

SKF India Ltd (SKF)

- Beneficiary of Economic Recovery

Recommendation : Buy
CMP : Rs. 1467.40
Sector : Bearings

NSE Code : SKFINDIA
BSE Code : 500472

Financial break up

Market Cap (Rs. Cr) : 7253
EPS (FY22E) : 60.00
PE : 24.46
Face Value : Rs.10/-

Share Holding Pattern:

Promoters : 52.58
Others : 47.42

Background: SKF India is a subsidiary of AB SKF which is a Sweden based publicly listed bearing company, known for its excellence in the Ball Bearings across the globe. SKF India is one of the oldest Bearing companies in India and maintained its leadership position in the Bearing till recently, only lose some ground to Schaeffler India off-late. The Company continues to remain the second largest bearing company in India. The Company has been a technology leader in the Ball Bearing with a very diverse portfolio of Ball Bearings ranging from High Precision Ball Bearings to Deep Groove Ball Bearing, suitable for various applications.

Market Leader - Ball Bearings segment

SKF India enjoys leadership in the Ball Bearings technologies and it manufactures a large variety of Ball Bearings with varied applications. The Company enjoys leadership position in the Automobile Wheel End Bearings, although it also manufactures Cylindrical, Spherical and Tapered Roller Bearings. As Roller Bearings gained traction due to its superior load carrying capacity, the Company has lagged in growth. However, it leveraged superior research capabilities to match its peers and it is gradually gaining traction in high-load applications like Freight Wagons. Further, the Company has a strong presence in the Industrial space, with varied applications and caters to over 40 Industries.

OEM & After Market Contribution

Within the Automobile segment, the Company caters both the OEMs as well as Aftermarket. Aftermarket accounts for ~30% of the Automobile revenue, while the balance 70% comes from the OEMs. 2W and 4W OEMs account for 39% and 32% of revenue respectively. PV and CV have almost equal contribution to 4W OEMs revenue of the company. Similarly, OEMs and Aftermarket account for 50% each of the Industrial revenue of SKF India, showing its strong positioning in the Industrial Aftermarket. Strong presence in the Aftermarket makes SKF India uniquely placed in the domestic bearing space.

Top 3 Supplier to Indian Railways

SKF India is among the top three bearing suppliers to the Indian Railways, with a strong presence in the Conventional Coach segment. SKF India is the largest supplier of Bearings for the Conventional Coaches of the Indian Railways and it has a market share of 60% in this segment. The segment accounts for just 40% of the total addressable Railway business.

Outlook & Valuation

We recommend a **Buy** on SKF for long term investors. Given the leadership in Automotive wheel end bearings, Diverse product range, Leading supplier to Indian Railways, Strong After Market contribution, and Increasing Localisation are key positives for the stock. At the CMP of INR 1467.40, the stock trades at 24.46x Consolidated EPS of FY22E. The key risks to the business include Steep increase in Raw Material cost, Slowdown in Auto Sector and Weak rupee are the key risks of the company.

Investment Arguments

Company Profile:

