Date: 28th February 2024

National Stock Exchange of India Limited,	BSE Limited,
Exchange Plaza 5th Floor,Plot No. C-1, G Block, Bandra Kurla Complex, Bandra (East),Mumbai – 400051, Maharashtra, India	Phiroze Jeejeebhoy Towers,Dalal Street, Mumbai – 400001, Maharashtra, India
NSE Scrip Code – SKFINDIA	**BSE Scrip Code -500472**

Subject: **Transcript of Analyst/Institutional Investor Meeting held on 21st February 2024**

Reference: Our Intimation Dated 13th February 2024 for meeting and Intimation dated 22nd February for Audio Link

Dear Sir/Ma'am,

Pursuant to Clause 15(b) of Schedule III, Part A, Para A read with Regulation 30 (2), Regulation 30 (6) & Regulation 46(2) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (as amended from time to time) ("SEBI LODR"), please find enclosed herewith transcript of Analyst / Institutional Investor Meeting organized by Kotak Securities Limited on 21st February 2024 at Mumbai.

Transcript will also be available on the website of the company.

We request you to take the above information on record and disseminate the same on your respective websites.

Thanking you,

Yours faithfully,
For SKF India Limited

RANJAN KUMAR

Digitally signed by RANJAN KUMAR
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Ranjan Kumar
Company Secretary & Compliance Officer

Kotak Chasing Growth, 2024

February 21, 2024

MANAGEMENT: MR. ASHISH SARAF, CFO

ICICI Pru Speaker: Thanks for the opportunity. Just to start with, there's a broad mix in terms of segment wise, then we can jump on to specific things.

Ashish Saraf: Sure. So, from a business perspective, we are broadly divided into industrial, automotive and then we have a small amount of exports. In terms of the overall business, I would say 50% is industry, 40% is automotive and the remaining 10% is exports. So that's how broadly from a segment standpoint we are. And within each of these businesses, we have sub-segments.

ICICI Pru Speaker: I'm sorry, one clarification here. Industry includes tractors and…

Ashish Saraf: No, industrial doesn't include tractors. Tractors is part of the automobile.

ICICI Pru Speaker: And railways.

Ashish Saraf: So again, in industrial, we have segments like railways, wind. Then we have metals. Then we have heavy industries. So, within heavy industries, basically cement, yarn, pulp and paper, all industries which are basically related to infrastructure. And then we have wind. I said railways and then, textiles. And then we have something called general machinery, which is a combination of various small, small segments, which is like your fluid power, your textiles, your pumps, and motors. All of that is basically part of that. Agriculture, F&B, all of that is basically clubbed together. And then we have a big aftermarket in the industry for basically catering to the industry.

ICICI Pru Speaker: This 50%, as you said, the sub-segments. How much would be rail, wind? The bigger segment, how big is that?

Ashish Saraf: Yes. So just to give you -- so say, for example, so broadly your -- again, each of our businesses, I would say it's within industry, it's pretty much a reasonable share for each one of them. So, say, for example, your rail is around 8%. Your general machinery is again 8%. Heavy industries, another 5%-6%. Metal is 4%. And then the wind is again 4%. And a big part of 23% is distribution. That would be aftermarket.

ICICI Pru Speaker: Distribution would include the aftermarket as well.

Ashish Saraf: Distribution is aftermarket. So basically, we sell directly to OEMs. Rest all the business that we do with the end users predominantly is for the distribution.

ICICI Pru Speaker: That is, it. Within this segment, as you said, the rail is mostly we are on the EV side or on the freight side? Sorry. On the passenger side or on the freight side?

Ashish Saraf: So, see, railway segments are basically -- railway businesses is basically broadly into four categories. One is a passenger. Second is locomotive. Third is basically the metros which are coming up. And the last is freight, right? So, we are big on the passenger, the locomotive, and the metro side, right? Freight, our market share is growing. But again, relative to other segments, our share is relatively low.

ICICI Pru Speaker: In these three segments, what will be our share versus, you know, maybe the further dynamic of the operators?

Ashish Saraf: 40% plus in these three segments.

ICICI Pru Speaker: And in Vande Bharat also there will be some…?

Ashish Saraf: Yes. Vande Bharat we are already supplying.

ICICI Pru Speaker: Locos, which these are Siemens or Alstom, these companies are executing. So, we will be the one-stop supplier for them or there will be...

Ashish Saraf: No, there are other suppliers who are also kind of catching up. Because again, as I said, we have a 40% share in that aspect. So, there are other players who are competing.

ICICI Pru Speaker: So, 40% is in the -- more focus on the passenger side, including the metros.

