

OVERVIEW: Bearings Industry:

Bearings, as per Wikipedia is defined as the device used between two parts that allows rotational or linear movement, thus reducing friction and enhancing efficiency. In the industrial sector, bearings are majorly used in motors, mining and drilling machines, fans and heavy industries such as cement, sugar and power generating units. Bearings have become indispensable in engineering, automotive industry by helping reduce energy costs, improve productivity. Essentially, bearings are meant to reduce friction and save energy. Different types of bearings are used across different industries like ball bearings, roller bearings and plain bearings to mention a few.

Exhibit 1: Types of Bearings

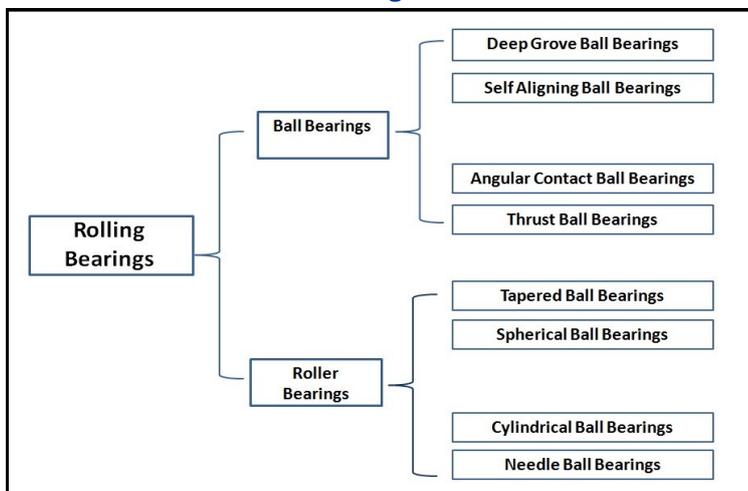


Source: Company Website- SKF India Limited

Indian Bearing Market:

The Indian bearing market estimated to be in the range of Rs95-100bn (constituting less than 5% of the global bearing demand) is highly capital intensive and technology driven catering to the two key user segments namely automotive and industrial sectors. Usage of bearings is fairly diversified in automotive (PV, CV, 2W, 3W, tractors) as well as industrial segments. The business is further divided into Original Equipment Manufacturer (OEM) and End User Market. With regard to the consumption, about 60% of the requirement is catered through domestic production while remaining is met through imports. In context to the demand, OEMs constitute 60% of demand whereas rest is driven by aftermarket and exports. While there are large numbers of players present in the industry, the competitive intensity is moderate as top five players constitute ~75% of the market share. Factors such as increasing automation in manufacturing units, thrust by Government's 'Make in India' program, spending towards railways and metros would further support growth of manufacturing and engineering sector, that augurs well for the bearing industry.

Exhibit 2: Classification of Bearings



Source: nsk.com

SNAPSHOT	
52 week H / L	Mcap (INR mn)
2000 / 1610	99,711
Face value: 10	
BSE Code	NSE CODE
500472	SKFINDIA

Annual Performance				
(Rs mn)	FY16	FY17	FY18	FY19E
Total Revenue	29,973	26,314	27,504	30,851
EBITDA	3,615	3,361	4,348	4,689
EBITDA (%)	12.1	12.8	15.8	15.2
Other Income	1,014	873	714	680
Interest	-	-	50	42
Depreciation	684	479	460	536
PBT	3,945	3,756	4,552	4,791
PAT	2,559	2,439	2,956	3,114
Equity (Rs mn)	527	527	513	513
EPS (INR)	49	46	58	61

Quarterly Performance				
Parameters (Rs mn)	Dec-17	Mar-18	Jun-18	Sep-18
Sales (Net)	7,005	7,036	7,550	7,660
EBITDA	1,156	1,342	1,345	1,385
EBITDA (%)	17.6	15.1	15.4	16.0
Other Income	200	188	225	214
Interest	16	17	17	21
Depreciation	113	115	117	117
PAT	862	716	809	843
Equity (Rs mn)	513	513	513	513

Ratio Analysis				
Parameters (Rs mn)	FY16	FY17	FY18	FY19E
EV/EBITDA (x)	27.5	29.1	22.9	21.3
EV/Net Sales (x)	3.3	3.7	3.6	3.2
M Cap/Sales (x)	3.3	3.8	3.6	3.2
M Cap/EBITDA (x)	27.6	29.7	22.9	21.3
Debt/Equity (x)	0.1	0.1	0.1	0.1
ROCE (%)	47	21	25	24
Price/Book Value (x)	6.2	5.7	5.4	4.8
P/E (x)	40.0	42.0	33.7	32.0

