

### High cost imports led to huge Gross margin erosion

SKF India reported subdued set of numbers for 2QFY24 on all fronts – Revenue growth, margins and PAT growth. The numbers were substantially lower than our and consensus estimates. The highlight of the results has been whopping 830 bps YoY erosion in the gross margin to 34% (Centrum – 36.2%), the lowest since 3QFY20. This has been attributed to the increase in the import costs. Revenue up by 4.4% YoY to Rs 11,252 mn (Centrum – Rs 11,645 mn / Consensus – Rs 12,060 mn). EBITDA margin lowered by 910 bps to 10.8% (Centrum & Consensus- 18%). PAT registered a YoY decline of 42% to Rs 902 mn (Centrum – Rs 1,488 mn / Consensus – Rs 1,630 mn). Accordingly, we cut Revenue/PAT estimates for FY24 by 2.5%/9.7% and for FY25 by 2.4%/2.9% respectively. However, we believe SKF India's Gross and EBITDA margins to bounce back to near long range average in FY25E. Hence, we assign current FY25E earnings multiple of 40x (earlier 44x) to 1HFY26E EPS of Rs127 (earlier Rs 131) to arrive at a Target Price of Rs5,095 (earlier Rs 5,764) and recommend REDUCE (earlier ADD).

#### Revenue growth driven by growth in heavy industry and light vehicles

3QCY23 results presentation and transcript of SKF AB reveals revenue growth drivers for SKF India in 2QFY24. In the industrial segment, sales to heavy industries, off-highway, material handling and automation were significantly higher. Sales to high-speed machinery & electrical drives were higher while sales to other and agriculture, food & beverage were slightly higher. To industrial distribution, aerospace, railway and marine it was relatively unchanged while sales to renewable energy and traditional energy were significantly lower YoY. In the automotive segment, sales in the quarter were significantly higher compared to last year with significantly higher sales to light vehicles. To the vehicle aftermarket it was relatively unchanged while sales to commercial vehicles were slightly lower.

#### Gross margin remained volatile on the quarterly basis historically

A 17.7% YoY growth in the purchase of stock-in-trade led to 830 bps erosion in the gross margin to 34% vs 42.2% same period last fiscal. (Centrum – 39.8%). This has been the lowest gross margin since Dec 2019 quarter (34.4%). Traded stock as a percentage of net revenue has grown to 39.4% vs 35% YoY (Centrum – 36.2%). Industrial bearings are mostly traded and governed by transfer pricing mechanism. This causes a lot of volatility in the gross margin on quarterly basis for SKF India. Moreover, the management attributed gross margin erosion to higher import costs. On an annualized basis, gross margin has broadly remained in the range of 38-41% historically.

#### EBITDA margin decline by 910 bps to 10.8% and PAT decline 42% YoY

An 830 bps YoY erosion in Gross margin coupled with 7% YoY growth in employee cost and 8.7% YoY increase in Other expenses transpired into 910 bps contraction in EBITDA margin to 10.8%. Lower EBITDA margin coupled with 14.5% YoY jump in depreciation and 117 bps increase in the tax rate led to whopping 42% YoY fall in the PAT.

#### Financial and valuation summary

YE Mar (Rs mn)	2QFY24A	2QFY23A	YoY (%)	1QFY24A	QoQ (%)	FY24E	FY25E	FY26E
Revenues	11,252	10,783	4.4	11,496	(2.1)	46,431	50,695	56,535
EBITDA	1,215	2,146	(43.4)	2,029	(40.1)	7,063	8,281	9,104
EBITDA margin (%)	10.8	19.9	(45.7)	17.6	(38.8)	15.2	16.3	16.1
Adj. Net profit	902	1,560	(42.1)	1,545	(41.6)	5,150	6,042	6,554
Adj. EPS (Rs)	18.2	31.5	(42.1)	31.3	(41.6)	104.2	122.2	132.6
EPS growth (%)						(1.9)	17.3	8.5
PE (x)						47.6	40.6	37.4
EV/EBITDA (x)						33.2	28.4	25.3
PBV (x)						8.9	8.2	6.9
RoE (%)						20.2	21.0	20.1
RoCE (%)						22.0	22.9	21.7