Ashish Saraf: Including the metros, including the locomotives business.

ICICI Pru Speaker: And freight, how -- it could be single digit shares?

Ashish Saraf: See, we can always increase our share. It's not an issue that we don't have the products in place. We have all the approvals in place. That's not an issue. But we need to get the right price in the market, right? So, we closely work with a lot of private players in coach, right? Because like government preferences to go down the reverse auction side, right, and that time sometimes it becomes non- competitive for us. That's where we are focusing on how we can kind of make changes in our products so that we can kind of be more competitive as we go and create our share in the freight side.

ICICI Pru Speaker: In the reverse auction, you participate, or the OEMs participate and then they procure from you?

Ashish Saraf: It's a mix, right? So certain OEMs will participate. So that is where we are very active. And there is also where you can directly participate. There is a portion which railway directly buys for their existing freight.

ICICI Pru Speaker: For the aftermarket type.

Ashish Saraf: Yes, for the aftermarket. Railway, there is no real aftermarket.

ICICI Pru Speaker: Existing bag and cover…

Ashish Saraf: Existing bag and replacements that they do. Because they are themselves growing their overall share.

ICICI Pru Speaker: So rather than participating in the replacement demand, you will go rely rather with the likes of.

Ashish Saraf: That's right. We work closely with them.

ICICI Pru Speaker: And say on the Vande Bharat and all when the tender is getting floated. Based on that, what are the bearings and all that could be avoided? In that incremental order, how is the market share moving?

Ashish Saraf: It's moving in the right direction.

ICICI Pru Speaker: Are others also within it? Because on the one hand, others have been sitting. They are also sitting on the Vande Bharat side?

Ashish Saraf: As I said, in all of that, we have more than 40% market share. So that is something that we are focusing on continuing to defend. I wouldn't say that we are likely to be able to, because there are other players which are coming in. It's not…

ICICI Pru Speaker: What will be the market, the real bearing market?

Ashish Saraf: The real bearing market would be around INR1,000 crores plus.

ICICI Pru Speaker: Roughly including freighter? And roughly how much -- how big will be freight?

Ashish Saraf: I don't know exact because I won't have the split. But as I said, freight would be -- currently, I know that the competition has a much bigger share of the freight business, and we are consciously not doing it. But I would say our share would be, the freight side, would be around 10%-15%.

ICICI Pru Speaker: So just to look at this INR1,000 crores market, as it says to us, it is only MHC. It is like you have to get the RDS as well. Are other players, the smaller ones, also allowed now with the growth which is coming up?

Ashish Saraf: Again, they have to go through the entire process. From railway perspective, they don't differentiate between what SKF is doing versus any local player. They have to go through that process. As long as they go through the process and get the necessary approval, that whole process takes two-three years. And it has to pass at all different levels before they can be a kind of participant.

ICICI Pru Speaker: But still, what was the…

Ashish Saraf: As of now, pretty much mostly it's SKF, FAG, and NKS. And in some cases, NBC.

ICICI Pru Speaker: So apart from these four, based on the new orders, are others also getting empowered?

Ashish Saraf: Not that I am aware of.

ICICI Pru Speaker: Okay. How fast is this market growing? How many crores itself?

Ashish Saraf: So again, our share has been growing pretty well. We have been pretty close to double digit growth in railways year-on-year. And even if I look at 2024, we are pretty much expecting a similar growth.

ICICI Pru Speaker: So, in the entire industry itself, we can get 10%-15% for the carbon footprint as a whole. And going to the wind side, before we switch into autos. Wind is a small sector. One thing, railways, everything gets started only under the 70s. SKF does not do anything of rail industry.

Ashish Saraf: See, in terms of direct selling, it's all SKF. They don't do anything.

ICICI Pru Speaker: But manufacturing, they do…

Ashish Saraf: They do manufacture.

ICICI Pru Speaker: Okay. But they are predominantly industrial. So just on the wind side, it is a small segment. Within that, how much would be domestic? And how much would be catered to the export market?

Ashish Saraf: So again, we don't export anything for wind directly. We sell to the OEMs. And if they are exporting, I know there are a lot of wind players who are looking at making India as a hub to export globally. So that visibility I do not have in terms of what is their export share vis-à-vis the local economy?

ICICI Pru Speaker: Going to the auto side, on the EVs, which is first starting to be visible on the two-wheeler side. So how is the content of the vehicle? We are seeing that the number of bearings are going to come down.

Ashish Saraf: See, the number of bearings are going to come down. Again, first of all, EVs are relatively very, very small even though there is a lot of use of the EV product. See, if you look at the size of the business, the EV is relatively not even 3%-4%. Secondly, the number of bearings are going to come down. But the value per bearing is going to go up. So, it is not going to impact on our top line.