Shareholding Pattern as on 30th September, 2018		
Parameters	No of Shares	%
Promoters	26,860,968	52.32
Institutions	17,574,058	34.23
Public	6,902,937	13.45
TOTAL	51,337,963	100.00

Source: Annual Report

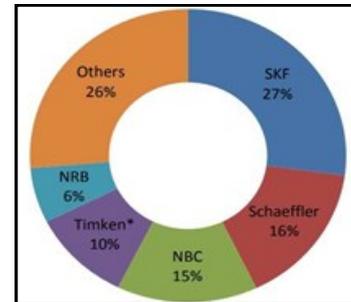
Note: All the data is calculated as per Market Price on 16 January, 2019

Indian Bearing Market (Contd.):

The bearings industry in India had faced rough weather due to demonetization, GST implementation in the past two years but then successfully overcome the crisis. Steady economic growth and increase in automobile demand have been the main drivers of bearings industry. Over the past ten years, India has emerged as one of the most preferred locations in the world for manufacturing high quality auto components and vehicles of all kinds. The industry continues to be relentless in its pursuit of economies of scale and in scope of design and engineering of automobiles and components, while also pursuing low cost manufacturing destinations.

As per the report by ICRA, during FY09-FY12, domestic bearings manufacturers witnessed revenue growth of 17.4% in the backdrop of strong uptick in investment activity as well as robust growth in automotive sector. Subsequent slowdown in economic activity and moderation in automotive growth resulted in CAGR growth of just 4.3% during FY12-FY17 period. With expected improvement in industrial activity as well as healthy growth prospects for automotive segment, especially 2W, PV and tractor industry; ICRA expects domestic bearing manufactures to witness revenue growth of 9-10% during FY17-FY20 period.

Exhibit 3: Market Share



Source: Industry, ICRA Research
*includes ABC

Automobile Bearing Market:

Bearings find extensive usage in both OEM and aftermarket for automobiles as not only new vehicles but the replacement market of automobiles also has significant demand for new bearings as regular wear and tear and accidents require the replacement of bearings. The Indian automobile market has undergone a cyclical trend with the sales increasing and decreasing periodically. The recent global slowdown and the increase in fuel prices have negatively influenced the automobile sales in India thus impacting the automobile bearings market in India. However, since every vehicle require bearings to maintain friction, growth for automobile bearings market is bound to happen. Moreover, the emergence of bearing manufacturer in India coupled with extensive rise in production capacities by existing manufacturers is anticipated to fuel the growth of this segment further. Two-wheelers occupied the largest share in Indian automotive bearing market in 2015. The segment is anticipated to maintain its dominance going forward as well, owing to the growing motorcycle and scooters production and sales in the country. *Deep groove ball bearing angular is the most preferred type of automotive bearings in India. Region-wise, north region is the largest demand generating region for automotive bearings in the country.*

Industrial Bearing Market:

The industrial bearing market in India has been segmented on the basis of type of demand emerging from either OEMs or aftermarket. The bearing industry is extremely capital intensive with low asset throughput and is largely dependent on industrial growth. Industrial bearings has its end user applications across power, railways, material handling equipment, defence, renewable, machine tools, mining and other sectors. The emergence of global players which are seeking to set up manufacturing units in India will lead to a visible increase in the demand for industrial bearings in the country.

