sep-20   | 2.9   | 1.41m        | 0.03m   |
| 8    | Mirae Asset Emerging | 31-Mar-20   | 2.2   | 1.10m        | 1.10m   |
| 9    | Uti Asset Management | 30-Sep-20   | 2.1   | 1.04m        | (0.00)m |
| 10   | Kotak Mahindra Asset | 30-Sep-20   | 2.0   | 0.97m        | 0.04m   |

Source: Reuters, ICICI Direct Research

Exhibit 10: Shareholding Pattern

| (in %)   | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 |
|----------|--------|--------|--------|--------|--------|
| Promoter | 52.6   | 52.6   | 52.6   | 52.6   | 52.6   |
| FII      | 8.1    | 7.7    | 7.3    | 7.8    | 7.2    |
| DII      | 27.1   | 27.7   | 28.5   | 27.8   | 27.4   |
| Others   | 12.3   | 12.0   | 11.6   | 11.8   | 12.8   |

Source: Company, ICICI Direct Research

## Financial summary

| Exhibit 11: Profit and loss statement |              |              |              |              |
|---------------------------------------|--------------|--------------|--------------|--------------|
|                                       | ₹ crore      |              |              |              |
| (₹Crore)                              | FY19         | FY20         | FY21E        | FY22E        |
| Revenue                               | 3,035        | 2,842        | 2,503        | 3,154        |
| Growth YoY (%)                        |              | -6%          | -12%         | 26%          |
| Other Income                          | 92           | 104          | 45           | 65           |
| <b>Total Revenue</b>                  | <b>3,127</b> | <b>2,946</b> | <b>2,548</b> | <b>3,219</b> |
| Cost of materials consum              | 734          | 603          | 532          | 672          |
| Purchase of stock-in-trad             | 1,086        | 1,203        | 1,051        | 1,261        |
| Change in inventories                 | (44)         | (16)         | 20           | (32)         |
| Employee cost                         | 258          | 240          | 238          | 284          |
| Other Expenses                        | 514          | 462          | 401          | 511          |
| <b>Total expenditure</b>              | <b>2,549</b> | <b>2,492</b> | <b>2,242</b> | <b>2,696</b> |
| EBITDA                                | 486          | 349          | 262          | 457          |
| Growth YoY (%)                        |              | -28%         | -25%         | 75%          |
| Interest                              | 8            | 9            | 8            | 8            |
| PBDT                                  | 571          | 444          | 299          | 514          |
| Depreciation                          | 46           | 57           | 62           | 70           |
| Profit Before Tax                     | 524          | 387          | 237          | 444          |
| Tax                                   | 188          | 98           | 66           | 124          |
| <b>PAT</b>                            | <b>336</b>   | <b>289</b>   | <b>171</b>   | <b>320</b>   |
| Growth YoY (%)                        |              | -14%         | -41%         | 87%          |
| EPS                                   | 67.9         | 58.5         | 34.5         | 64.6         |

Source: Company, ICICI Direct Research

| Exhibit 13: Balance sheet     |                |                |                |                |
|-------------------------------|----------------|----------------|----------------|----------------|
|                               | ₹ crore        |                |                |                |
| (₹Crore)                      | FY19           | FY20           | FY21E          | FY22E          |
| Share Capital                 | 49.4           | 49.4           | 49.4           | 49.4           |
| Reserves & Surplus            | 1,648          | 1,856          | 1,319          | 1,540          |
| Networth                      | 1,697          | 1,905          | 1,369          | 1,589          |
| Total Debt                    | 90.0           | -              | 45.0           | 45.0           |
| Other non-current liabilities | 24.0           | 47.6           | 47.6           | 47.6           |
| <b>Total Liabilities</b>      | <b>1,810.9</b> | <b>1,952.9</b> | <b>1,461.4</b> | <b>1,682.1</b> |
| 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            | 380            | 479            |
| Sundry debtors                | 521            | 436            | 384            | 484            |
| Cash and bank balances        | 603            | 618            | 159            | 214            |
| Other financial assets        | 97             | 275            | 275            | 275            |
| Other current assets          | 28             | 60             | 53             | 66             |
| <b>Total Current Assets</b>   | <b>1,711</b>   | <b>1,840</b>   | <b>1,250</b>   | <b>1,518</b>   |
| CL& Prov.                     | 486            | 517            | 458            | 575            |
| Net Current Assets            | 1,225          | 1,324          | 792            | 943            |
| <b>Total Assets</b>           | <b>1,810.9</b> | <b>1,952.9</b> | <b>1,461.4</b> | <b>1,682.1</b> |