ICICI Pru Speaker: But how is the trend with the same currency based on whatever two-wheeler model you would have wanted?

Ashish Saraf: I would say that we are playing with all EV players. We are already engaged with Ola. We are already engaged with Ather. So, these two big players in the two-wheeler space, we are very, very well engaged. We are very well engaged with Mahindra and Tata with their EV products coming out with respect to four-wheelers. So, from that perspective, there is no product gap as such. We are closely working with all the EV players and actually gaining a good market share with them.

ICICI Pru Speaker: So, say Ola, Ather or something, compare it back to ICE vehicle, say TVS Jupiter or something. Because we would be catering to both. So how is the content of vehicle different? Is it the same?

Ashish Saraf: That's what I said. The number of bearings are going to come down in the electric vehicle compared to ICE vehicles. But the price for bearing is going to be higher.

ICICI Pru Speaker: But that trend is seen today. Like say Ola S1, whatever we are serving, the content we are supplying for Ola, that's the same as the ICE scooter which we are supplying. The trend is visible today also even offsetting is the volume decline

Ashish Saraf: Again, the share is very, very less for EV vehicle requirement compared to what we are selling for…

ICICI Pru Speaker: Per vehicle. And the content per vehicle, not as an overall revenue base.

Ashish Saraf: That's what I said, the content per vehicle is lesser. If you require, say, 10 bearings for an ICE vehicle, you require 7 bearings only. So, the number of bearings are going to come down. But that's what I said, the price per bearing is much higher in an EV vehicle. So that kind of offsets.

ICICI Pru Speaker: So, it will be similar to what you are saying. That's a trend we are seeing even now.

Ashish Saraf: But as I said, relatively if you talk about my current revenue, the amount of revenue that I generate from an ICE vehicle and the volumes that we have is significantly higher compared to an EV. Even though I have a good share with both Ola and Ather.

ICICI Pru Speaker: Okay. And on the PV or the CV side, so any further wins we have on that side? Can we gain market share or the market share across the players is fairly stable? It can be only industry growth for that reason.

Ashish Saraf: On the…?

ICICI Pru Speaker: PV, CV side, within auto.

Ashish Saraf: See, on the auto side, our big customers are Tata and Nitra. So, we are closely working with them both on the PV side as well as on the ICE side. So, we work very closely with these two customers. If you talk about Japanese or Korean players, it's going to be relatively -- again we have some share with Maruti, but with other Japanese players and Korean players, they have their own suppliers. So typically, it's very difficult.

ICICI Pru Speaker: For the Japanese suppliers?

Ashish Saraf: They have Japanese or Korean suppliers supplying them. So, it's very difficult to kind of get that market share.

ICICI Pru Speaker: So, none of the Indian players are supplying?

Ashish Saraf: None of the Indian players are supplying.

ICICI Pru Speaker: So, are we focusing on increasing this share? Maybe with Maruti or someone or…?

Ashish Saraf: See, as I said, we are big on the two-wheeler front. Our car -- as I said, our market share is going to increase with Tata and Nitra, right? Because that is where we are closely working with new product developments in terms of new cars which are coming out and all that. On the two-wheeler side, we continue to work very closely with customers like Bajaj, Honda, Royal Enfield. And they continue to develop new products with them, right? So, we continue to see a strong improvement in our two-wheeler market share. So that's just to give you an idea. We've already seen almost 50% improvement in our overall share of business that we are doing.

ICICI Pru Speaker: TVS, you are not?

Ashish Saraf: TVS, we are doing but not that much.

ICICI Pru Speaker: We'll be the major supplier there?

Ashish Saraf: Not really sure.

ICICI Pru Speaker: When you talk about winning more share with Tata and Nitra, are we replacing some of the existing players? Or is it just their growth which would get reflected in us?

Ashish Saraf: See, it is their growth plus, like when you work closely with them in terms of new product developments with respect to the new cars which are coming out, you are likely to gain more share with them. As they launch a new car, if you do a joint development, meet their productivity requirements, meet their pricing requirements, that kind of helps you gain the full share of the new product.

ICICI Pru Speaker: But they do have multiple suppliers?

Ashish Saraf: They work with multiple suppliers. .

ICICI Pru Speaker: But within that multiple supplier, we have a majority?

Ashish Saraf: We will have a good share.

ICICI Pru Speaker: So, 40% is the overall pie of revenue, right? So how much would be two wheelers?

Ashish Saraf: Two-wheelers, as I said, would be a good share. Two-wheelers would be around 13% to 15%.