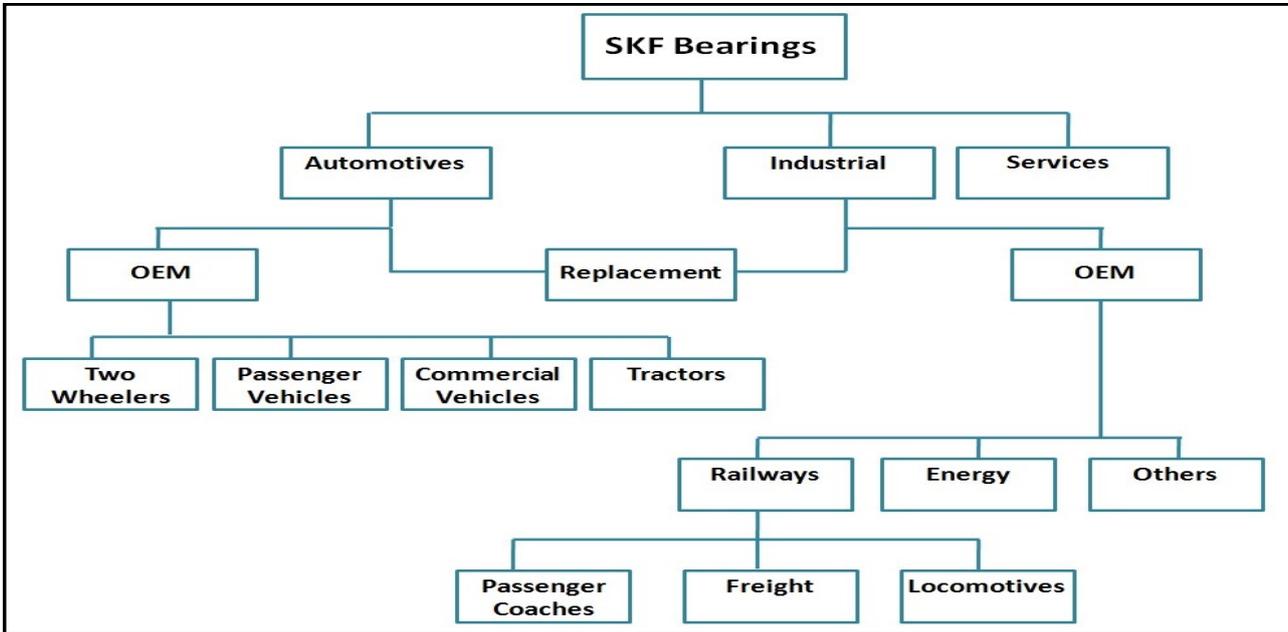
With increased automobile production, automotive bearings demand is expected to grow rapidly in the next few years. Expanding middle class, rising disposable income leading to increased sale of vehicles and machines are positive for the bearings market. The demand for vehicles with technologically advanced solutions is increasing, thereby, resulting in a rise in vehicle manufacturing that requires instrumented products. Technological advances in lubrication systems, seals and the use of lightweight materials in high performance products are creating huge opportunities for companies operating in the market. The bearing industry is anticipated to grow because of various initiatives from Government of India under the 'Make in India' program, which is expected to spur manufacturing, giving a boost to bearings consumption.

About the Company:

SKF India Limited (SKF) was incorporated in 1961, as an associated bearing company of Swedish SKF Group. It has a wide range of product portfolio consisting of bearings, linear motion products, seals, mechatronics, lubrication systems, special steel, high-tech industrial components and services like technical support, maintenance and reliability services, engineering consulting, etc. These products find applications in automotive, industrial, electrical, service and textile machinery, etc. SKF is the market leader, with 40% share in ball bearings and overall 27% market share in the Indian Bearing market. SKF offers the unique service of Rotating Equipment Performance (REP) based solution, thus achieving its innovation based growth led by customer centricity, coming a long way from being only a pioneer bearing based company. SKF manufactures automotive bearings in India and calls it manufactured goods (58% contribution to the revenues) while industrial bearings are imported from the parent SKF Technologies and is termed as traded goods (42% contribution to revenues). The company has Mr Carl Orstadius as the Managing Director and Mr. Rakesh Makhija as the Chairman.

SKF has three manufacturing facilities in Pune, Bengaluru and Haridwar. Each of the facilities is dedicated for a specified purpose; Pune factory caters to Automotive and Industrial Electrical segments where all types of bearings are manufactured. Bengaluru also caters to Automotive and Industrial segments where Deep Groove Ball Bearings (DGBB), customized products and assemblies are manufactured and other value-added services are provided. The third factory in Haridwar manufactures DGBB for two wheelers only. Some of the major clients which the company caters to include Tata Steel, Harley Davidson India, Hindalco, Bajaj Auto, Grasim etc.

Exhibit 4: Business Structure



Source: Progressive Research

INVESTMENT RATIONALE:

A) Caters Diversified Industries:

SKF has a diversified business model with 60% of its revenues derived from automotive segment, 39% from industrial segment and 1% from services. Also, major chunk of revenues is derived from after sales market, making its revenue profile less cyclical. The company has created new products, solutions and services that leverage cutting edge technology to create optimized asset performance across applications and industries. Thus, it ranges across a wide range of industries from automotive to aerospace, renewable energy to railways and from mining to marine.