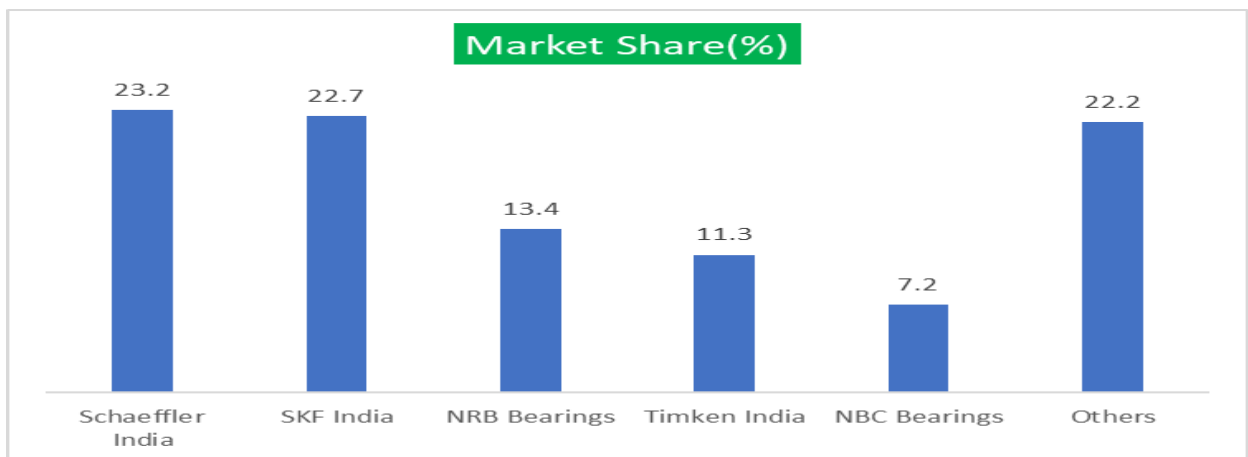
SKF India is a subsidiary of AB SKF which is a Sweden based publicly listed bearing company, known for its excellence in the Ball Bearings across the globe.

The SKF group is a global giant in the field of Engineering Bearings and Mechanical Powertrains and it caters to more than 40 industries across the globe. The group is known for anti friction solution globally. Established in 1907, AB SKF is one of the world leaders in the bearing manufacturing and have been present in all the five continents within 14 year of establishment. AB SKF has operations in 130 countries with 103 manufacturing units worldwide, 15 Technologies Centers and a workforce of 43,360 employees.

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SKF India has grown at a relatively slower CAGR of 4.9% over the last decade in the domestic market, compared to significantly higher growth reported by the competitors like Schaeffler India and Timken India. The lower growth on two accounts: Lower presence in railways and export markets and secondly, both Schaeffler and Timken's higher growth led by inorganic growth through merger and acquisition. Consequently, SKF's market share has come down from ~28% in FY15-16 to 22.7% in FY20. Late entry into the burgeoning Railway's Freight Wagon business and muted demand of domestic automobile business, where it enjoyed leadership position resulted in erosion of its market share. However, the Company has made an entry to the Freight Wagon side and is gaining momentum, with the launch of Class K Bearings, which are replacing the Class E Bearings. The Company is a leader in the conventional wagon business, which is now being replaced by LBH Coaches and SKF India is hopeful of getting preference as it has over 60% market share in the Conventional Coaches. Launch of Hub-3 for PV will lead to recovery in its lost prominence in the automotive Wheel-end business.



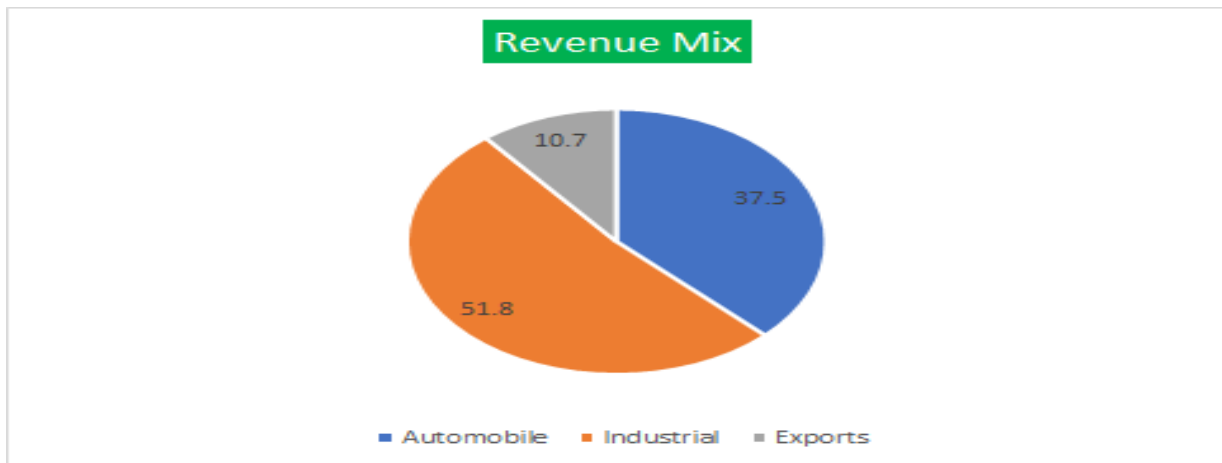
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The Company has a diverse product offering Deep Groove Ball Bearings, High precision Ball Bearings, Self-aligning Bearings, Thrust Bearing etc.