ICICI Pru Speaker: 13% to 15% is two wheelers. You mean percentage points? Of the 40%?

Ashish Saraf: Of the 40%.

ICICI Pru Speaker: So, of the total revenue, the breakup…

Ashish Saraf: No. So, 15% of 40%. So not 6%. 6% overall. 6% of the overall SKF revenue.

ICICI Pru Speaker: So, 85% is PV and CV.

Ashish Saraf: So, 100 split with 40% is automotive. Out of that 40%, the split, when I say it's 15%, 25% is rest of the business. 15% is...

ICICI Pru Speaker: That's what I'm saying. It's not 6%. And 25% would be also largely PVs. CVs would be small for us.

Ashish Saraf: See, I can give you the split. So commercial vehicles, and I'm including tractors in that, which is part of automotive. So around 6% would be -- out of that 40%, 6% would be your commercial. And the rest all would be...

ICICI Pru Speaker: 19%-20%, okay.

Ashish Saraf: Not 19%-20%. 15% I said two wheelers.

ICICI Pru Speaker: So, it's more than two wheelers.

Ashish Saraf: No, there is aftermarket also. So, aftermarket is around 11%.

ICICI Pru Speaker: And that would include everything. Or it would be two-wheeler aftermarket for us.

Ashish Saraf: It would be two-wheeler.

ICICI Pru Speaker: So just now, it's been towards the industrial and the auto part. Just wanted to understand what is the localization in the industrial segment versus what is the localization in the auto segment?

Ashish Saraf: See, automotive is pretty much everything is localized. Almost 90% to 95% is fully localized. Industrial is around, I would say, 35% to 40% localized. Rest all is we are either importing from Europe or from China.

ICICI Pru Speaker: So just when we talk about 35% localization, coming to the next point, that means localized that is manufactured in SKF India or including SKF technology.

Ashish Saraf: Okay. I have included SKF technologies also. Also, the overall localization. So, if you purely look at it from an SKF India perspective, it could be a little lower. So I would say 35% is industrial localized. Automotive is all in SKF India. Industrial as I said 35% is localized.

ICICI Pru Speaker: So basically, we are on marketing margin whereas manufacturing margin will be captured in SKF India.

Ashish Saraf: That's right.

ICICI Pru Speaker: So was SKF India 20% only.

Ashish Saraf: See, overall, I can broadly tell you in terms of my mix. My 60% is -- so 60% is localized and 40% is what we -- so I am just giving you a broad split between manufacturing and traded. So, 60% is manufacturing and 40% is traded.

ICICI Pru Speaker: So, this is SKF India overall, including auto. So auto is fairly stable. We know it at 80%-90%. So just to focus on industrial, overall, if you include SKF technologies you are saying 35% is manufactured in India.

Ashish Saraf: That's right.

ICICI Pru Speaker: 65% is imported either from China or anywhere, right? So, if we say 35, then that's how much would be manufactured under SKF India? Purely looking from SKF India perspective.

Ashish Saraf: We have to do the math in a sense. 90% -- I would say maybe you reduce by 5% to 10%, so maybe 25% which is what is getting manufactured in SKF India. So industrial 25% to 30% is what is getting manufactured in India. The rest all is getting manufactured either in SKF technologies or outside.

ICICI Pru Speaker: SKF technologies -- what's the revenue for SKF technologies?

Ashish Saraf: SKF technologies have other businesses also. It is not just that it is doing manufacturing for the industrial business. They are into lubrication and seals business as well. So overall their turnover would be to the tune of INR1,000 crores.

ICICI Pru Speaker: Just to get this number clear. 60% you said is overall manufactured in India, SKF in India…

Ashish Saraf: SKF in India. SKF India, 60% is manufactured. 40% is industrial.

ICICI Pru Speaker: 15%-25% is what is manufactured. 25% you said. SKF is 10%.

ICICI Pru Speaker: Automotive is 40%. 48%-50% exports to India.

Ashish Saraf: We have exports also. That's why I am saying overall 60% is what we are manufacturing. If exports are complete, manufacturing is complete. If exports are complete, manufacturing is complete.

ICICI Pru Speaker: Just to have the perspective of SKF as a group in India. What would be the capex we are looking at when we are talking about increasing the localization level? How should we look at the split in terms of capital allocation of the two entities?

Ashish Saraf: See, I would say we are spending around INR100 crores on capex for SKF India. I wouldn't have the -- typically if you look at our trade, we would be spending INR100 crores. This year I expect our capex to go to INR150 crores for SKF India. I don't have SKF engineering numbers. I won't be able to tell you in terms of what is the capex investment happening there. But purely from SKF India standpoint, I expect that our capex investment is going to be in the range of INR150 crores for us as we move forward.