Source: Company, Centrum Broking

#### Result Update

India I Auto Ancillaries

11 November, 2023

#### REDUCE

Price: Rs4,960

Target Price: Rs5,095

Forecast return: 3%

Institutional Research

#### Market Data

Bloomberg:	SKF IN
52 week H/L:	5,535/3,960
Market cap:	Rs245.2bn
Shares Outstanding:	49.4mn
Free float:	47.4%
Avg. daily vol. 3mth:	21,480

Source: Bloomberg

#### Changes in the report

Rating:	REDUCE; Changed
Target price:	Rs5,095 (earlier: Rs 5,764)
EPS:	FY24E:Rs104.2 (earlier: Rs115.3) FY25E:Rs122.2 (earlier:Rs125.9)

Source: Centrum Broking

#### Shareholding pattern

	Sep-23	Jun-23	Mar-23	Dec-22
Promoter	52.6	52.6	52.6	52.6
FIIs	6.5	6.4	6.5	6.5
DIIIs	29.0	29.4	29.1	29.0
Public/other	12.0	11.6	11.8	12.0

Source: BSE

#### Centrum estimates vs Actual results

YE Mar (Rs mn)	Centrum Q2FY24	Actual Q2FY24	Variance (%)
Revenue	11,645	11,252	-3.4
EBITDA	2,105	1,215	-42.3
EBITDA margin	18.1	10.8	(728 bps)
Rep. PAT	1,488	902	-39.4
EPS (Rs)	30.1	18.2	-39.4

Source: Centrum Broking

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# Thesis Snapshot

## Estimate revision

YE Mar (Rs mn)	FY24E		% chg	FY25E		% chg
	New	Old		New	Old	
Revenue	46,431	47,630	-2.5	50,695	51,933	-2.4
EBITDA	7,063	7,995	-11.7	8,281	8,648	-4.2
EBITDA margin	15.2	16.8	(157 bps)	16.3	16.7	(32 bps)
Adj. PAT	5,150	5,701	-9.7	6,042	6,222	-2.9

Source: Centrum Broking

## SKF India versus NIFTY Midcap 100

	1m	6m	1 year
SKF IN	(5.8)	19.9	3.8
NIFTY midcap 100	5.8	35.9	36.3

Source: Bloomberg, NSE

## Key assumptions

YE Dec	FY24E	FY25E	FY26E
<b>YoY Growth %</b>			
Exports	-10.0	-2.0	5.0
Total Automotive	8.5	7.6	9.0
Total Industrial	9.0	10.6	13.0
Sale from Services	30.0	30.0	30.0
Other Operating Income	15.0	15.0	15.0

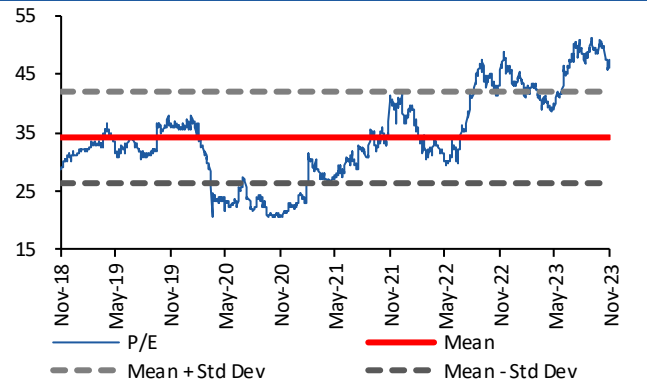
Source: Centrum Broking

## Valuations

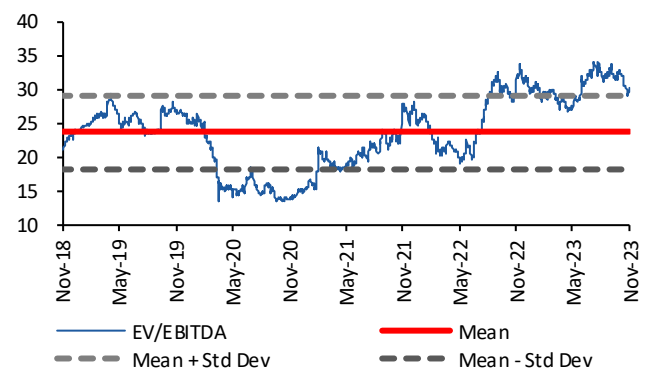
The company is estimated to achieve near double digit revenue growth with lesser contraction in margins on account of the lower presence in the stressed export market and contracts on hand in the domestic market till FY26E. We estimate FY23-26E revenue CAGR of 9.5% and PAT CAGR of 7.7%. We assign current FY25E earnings multiple of 40x to 1HFY26E EPS of Rs127 to arrive at a Target Price of Rs5,095 and recommend REDUCE.