The management is expecting a major uptick in revenues from the railway sector with the Indian Railways being all set to upgrade with major spends allocated for key development projects like high speed trains, DFS, automation, etc., which in turn will offer higher incentives to manufacturing companies like SKF. Till date, the company is a major supplier in LHB coaches. Now with the modification in railway policies there would be separate tendering for both production factories and railways as per their requirement, unlike erstwhile policy where only 10% of the requirement was allowed from a single supplier. Currently, railways contribute 7% to the total revenues of the company but with the government’s focus towards this sector, it will boost the revenues going ahead. There has been increase in demand from industries like Steel, Cement, material handling, F&B and mining & construction segment as well. SKF enjoys nearly 100% share in business for all converters in India. It is the only service provider to Indian steel industry. Wind energy segment would be the next focus for the company.

B) Rotating Equipment Performance (REP):

SKF’s REP based solution helps industries with the availability of right bearings at the right time, with regular health check, which increases the asset reliability and reduces downtime. This customer centric solution of the company proved to be time and cost effective, overcoming the challenge of bearing failure and machine replacement. Thus, SKF’s customers are in a position to undertake planned maintenance, scheduling of resources and elimination of unplanned downtimes, enabling them to achieve lower maintenance and operating costs. This is done through SKF’s Remote Diagnostic Centre and online spindle monitoring, ultimately helping industries to increase their output, speed and conditioned monitoring.

This is a key differentiator between SKF and its peers, placing it as a pioneer in detecting, analyzing and resolving customer issues. This new business model offering provides support to customers in measuring efficiencies in terms of performance and machine functionality. Thus, this performance based approach allows the company to successfully secure contracts from cement, steel, paper and pulp industries. It is further in the process to develop REP value propositions together with the industrial customers such as railways, wind turbine manufacturers and F&B.

Exhibit 5: Spindle Condition Monitoring



Source: SKF Annual Report 2018

INVESTMENT RATIONALE (Contd.):

C) Highest Investment Plan :

The company has been on an average investing ~Rs500mn as its capex. However, there has been an increase in the same with Rs1bn-1.5bn expected in FY19-20E as the company is operating at 100% capacity utilisation. Most of the automotive segments that the company caters to such as two-wheelers, passenger or commercial vehicles are planning to expand their production, thus there is an overall increase anticipated in the demand for bearings. In accordance, SKF decided to set up a new plant to meet this upcoming demand. New capex will be for product development and setting up of manufacturing lines for new and existing orders. The installation of the new machines would take 6-7months as indicated in the Q2FY19 conference call. The ramp-up would happen through FY19 with benefits expected to start from Q1FY20E. Further, the management has indicated a more rigorous capex after FY20.

D) Value Added Products/Services:

As the leading bearing supplier; SKF manufactures a wide assortment of super-precision bearing types, series, designs, variants and sizes. The most common of them are introduced under Bearing types and designs. Rolling bearings for general industrial applications can only partly fulfil these requirements. Therefore, SKF manufactures a comprehensive assortment of super-precision bearings. SKF has been able to garner value added businesses with the development of **Super Precision Bearings (SuPB)** that satisfy the high performance demand related to extended speeds, low heat generation, low noise, high running accuracy. Typical applications of SuPB are at high speed rolling mills, printing machinery, vacuum pumps, etc.

SKF has also introduced a new range of housings, accessories and heavy duty grease guns. Also, Pinion bearings, the first of its kind ever, is developed by SKF, to be used in any heavy commercial vehicles that reduces operational efforts and assembly time by 50% resulting in higher productivity. **Split THU**, which is also a unique product for commercial vehicles will reduce friction by 15% and will reduce fuel consumption by 100lts per year.

HUB3 is the third generation bearings offered by the company, used for reducing weight, noise, vibration and thereby enhance performance of the automobiles. It is a specially developed bearing for passenger and utility vehicles in India. These wheel end bearings are lower in weight and have optimized friction. This together reduces fuel consumption of the vehicles. These are greased for life and do not need re-greasing, thus reduces disposal to the environment. SKF currently has a capacity of 3,50,000 bearings which is already fully utilized as per demand in FY19-20.