Wheel End Bearings

SKF India has a fairly diversified revenue-mix in term of the sectors and Industries it caters. The company's dependence on the domestic Automobile has marginally declined over the past five from 43% to ~37-38% now, while contribution of the Industrial segment has gone up from 49% to 52-53% over the same period.



OEM & Aftermarket contribution

Within the Automobile segment, the Company caters both the OEMs as well as Aftermarket. Aftermarket accounts for ~30% of the Automobile revenue, while the balance 70% comes from the OEMs. 2W and 4W OEMs account for 39% and 32% of revenue respectively. PV and CV have almost equal contribution to 4W OEMs revenue of the company.

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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.

EV - Unlikely to have negative impact

Majority of Automobile Bearing portfolio of SKF India fall under Wheel End category. Adoption and penetration of Electric Vehicles in the domestic market will result in adoption of lighter and simpler transmission systems. Bearings used in the engines will become obsolete in case of EVs and will be replaced by lighter and lesser number of Bearings in the electric drives. Further, the Wheel End Bearing will still be in use, albeit it will evolve into lighter and low friction Bearings, employing lighter alloys than carbon steel. Consequently, SKF India will be least impacted by the EV disruption.

Low-friction Tapered Roller Bearings

During 2019, SKF group has been working to develop low-friction Tapered Roller Bearings. These are being tested on specific applications and have shown to reduce power losses by up to 50% in comparison with conventional bearings. For EVs to work efficiently, the motors that drive them must run at very high speeds. This places enormous strain on the bearings they employ. SKF is developing designs for Bearings and associated Polymer Cages and Lubricants that will ensure that they can withstand the higher speeds, acceleration and temperatures generated by these motors.