Valuations	Rs/share
1H FY26E EPS	127
Target Multiple (Current FY25E) (x)	40
Target price (Rs)	5,095

## P/E mean and standard deviation



## EV/EBITDA mean and standard deviation



Source: Bloomberg, Centrum Broking

## Peer comparison

Company	Mkt Cap	CAGR (CY22/FY23-25E/FY26E)				P/E (x)				ROE (%)			ROCE (%)		
	(Rs mn)	Sales	EBITDA	EPS	CY23E/FY24E	CY24E/FY25E	CY25E/FY26E	CY23E/FY24E	CY24E/FY25E	CY25E/FY26E	CY23E/FY24E	CY24E/FY25E	CY25E/FY26E		
SKF India	2,45,222	9.5	6.7	7.7	47.6	40.6	37.4	20.2	21.0	20.1	22.0	22.9	21.7		
Timken India	2,25,130	11.6	9.6	3.6	61.0	62.2	51.8	16.7	14.1	14.7	16.7	14.2	15.1		
Schaeffler India	4,31,544	8.5	7.6	5.9	46.5	44.8	44.8	20.3	18.8	18.1	19.9	18.4	17.9		

Source: Companies, Centrum Broking Note - \* CY

## Quarterly Performance Trend

### Exhibit 1: Quarterly Financial Snapshot

Y/E Dec (Rsmn)	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24	YOY (%)	QOQ (%)
<b>Revenue</b>	<b>9,670</b>	<b>10,390</b>	<b>10,547</b>	<b>10,783</b>	<b>10,772</b>	<b>10,947</b>	<b>11,496</b>	<b>11,252</b>	<b>4.4</b>	<b>-2.1</b>
Direct Cost	6,229	6,499	6,415	6,225	6,306	6,713	6,919	7,429	19.4	7.4
<b>Gross Profit</b>	<b>3,440</b>	<b>3,892</b>	<b>4,132</b>	<b>4,558</b>	<b>4,467</b>	<b>4,234</b>	<b>4,577</b>	<b>3,823</b>	<b>-16.1</b>	<b>-16.5</b>
Staff Cost	696	759	777	788	674	758	868	843	7.0	-2.9
Other Expenses	1,513	1,538	1,518	1,625	1,952	1,806	1,680	1,765	8.7	5.1
<b>Total Expenditure</b>	<b>8,438</b>	<b>8,796</b>	<b>8,710</b>	<b>8,637</b>	<b>8,931</b>	<b>9,277</b>	<b>9,467</b>	<b>10,037</b>	<b>16.2</b>	<b>6.0</b>
<b>EBIDTA</b>	<b>1,232</b>	<b>1,594</b>	<b>1,837</b>	<b>2,146</b>	<b>1,841</b>	<b>1,670</b>	<b>2,029</b>	<b>1,215</b>	<b>-43.4</b>	<b>-40.1</b>
Depreciation	156	152	161	169	170	169	175	193	14.5	10.0
<b>EBIT</b>	<b>1,076</b>	<b>1,443</b>	<b>1,676</b>	<b>1,977</b>	<b>1,670</b>	<b>1,501</b>	<b>1,853</b>	<b>1,022</b>	<b>-48.3</b>	<b>-44.9</b>
Interest	5	7	5	4	4	3	3	5	37.1	65.5
Other Income	162	21	89	102	130	198	225	203	99.4	-10.1
<b>PBT</b>	<b>1,234</b>	<b>1,457</b>	<b>1,761</b>	<b>2,075</b>	<b>1,797</b>	<b>1,696</b>	<b>2,076</b>	<b>1,220</b>	<b>-41.2</b>	<b>-41.2</b>
Tax	345	362	469	516	632	467	531	317	-38.5	-40.2
Extraordinary item	0	0	0	0	0	0	0	0	NA	NA
<b>PAT</b>	<b>889</b>	<b>1,095</b>	<b>1,292</b>	<b>1,560</b>	<b>1,165</b>	<b>1,229</b>	<b>1,545</b>	<b>902</b>	<b>-42.1</b>	<b>-41.6</b>
EPS (Rs/share)	18	22	26	32	24	25	31	18	-42.1	-41.6
<b>As a % of revenue</b>										
Direct Cost	64.4	62.5	60.8	57.7	58.5	61.3	60.2	66.0		
Gross Profit	35.6	37.5	39.2	42.3	41.5	38.7	39.8	34.0		
Staff Cost	7.2	7.3	7.4	7.3	6.3	6.9	7.6	7.5		
Other Expenses	15.6	14.8	14.4	15.1	18.1	16.5	14.6	15.7		
EBIDTA Margin	12.7	15.3	17.4	19.9	17.1	15.3	17.6	10.8		
PAT Margin	9.2	10.5	12.2	14.5	10.8	11.2	13.4	8.0		
Tax Rate	27.9	24.9	26.6	24.9	35.2	27.6	25.6	26.0		