The management is pretty confident about its new products including HUB3 and Split THU, which will help boost overall revenues. Realisations for HUB3 are 1.5-1.7x of the existing products in Q2FY19. The commercialization of HUB3 will begin from January 2019 and is expected to give incremental revenue of Rs400-500mn when at maximum utilization.

SNH Housing, launched recently, have a distinct advantage of being cost effective and easily available. The launch of the SNH Housing helps SKF leverage the shift in the market trends and extend product offerings in the market at multiple price and performance points.

Exhibit 6: Technology Driven Bearings



Source: SKF Annual Report 2018

SKF offers a full range of services and solutions to both OEM and aftermarket customers around the world, in every major industry, at each phase of the asset life cycle. Services and solutions range from new machine development and design verification, to reconditioning, Integrated Maintenance Solutions, training and remote monitoring. SKF Spindle simulator is an advanced simulation software program for the analysis of spindle application and contains detailed and up-to-date models of SKF super-precision bearings. SKF offers technologies to collect and analyze data from customers to optimize performance and give them control over their machine functionality. **Manufacturing 4.0** is one such technology, which collects data from machines to know the exact health of the machines so that customers are better prepared in allocating resources elsewhere, ordering for spares, increasing output at alternate machines and negating unplanned downtimes efficiencies and business excellence. The manufacturing industry currently is striving towards harnessing this to achieve operational excellence. SKF, being customer centric, is ready to serve this future demand.

INVESTMENT RATIONALE (Contd.):

E) Standing Strong Amongst The Peers:

Indian industry manufactures small and medium bearings mainly in five categories, i.e. ball bearings, cylindrical roller bearings, taper roller bearings, spherical roller bearings and needle roller bearings. While leading players such as SKF, FAG, Timken & NRB are present in production of all types of bearings; the competitive intensity in the bearing industry is relatively moderate due to individual specializations in one particular segment.

Exhibit 7: Competencies

Company	Segment Specialised
SKF	Deep Groove Ball Bearings
FAG	Roller Bearings
TIMKEN	Roller Bearings
NRB	Needle Roller Bearings

Source: Progressive Research

F) Parentage Advantage:

SKF has the advantage of multinational parentage that adheres to stringent norms and policies framed by the SKF group. Currently, SKF India is a supplier to leading electric auto majors, supplying ceramic bearings instead of metal bearings. The company does not design products. Designing is done by SKF group. SKF's parent company has already built in competencies in this space. Thus, SKF India will enjoy the sweet spot in future as well for any new/better solutions that electrical vehicles (EVs) may require in the coming years. Strong global parentage provides huge expertise and global processes to the company which new companies find difficult to replicate.

Exhibit 8: SSRB and SSAB



Source: SKF Annual Report 2018

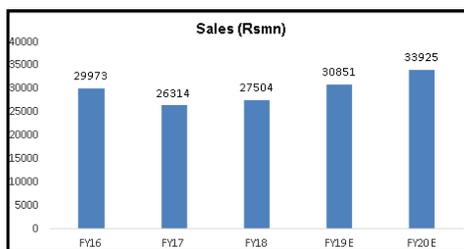
One of the examples of SKF group design is Sealed Spherical Roller Bearings (SSRB), which has improved performance through 50% less seal friction, lower operating temperature, etc. as compared to traditional open bearings. Also, SKF group supplies Sealed Self Aligning Bearings (SSAB), which helps customers to reduce annual grease consumption by 47 tonne per caster and also reduce annual bearing consumption by an average of 40%, as compared to open bearings.

Financials:

With the uptick in the overall demand of bearings, there has been a gradual increase in the revenues and profits of the company. Since last year, there has been a drastic improvement seen in the margins which depicts the operational efficiencies despite the revenues being flat. This was majorly due to the change in the product mix and focusing more on high margin products. Also, after the introduction of GST, SKF has reduced the number of warehouses from thirteen to seven. Also, it has maintained new distribution centre where inventories of imported goods are stored, which is a Centralised Distribution Centre at Chakan. Such reduction helps the company to reduce the warehousing cost and thus contributing to the profits. SKF has been enjoying the status of being debt free over the last many years. The company has been funding its capex through internal accruals.