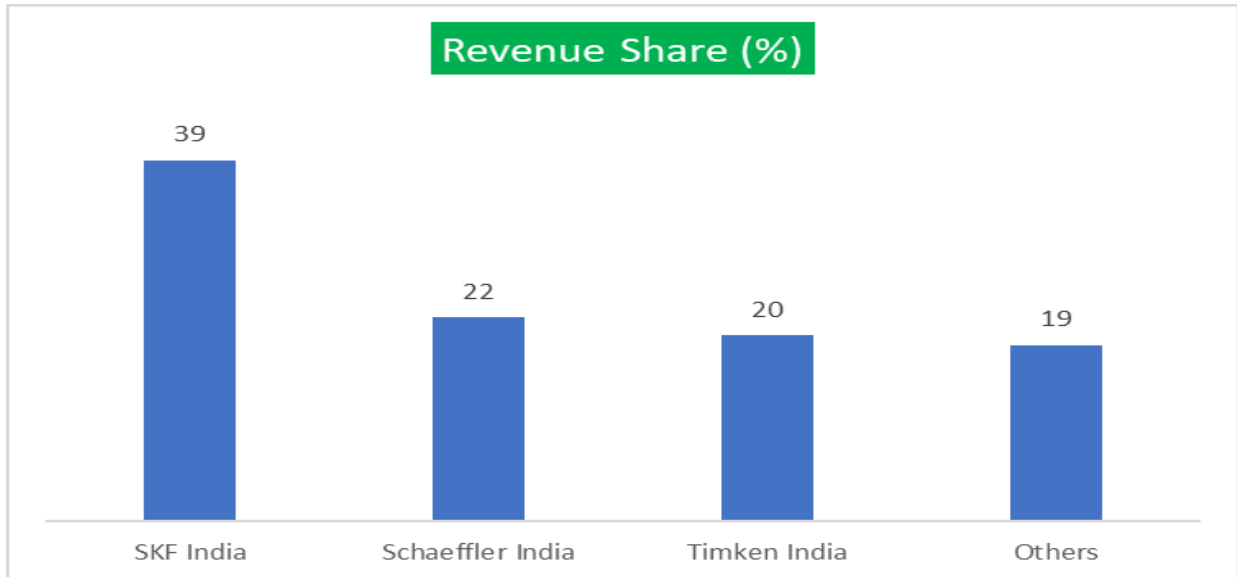
Supplies to Indian Railways

SKF India is among the top three bearing suppliers to the Indian Railways, with a strong presence in the Conventional Coach segment. Over the past four years, the Company's Railway business has grown at CAGR of 11.4% in the railways business and it now accounts for ~7% of the overall revenue. The Railway business of SKF has underperformed that of its peers like Schaeffler India and Timken India due its late entry to the Freight segment, which takes three years to start bidding for the entire business. Also, the Conventional passenger Coaches are being converted to LHB coaches and the disruption can cause other players like Schaeffler India and Timken to enter the business in a big way. However, the management expects to get preference over the other player, given its presence in the Conventional Coaches.

SKF India is the largest supplier of Bearings for the Conventional Coaches of the Indian Railways and it has a market share of 60% in this segment. The segment accounts for just 40% of the total addressable Railway business.

SKF India entered in the wagon segment late and got registered in 2015. Over the next three the company was allowed to bid just 10% of the business. The company's launch of Class K Bearings has given it an opportunity to ramp up the supply to Freight wagon and had reached 10% of share of business by FY17. The company is expected to benefit from DFC, with Class K Bearing in its portfolio.

SKF's Locomotive business is showing ramp up on account of localization of production of Electric Locomotive in India by the global OEMs like GE, Siemens etc. The company has already entered into an agreement to supply Bearing to GE for 10 years. The annual revenue run rate for the contract is ~Rs.300mn.



Wind Energy

SKF India is strong player in the domestic Wind market and supplies bearings for the gear boxes and the alternators. After showing a sharp decline in FY18 to a mere 1% of revenue from earlier 5-6% of revenue, the segment has shown a strong comeback in FY20 to account for 5% of the revenue. Apart from large capacity addition expected in the domestic market, localization of manufacturing of Wind turbines by global OEMs like Siemens Gamesa, GE, Vestas etc offer a large opportunity for SKF India.

Innovative Products

SKF India identifies Industrial segment as one of its key growth drivers. The company currently caters to over 40 industries and is focusing on application based product/solution to target the systems. The Industrial segment accounts for ~52-53% of its revenue, which is equally divided between OEMs and Aftermarket.

The company offers REP (Rotatory Equipment Performance) Solution, a solution to offer monitoring and enhancing the Bearings performance for its clients. Further, Remanufacturing is another service, through which it is targeting the Industrial Aftermarket, under which a used Bearing is remanufactured/repaired to its original performance, with a warranty equivalent to, or better than that of a newly manufactured product.

Further, SKF is launching application based products and condition monitoring products to enhance its footprint in the Industrial segment.

Localization to gain traction

SKF India's localization continues to remain low at 54.3% of sales. Part of traded goods (~25%) is sourced from its sister concern SKF Technologies, while balance is imported from SKF entities abroad. Consequently, imports continue to remain elevated at 41.7% of sales. However, SKF India has doubled its investment from Rs 800-900mn to ~Rs 1.5bn over the past few years, to enhance its product localization, particularly the products supplied to the Industrial segments. It includes localization of Freight Wagon Bearings as well as other Industrial Bearings. The company feels that localization of Industrial products is likely to play out in the coming years and the company is expected to report significant margin improvement going forward.