Source: Company, Centrum Broking

### Exhibit 2: Quarterly Gross Margin Trend

Particulars	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24
Gross Margin (%)	34.4	37.8	39.0	37.2	46.7	41.1	45.4	38.5	35.6	37.5	39.2	42.3	41.5	38.7	39.8	34.0

Source: Company, Centrum Broking

P&L					
YE Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
<b>Revenues</b>	<b>36,659</b>	<b>43,049</b>	<b>46,431</b>	<b>50,695</b>	<b>56,535</b>
Operating Expense	24,813	28,368	31,860	34,204	38,177
Employee cost	2,857	2,996	3,295	3,625	3,988
Others	3,433	4,191	4,213	4,586	5,266
<b>EBITDA</b>	<b>5,555</b>	<b>7,494</b>	<b>7,063</b>	<b>8,281</b>	<b>9,104</b>
Depreciation & Amortisation	571	668	774	867	951
<b>EBIT</b>	<b>4,984</b>	<b>6,826</b>	<b>6,288</b>	<b>7,414</b>	<b>8,153</b>
Interest expenses	21	15	15	15	15
Other income	346	519	831	935	902
<b>PBT</b>	<b>5,310</b>	<b>7,329</b>	<b>7,104</b>	<b>8,333</b>	<b>9,039</b>
Taxes	1,358	2,081	1,954	2,292	2,486
Effective tax rate (%)	25.6	28.4	27.5	27.5	27.5
<b>PAT</b>	<b>3,951</b>	<b>5,248</b>	<b>5,150</b>	<b>6,042</b>	<b>6,554</b>
Minority/Associates	0	0	0	0	0
<b>Recurring PAT</b>	<b>3,951</b>	<b>5,248</b>	<b>5,150</b>	<b>6,042</b>	<b>6,554</b>
Extraordinary items	0	0	0	0	0
<b>Reported PAT</b>	<b>3,951</b>	<b>5,248</b>	<b>5,150</b>	<b>6,042</b>	<b>6,554</b>

Ratios					
YE Mar	FY22A	FY23A	FY24E	FY25E	FY26E
<b>Growth (%)</b>					
Revenue	37.3	17.4	7.9	9.2	11.5
EBITDA	32.2	34.9	(5.8)	17.2	9.9
Adj. EPS	32.7	32.8	(1.9)	17.3	8.5
<b>Margins (%)</b>					
Gross	38.8	40.4	37.9	39.1	39.0
EBITDA	15.2	17.4	15.2	16.3	16.1
EBIT	13.6	15.9	13.5	14.6	14.4
Adjusted PAT	10.8	12.2	11.1	12.0	11.6
<b>Returns (%)</b>					
ROE	22.9	24.8	20.2	21.0	20.1
ROCE	23.8	26.1	22.0	22.9	21.7
ROIC	28.1	34.3	25.9	27.1	28.5
<b>Turnover (days)</b>					
Gross block turnover ratio (x)	4.9	5.2	4.8	4.9	5.0
Debtors	63	58	56	56	55
Inventory	93	97	93	97	98
Creditors	88	79	79	78	77
Net working capital	87	59	74	75	76
<b>Solvency (x)</b>					
Net debt-equity	(0.2)	(0.4)	(0.4)	(0.3)	(0.4)
Interest coverage ratio	267.1	496.3	467.7	548.4	602.9
Net debt/EBITDA	(0.7)	(1.3)	(1.5)	(1.3)	(1.7)
<b>Per share (Rs)</b>					
Adjusted EPS	79.9	106.1	104.2	122.2	132.6
BVPS	381.5	473.6	558.3	603.6	716.8
CEPS	91.5	119.7	119.8	139.7	151.8
DPS	14.5	40.0	20.0	20.0	20.0
Dividend payout (%)	18.1	37.7	19.2	16.4	15.1
<b>Valuation (x)</b>					
P/E	62.1	46.7	47.6	40.6	37.4
P/BV	13.0	10.5	8.9	8.2	6.9
EV/EBITDA	43.4	31.4	33.2	28.4	25.3
Dividend yield (%)	0.3	0.8	0.4	0.4	0.4