ICICI Pru Speaker: So, maintenance capex will be around INR100 crores.

Ashish Saraf: We are also setting up new -- putting up new channels also. See, again, you will also have to understand that from a bearing industry standpoint, there are different sizes of bearings that we manufacture. So, in terms of capability, if you look at the manufacturing plants which are part of SKF India, they have capability to make smaller size bearings. And which is what we manufacture. Whereas for the industrial business, for different segments, different size bearings are required.

To give you an example, wind bearing could be as big as this room. That kind of capability you need a different kind of treatment plant. You have a different kind of steel requirement which may not be even that you have to build suppliers over a period of time. So that is not something that you can easily localize. And in terms of expertise, some of that expertise lies in the Ahmedabad factory because they have been traditionally manufacturing bearings for railways and wind. So, it continues to make sense for us to do -- when we are doing localization, continue to do localization and leverage the infrastructure which is already in place in Ahmedabad for these two segments.

ICICI Pru Speaker: Just to understand, on the SKF technologies part, railways, and wind we know. That's 100% over there. The industrial -- are there some specific industrial bearings which we do make.

Ashish Saraf: That's why I said railways and wind are part of industry. Other than that, there are some bearings which we do make but the relative size, volumes would be relatively limited.

ICICI Pru Speaker: Is there some in terms of the diameter?

Ashish Saraf: That's what I'm saying. It's pretty much based on the diameter. So whatever bearings will fall at that particular diameter, if the channel has the ability to manufacture that kind of a diameter, then it will get manufactured.

ICICI Pru Speaker: So, the capex which you are talking about, INR100 crores or INR150 crores, will be mostly towards the industrial segment?

Ashish Saraf: No, it will be both industrial as well as automotive. Because as we work with automotive industry and we do production, so we will enhance capacity as our share of business. There is also a lot of customers who are like, from an export perspective, we have one customer who is looking at exporting from here. So, we are kind of setting up a channel for that.

ICICI Pru Speaker: So, sir, the overall localization of 60% of what we traded will remain the same then? I don't think that is going to change?

Ashish Saraf: See, it's not going to -- I don't think it's going to -- you will not see a significant change that year-on-year, it's going up by 5%-10%. But definitely, with the focus on regionalization and localization, right, we are going to in general manufacture more in India, right, depending upon the size of the bearing, it's going to be either in the SKF India entity, or if it is a large size bearing, it's going to be possibly in Ahmedabad. So, from that perspective, we will continue to see an increase. To give you an idea, at an overall level, my manufacturing content was at around 55% if you look at two years back. So, over a period of time, it's gone up.

ICICI Pru Speaker: But that's also due to the mix also.

Ashish Saraf: It could be all the factors. It could be automotive; it could be depending on where you are getting from. But we definitely see that this mix should improve. Again, you will not see a substantial increase that it will go and touch 80%.

ICICI Pru Speaker: But sir, in terms of growth, when you have explained all these segments, where do you see the most growth? I think rail will be the highest kind of growth. Now if the segments like rail or...

Ashish Saraf: No. See, we believe from a growth perspective, if I talk about industry, we believe the growth is going to be whole infrastructure there. So, we have seen strong growth in rail, we have seen strong growth in heavy industry, we have seen strong growth in metals. And also [general machinery]. So, these four segments from the industrial perspective are definitely going to have a very good place. If that is the case, then our gross margins will take a knock. Because we depend on stable exchange.

ICICI Pru Speaker: What it means is that the industrial pie will increase more than the auto pie. So, as a result, the credit part will keep on increasing from a state of technologies or imports leading to a summit on the gross margins part. Unless the pricing is so good because of the demand which will take care of it.

ICICI Pru Speaker: Do you guys see it at a ROC level?

Ashish Saraf: See, I don't see our net margins dropping. That I can tell you from an overall perspective. Our intent is to grow our net margins. So even though you might see a bit of a change in the mix and all that. Overall, I don't see our overall margin dropping from where it is.

ICICI Pru Speaker: Sir, this quarter if you see, there has been a fall in margins.

Ashish Saraf: Not really margins, we are pretty much in line with the last...

ICICI Pru Speaker: So, on the margins part, if you see like 2Q and this time there was a transfer pricing adjustment. So, we are on margins topic that go from there. So, 10.8 was the income margins. Okay, it's gross margins and everything. So how much of that had a retrospective transfer and adjustment impact?