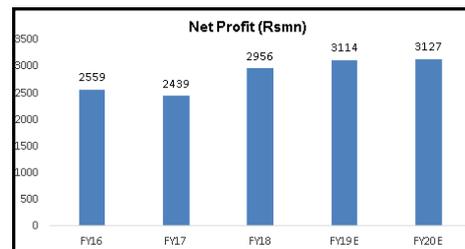
Buy back: SKF has announced two buy back in last two years. In Feb 2017, it approved a buyback of 26lakh shares (4.9% of total paid up capital) at a price of Rs1500 per share. Being a cash rich company (Cash reserves of Rs10bn), it has approved the second buyback proposal of 19lakh shares (3.7% of total paid up capital) at a price of Rs2100 per share for a total aggregate amount of Rs3.9bn. (Opening Date: 23rd January and Closing Date: 5th February, 2019).

Exhibit 9: Sales Breakup



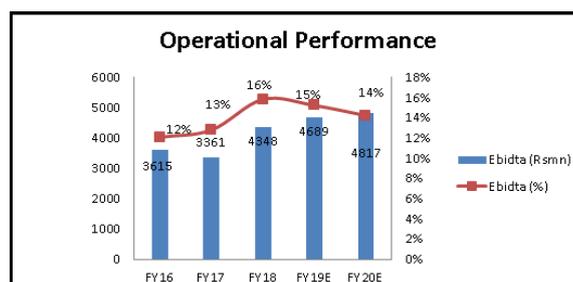
Source: SKF Annual Report

Exhibit 10: Profit After Tax



Source: SKF Annual Report

Exhibit 11: EBITDA & Margins



Source: SKF Annual Report

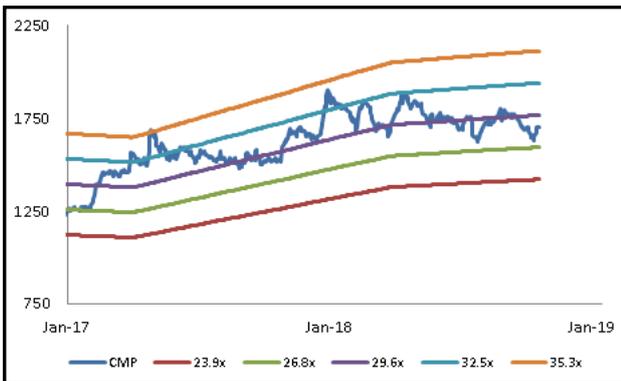
Risks & Concerns:

- It has both import and export transactions in foreign currencies leading to currency related risk. The imports are higher than the exports and hence the company has foreign currency exposure to the extent of purchases being higher than exports, but any material variation in currency is recovered from the customers, through on going negotiation process. Thus, the risk for currency fluctuation is slightly mitigated.
- Currently, the unorganized segment constitutes 20% of the domestic bearing market. The expected shift from unorganized to organized post implementation of GST has been slow. Thus, a risk to SKF India, being an organized player.
- Slowdown in industrial activity and auto sales along with the failure to win the railways bidding status as Part-1 supplier may be a concern going ahead.

Outlook and Valuation:

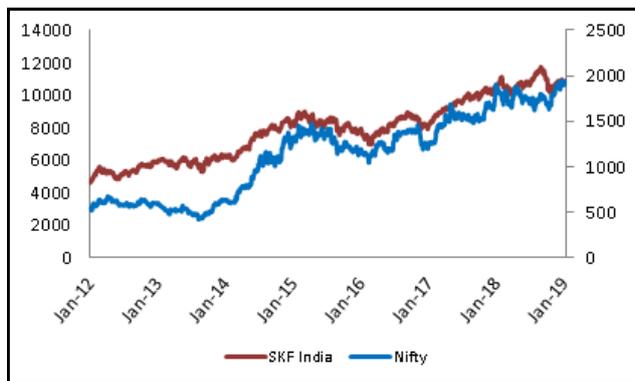
The various opportunities arising from the railways, increasing demand in both automotive and industrial, led by strong capex plans in the near future due to potential revival in industrial capex cycle, has aptly placed the company to capitalize from the same. Also, it caters to wide range of industries with good clientele, thus positioned itself strongly across all segments. Considering all these positive factors, the company is poised for growth. We recommend a BUY on the stock with a target price of Rs2620 over a 12 months horizon.

Exhibit 12: One year forward P/E



Source: ACE Equity

Exhibit 13: Price vs. Nifty



Source: ACE Equity

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