Source: Company, Centrum Broking

Balance sheet					
YE Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Equity share capital	494	494	494	494	494
Reserves & surplus	18,365	22,921	27,108	29,349	34,942
Shareholders fund	18,859	23,415	27,603	29,844	35,436
Minority Interest	0	0	0	0	0
Total debt	0	0	0	0	0
Non Current Liabilities	481	404	433	461	492
Def tax liab. (net)	0	0	0	0	0
<b>Total liabilities</b>	<b>19,340</b>	<b>23,819</b>	<b>28,036</b>	<b>30,305</b>	<b>35,929</b>
Gross block	7,544	8,354	9,593	10,432	11,221
Less: acc. Depreciation	(3,519)	(4,113)	(4,888)	(5,754)	(6,706)
Net block	4,025	4,241	4,705	4,677	4,515
Capital WIP	515	634	500	500	500
Net fixed assets	4,540	4,875	5,205	5,177	5,015
Non Current Assets	1,813	2,187	2,711	4,011	3,661
Investments	25	25	25	25	25
Inventories	6,768	6,860	7,857	8,637	9,867
Sundry debtors	6,857	6,787	7,378	8,056	8,984
Cash & Cash Equivalents	4,019	9,580	10,449	10,443	15,217
Loans & advances	400	0	0	0	0
Other current assets	1,503	1,259	1,259	1,259	1,259
Trade payables	5,085	6,079	6,386	6,833	7,621
Other current liab.	1,485	1,512	292	292	292
Provisions	238	371	379	386	394
Net current assets	12,740	16,525	19,886	20,883	27,019
<b>Total assets</b>	<b>19,340</b>	<b>23,819</b>	<b>28,036</b>	<b>30,305</b>	<b>35,929</b>

Cashflow					
YE Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Profit Before Tax	5,310	7,329	5,150	6,042	6,554
Depreciation & Amortisation	571	668	774	867	951
Net Interest	(163)	(345)	(616)	(720)	(687)
Net Change – WC	(3,614)	1,321	(2,493)	(1,003)	(1,362)
Direct taxes	(1,486)	(2,119)	(1,954)	(2,292)	(2,486)
<b>Net cash from operations</b>	<b>571</b>	<b>6,902</b>	<b>863</b>	<b>2,894</b>	<b>2,971</b>
Capital expenditure	(916)	(1,067)	(1,105)	(839)	(789)
Acquisitions, net	0	0	0	0	0
Investments	(72)	(17)	0	0	0
Others	662	635	0	0	0
<b>Net cash from investing</b>	<b>(326)</b>	<b>(449)</b>	<b>(1,105)</b>	<b>(839)</b>	<b>(789)</b>
<b>FCF</b>	<b>245</b>	<b>6,453</b>	<b>(242)</b>	<b>2,055</b>	<b>2,182</b>
Issue of share capital	0	0	0	0	0
Increase/(decrease) in debt	(42)	(51)	0	0	0
Dividend paid	(717)	(719)	(989)	(989)	(989)
Interest paid	(21)	(15)	(15)	(15)	(15)
Others	0	0	2,115	(1,057)	3,596
<b>Net cash from financing</b>	<b>(780)</b>	<b>(786)</b>	<b>1,111</b>	<b>(2,061)</b>	<b>2,593</b>
Net change in Cash	(535)	5,668	869	(6)	4,774

Source: Company, Centrum Broking

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#### SKF India



Source: Bloomberg

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