Ashish Saraf: See, transfer pricing adjustment is a continuous process. You have to understand that the company keeps on adjusting whenever I import something. We continuously look at what price we are selling to our external customers, and we will continue to adjust our transfer prices. Sometimes those adjustments may not go in line with the expected margins that we are expecting under the transfer pricing guidelines and that is where you see in a particular quarter our margins dropping.

Or suddenly in a particular quarter, you might see a spike in our margins. But over a period of time, it's going to kind of under the transfer pricing guidelines, we have to maintain a certain level of margin. So, if you look at a span of one year, the margins will be relatively flat year-on-year. That's not going to change because that's pretty much the one by UCP guidelines.

ICICI Pru Speaker: So, like 2Q FY'24, 10.8, the drop of margins, that was not...

Ashish Saraf: That's what I'm saying. That is because the margins for that quarter from a transfer pricing perspective got reported much lower than what it should have been.

ICICI Pru Speaker: But it had retrospective adjustment for the previous four quarters as well. It was not just that one particular quarter mix.

Ashish Saraf: Again, as I said, you do a on a yearly basis. So, you look at what was your Q1 margin, what was my Q2 margin. Now Q2 margins came much lower than what it should have been because the prices at which I procured the material was much higher than the prices at which I sent. So, because of that, my margin tanked. So, we course corrected that as we move forward in this quarter. So that over a period of time, it stabilizes and comes to the average margin, what we're expecting.

ICICI Pru Speaker: But why were the prices higher?

Ashish Saraf: See, I don't know at what price I'm going to sell it in the market. Now if you look at my trend, like if you look at say 2022, 2022, we had significant inflation impact for Europe, energy prices and all that.

So, we took a lot of actions in terms of taking prices in the market. So, I got a price which was higher than the cost that I was incurring for imports. Because that was based on a certain baseline of pricing that I'll do to the customer. As we got that visibility of higher prices, we corrected our costs. So, as you correct your costs to maintain a certain level of margin, your margins will slowly start aligning. No, because they would factor in that trend.

ICICI Pru Speaker: Because you're carrying inventory risk. Everything will get revalued. Everything will get revalued. Because that's the OECD guideline. Because you're carrying inventory risk.

Ashish Saraf: That's what I'm saying. Don't look at margins. My recommendation to everyone, don't look at margins for one quarter and take a decision. Look at for below one year.

ICICI Pru Speaker: Pre-OECD guidelines, this is the word captured in SKF Singapore. Today you're having to do it at this entity level. Is that a fair understanding?

Ashish Saraf: I don't know what used to happen in SKF Singapore.

ICICI Pru Speaker: But that was where I was, right?

Ashish Saraf: Yes, again, I was not there. So, I don't know what used to happen earlier. But definitely, we have to do it up based on the FEMA guidelines or based on the OECD guidelines. We have to make sure that we do it up by the pre-OECD.

ICICI Pru Speaker: Typical inventory period is how much for these things. So that's a fair bit of understanding?

Ashish Saraf: See, at least two months of inventory you're carrying. Because the lead time itself is two months.

ICICI Pru Speaker: But in China, we don't have as much lead time, right?

Ashish Saraf: On an average, it's still two months.

ICICI Pru Speaker: Okay.

ICICI Pru Speaker: 3% to 17% margins is what one should overhead with.

Ashish Saraf: That's what I said. See, current margins is around 15% pre-OECD, right? That's what we are seeing over there.

ICICI Pru Speaker: Sorry. Let's focus on that. So, okay. So, 15% PBT is where we should kind of -- and...

Ashish Saraf: That's a reasonable expectation with the current mix. Definitely, depending on how the mix evolves with respect to manufacturing and trade. To that extent, we will see something.

ICICI Pru Speaker: So, just to understand 15% PBT part, with localization which is going on, not just India, but SKF technologies. But we understand the major part because manufacturing has a higher amount of risk. They get the manufacturing margin. But with more localization, will the traded margins itself improve for us?

Ashish Saraf: Traded margins will not improve because it will still remain the same from OECD. It's not actually cost-plus but yes, it's a transaction net margin that's what we typically use. So that's not going to change over a long period of time, right? Some years you might see a blip where you can see a higher margin and all of that. So, unless your manufacturing mix changes or improves, or improves my margins overall in general, you will like it, you might see some improvement in my overall margin, but it's not going to substantially improve from 15% to 50%.

ICICI Pru Speaker: What do you mean by transaction net margin? What do you mean by that?

You will have a market price. From the market price, whatever is the volatility will be absorbed by the transaction. You will have a certain trade margin.

ICICI Pru Speaker: Let's say cost-plus.

Ashish Saraf: It is not cost-plus. In a cost-plus, the volatility also comes to you. The customer won't absorb. In a cost-plus, you're looking at the external market. This is inward. Sure.