Source: Company, ICICI Direct Research

| Exhibit 12: Cash flow statement |              |              |              |              |
|---------------------------------|--------------|--------------|--------------|--------------|
|                                 | ₹ crore      |              |              |              |
| (₹Crore)                        | FY19         | FY20         | FY21E        | FY22E        |
| Profit after Tax                | 336          | 289          | 171          | 320          |
| Depreciation                    | 46           | 57           | 62           | 70           |
| Interest                        | 8            | 9            | 8            | 8            |
| Other income                    | (92)         | (104)        | (45)         | (65)         |
| Prov for Taxation               | 188          | 98           | 66           | 124          |
| Cash Flow before WC changes     | 486          | 349          | 262          | 457          |
| Change in Working Capital       | 29           | (83)         | 72           | (95)         |
| Taxes Paid                      | (188)        | (98)         | (66)         | (124)        |
| <b>Cashflow from Operations</b> | <b>326</b>   | <b>168</b>   | <b>267</b>   | <b>238</b>   |
| (Purchase)/Sale of Fixed Asset  | (80)         | (104)        | (102)        | (140)        |
| (Purchase)/Sale of Investments  | (1)          | 3            | -            | -            |
| Other Income                    | 92           | 104          | 45           | 65           |
| <b>Cashflow from Investing</b>  | <b>11</b>    | <b>3</b>     | <b>(57)</b>  | <b>(75)</b>  |
| Issue/(Repayment of Debt)       | 5            | (90)         | 45           | -            |
| Changes in Minority Interest    | -            | -            | -            | -            |
| Changes in Networth             | (397)        | (81)         | -            | 0            |
| Interest                        | (8)          | (9)          | (8)          | (8)          |
| Dividend paid                   | (79)         | -            | (707)        | (99)         |
| <b>Cashflow from Financing</b>  | <b>(479)</b> | <b>(180)</b> | <b>(670)</b> | <b>(107)</b> |
| Changes in Cash                 | (141)        | (9)          | (460)        | 56           |
| Opening Cash/Cash Equivalent    | 743          | 603          | 618          | 159          |
| Closing Cash/ Cash Equivalent   | 600          | 595          | 159          | 214          |

\*calculated, Source: Company, ICICI Direct Research

| Exhibit 14: Key ratios |       |       |       |       |
|------------------------|-------|-------|-------|-------|
| (Year-end March)       | FY19  | FY20  | FY21E | FY22E |
| Per share data (₹)     |       |       |       |       |
| EPS                    | 67.9  | 58.5  | 34.5  | 64.6  |
| Cash EPS               | 77.3  | 70.0  | 47.0  | 78.9  |
| BV                     | 343.2 | 385.4 | 276.9 | 321.5 |
| 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  | 14.5  |
| PBT / Net Sales        | 14.5  | 10.3  | 8.0   | 12.3  |
| PAT Margin             | 11.1  | 10.2  | 6.8   | 10.1  |
| 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  | 12.5  | 20.1  |
| RoCE                   | 29.4  | 20.3  | 16.8  | 26.9  |
| RoIC                   | 36.4  | 21.9  | 15.3  | 26.4  |
| Valuation Ratios (x)   |       |       |       |       |
| P/E                    | 22.1  | 25.7  | 43.5  | 23.2  |
| EV / EBITDA            | 14.2  | 19.5  | 27.9  | 15.8  |
| EV / Net Sales         | 2.3   | 2.4   | 2.9   | 2.3   |
| Market Cap / Sales     | 2.4   | 2.6   | 3.0   | 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   | 2.1   | 2.2   |
| Quick Ratio            | 2.4   | 2.2   | 1.3   | 1.3   |

Source: Company, ICICI Direct Research

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Buy: > 15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: < -15%



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