Blended EBITDA margin has strong correlation with localization. In case of SKF the margin improvement will be more pronounced, given the majority of the localization will be in the Industrial segment.

Exports

SKF India's exports have grown at CAGR of 11.1% over the past ten years, significantly higher than its domestic revenue growth the same period. However, it has been slower than the exports growth of its peers. Exports accounts for 10.7% of its revenue. The Company exports mostly Automobile Bearings.

SKF India exports products to mostly the developed market, particularly Europe and is linked to the European OEMs performance. German and Swedish OEMs are the main customers for its exports. SKF India has made a foray in the North American Aftermarket recently. The company has been focusing on application based new products lines for the exports. The company recently launched Housing for the European OEMs, which has shown good demand. This has led to spurt in exports in FY20. SKF India has been investing in R&D to indigenize the new technology.

Key Risks

Increase in the Raw Material Prices: SKF is likely to witness reduction in EBITDA margins in case its raw material cost increases steeply thereby impacting its margins and profitability.

Slowdown in the Auto Sector: SKF derives significant amount of income from the auto sector and any slowdown in the sector will result in lower demand which will impact the company's revenues & profitability.

Imports: The company has significantly higher imports (~41.7% of revenue) and weakening of Rupee also put pressure on margins.

Financials

P&L

P&L (Rs Cr)	FY19	FY20	FY21E	FY22E
Revenue	3,035	2,842	2,400	3,023
Other Income	92	104	45	65
Total Income	3,127	2,946	2,445	3,088
Cost of materials consumed	734	603	510	650
Purchase of stock- in- trade	1,086	1,203	1,008	1,209
Change in inventories	-44	-16	19	-30
Employee Expenses	258	240	228	272
Other Expenses	515	463	384	499
Total expenditure	2549	2493	2149	2600
EBITDA	486	349	251	423
Interest Cost	8	9	8	8
Depreciation	46	57	62	70
Profit Before Tax	524	387	226	410
Tax	188	98	63	115
PAT	336	289	163	295
EPS	68	58	33	60

Balance Sheet

Balance Sheet (Rs Cr)	FY19	FY20	FY21E	FY22E
Share Capital	49.4	49.4	49.4	49.4
Reserves & Surplus	1,648	1,856	1,312	1,508
Networth	1,697	1,905	1,361	1,557
Total Debt	90	0	45	45
Other non-current liabilities	23	48.6	47.6	47.6
Total Liabilities	1,810	1,954	1,454	1,650
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
Current Liabilities & Provisions	486	517	440	551
Net Current Assets	1,225	1,324	784	911
Total Assets	1810	1954	1454	1650

Cash Flow Statement

Cash Flow Statement (Rs Cr)	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
Cash Flow from Operations	326	168	275	217
(Purchase) /Sale of Fixed Assets	-80	-104	-102	-140
(Purchase) /Sale of Investments	-1	3	0	0
Other Income	92	104	45	65
Cash F low from Inves ting	11	3	-57	-75
Issue/(Repayment of Debt)	5	-90	45	-
Changes in Minority Interest	0	0	0	0
Changes in Networkth	-397	-81	-	0
Interest	-8	-9	-8	-8
Dividend paid	-79	-	-707	-99
Cash Flow 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

Key Financial ratio's

Key Financial Ratio's (Rs Cr)	FY19	FY20	FY21E	FY22E
Cash EPS	77.3	70	45.4	73.9
BV	343.2	385.4	275.3	315
DPS	16	130	13	20
Cash Per Share	44	48.5	61	75.2
EBITDA Margin	16	12.3	10.5	14
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	55.5	55.5
Debtor days	62.7	56	56	56
Creditor days	55.3	64.7	64.7	64.7
RoE	19.8	15.2	12	18.9
RoCE	29.4	20.3	16.1	25.3
RoIC	36.4	21.9	14.7	24.4
Current Ratio	3.3	3	2.2	2.2
Quick Ratio	2.4	2.2	1.3	1.3

Disclaimer

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