ICICI Pru Speaker: Just one last question. Last time, the loan was around INR67.6 crores. Maybe the September figure or whatever is the latest. How much is that?

Ashish Saraf: I don't have the number. I don't know if we did...

ICICI Pru Speaker: INR120 crores or something. We had this…

Ashish Saraf: I think we had given them a loan of -- maybe you wrote me a note. I can revert on that. Because I don't recollect the number. I don't want to give you...

ICICI Pru Speaker: Half of the people have to publish a related party transaction statement. Or is it an annual thing?

Ashish Saraf: Related party transactions are published annually.

ICICI Pru Speaker: Okay.

Ashish Saraf: But I can give you an answer on that. That's not an issue. I remember a number, but I don't want to give you a number unless I am 100% certain.

ICICI Pru Speaker: One thing is on, earlier when the auto proportion was higher, 2-wheeler proportion was higher, there was an element of spurious thing in the market which used to impact the ability to sell the genuine one. With the industry becoming a larger proportion, has that issue become smaller or are the issues still there?

Ashish Saraf: I think the issue is still there. There are counterfeit bearings being in the market continues to be there. To address that we continue to focus on improving our reach in the automotive space especially. So, we continue to appoint a large number of distributors to increase our reach. In the industrial space we continue to work with the retailer network. We have a strong retailer network. So that they buy from authorized distributors or industrial distributors. And we have seen good traction there in terms of just increasing our market share in the aftermarket. Both in the industrial side as well as in the automotive.

ICICI Pru Speaker: And how would we -- the manufacturing ecosystem how would we, say, ring manufacturers or cage manufacturers or others. Has it ecosystem largely there or you are having to depend on few players who are very good and…

Ashish Saraf: It takes time to develop suppliers. Because you need a certain trade-off scheme in our business. And you will have to work closely with your suppliers to build that network. We continue to increase but again I would still say that it takes years for someone to build that level of technology to give us a certain specific type of ring or a specific type called trade-off scheme that is required for manufacturing. So that still relatively remains limited.

And that's why localization takes time. Any localization that we do when we are looking at setting up a new channel if you don't have suppliers in place, it can easily take 2-3 years before you actually.

ICICI Pru Speaker: But the two recently listed ones, are good quality and this thing over it?

Ashish Saraf: Which two?

ICICI Pru Speaker: Rolex and Kashia?

Ashish Saraf: Yes, they have been there with us for a long time.

ICICI Pru Speaker: And what critical mass will you bring a certain channel into the country or…

Ashish Saraf: See, whenever we are doing an investment, we look at the return on investment. In terms of whether we have the right volume or the capacity of the channel and whether we don't want the channel to be denied, otherwise we need to continue with it. So, we will do that evaluation. One of the good things that have happened is that we looked at the entire ISEA market.

ICICI Pru Speaker: you are saying what market?

Ashish Saraf: India and South East Asia So that kind of gives us a clue at times So looking at the market requirements, which is there, looking at whether we will be able to have utilization, looking at the market price points to see whether we will be able to get a return on our investment. Based on which we take a decision Typical thumb rule is if anything has more than 5 years of ROI, then we typically do not sell

ICICI Pru Speaker: Typically, more than sorry?

Ashish Saraf: 5 years of payback. More than 5 years of payback

ICICI Pru Speaker: This is PBT Yes, in terms of margins, generally industrial followed by CV and then PV, that is how the margin is there, highest in industrial, then will be the lowest So for us it would be similar given that there is a traded concept in industrial. And…

Ashish Saraf: See, all-to-all margin for industrial is higher right, but if you are trading, your margins are going to be lower compared to say an automotive business which you are actually manufacturing. And you are sitting with all the costs. So, all-to-all margins for an automotive business in SKF India. Is sitting in SKF India.

ICICI Pru Speaker: Yes, that I understood. So, what I am saying is that even including the traded and the manufacturing of industrial the net margins are higher than the overall auto sector or it could be at par because of the higher trade?

Ashish Saraf: I would say it would be at par. At par, if you purely look at SKF India. From SKF India.

ICICI Pru Speaker: From a growth perspective the parent, when they look at India, they wanted to grow at GDP.

Ashish Saraf: See, typically in terms of growth the way we look at it is that India's GDP growth is heading to 6% to 7% plus we have inflation of 4%-5%. So ideally, we should be growing at 10%-12%, here on that's pretty much.

ICICI Pru Speaker: So, they are not -- they don't look at the ability to gain market share as an additional.

Ashish Saraf: No, no, we look at that, but I am saying that in the long run, minimum you should be able to grow at inflation plus GDP. …

ICICI Pru Speaker: And senior management organization. So is it are there ESOPs in the parent company or how is it, or is it linked to our option state to the current state based on the global shares or SKF India shares Just because we are on this management part what is the update on Mr. Manish Bhatnagar

Ashish Saraf: So, Manish continues to be the Managing Director for SKF India. Manish has taken the role of America's head. So he will move to Americas and basically looking for a replacement.

ICICI Pru Speaker: So long term growth you said is GDP but given that is currently going through an investment phase. So, what will be the growth period over the next five years? That is more important because obviously there will be periods of up cycle when the investment happens then a down cycle when the consumption happens. Howe are you looking at it?

Ashish Saraf: See as I said, we are not -- it's a mix of different industries. So, in some industries you will see a drop also for a short period of time. That's why I think the good benchmark is overall GDP plus inflation because you are operating in different industries you have a diversified portfolio. So, in some like for example last year there were a lot of investment in the metals sector. So, you will see a spike in growth happening in one year, but you will see textiles going through a lot of issues because of the election and all that.

So, you will see textiles probably going down because of that in the long term when you really look at it makes sense to look at overall GDP growth and the inflation. Plus definitely as you are able to gain more, again we are expecting our team to gain market share but in the long term bare minimum you should be growing is GDP growth plus inflation.

ICICI Pru Speaker: Dividend payout.

Ashish Saraf: We will continue as we did last year. Last year I think we gave a higher payout. So typically, I would say our assessment is that the dividend should remain again it should -- our profitability will improve so hopefully our dividends will go up per share but typically our intent is unless you are not doing any significant capex in investments at least whatever we are earning we should be paying out 40% to 50%

ICICI Pru Speaker: As you were mentioning about market share gains other players, other MNCs who are also investing they are also heavily investing here right the capex are huge. So how do you preserve your own market share given they would have the supply chain benefits and all coming in now? And they would have better pricing, better cost side?

Ashish Saraf: From our perspective one of the things that from an investor perspective we have always been able to leverage well, right, is we have been in India for a very long time we have had a very strong brand value with our customers. Especially when it comes to critical applications and the quality of product even when we go to the market the . first preference is a scale compared to our competition, right.

So that kind of gives you a significant edge and we are able to command a strong premium against our competition if you grew a page in the ball bearing stage. Even if you go and look at the price of our product versus you compare it with Scheffler and Timken most of the time you will find our pricing to be higher and the customers are willing to pay us more because we are able to create value for our customers we are focusing a lot more on value selling where we are closely engaging with our distributors, we are closely engaging with OEM players with our application engineers in terms of creating value and showcasing the long term benefits that they will have by buying SK, right.

And that is what is kind of helping us command premium how we can help, bearing is a very critical application right, if you look at it from a manufacturing standpoint from a cost perspective, it's a consumer for that. It's not a significant amount of money, but it impacts their production, their production stops. So that is what we constantly engage in terms of creating a strong application team where we go and give right solutions to our customers. So that their bearings do not fail, right, as frequently as they used to fail earlier, which will help them improve their production and they will buy more offices.

ICICI Pru Speaker: EVs it is still ball bearing, so it changes right?

Ashish Saraf: In EVs it changes, I am talking about industrial.

ICICI Pru Speaker: So, the aftermarket is grown at the similar rate compared to overall aftermarket? Or aftermarket would go lower versus no product sales?

Ashish Saraf: No, no. Our aftermarket, see if you have better reach, you will be able to address the counterfeit situation in a much better manner. Our internal expectation is that aftermarket should grow at a much faster pace compared to the reach, because the long-term impact like OEM, there could be a certain project and all that like see a growth, but aftermarket should be consistently growing.

ICICI Pru Speaker: And the margins are high…?

Ashish Saraf: Then much faster. Thank you so much.

ICICI Pru Speaker: Thank you, sir.

Ashish Saraf: Thank you.

You may now disconnect your lines.

Kotak Chasing Growth, 2024

February 21, 2024

MANAGEMENT: **MR. ASHISH SARAF, CFO , SPEAKER : ADITYA BIRLA SUN LIFE AM**

Speaker: Thank you for the meeting, sir. What has happened in this quarter?

Ashish Saraf: From the market perspective, the growth story remains intact. You might see a blip in one quarter but overall if you ask me, India continues to be an outlier compared to all other markets and we don't see, unless there is an adverse situation globally, we don't see any significant change to that. We expect our growth to replicate what we see in our overall economy in general. That is what is our expectation as the management of this business. GDP is at around 6-7%, inflation is 4-5% so easily bare minimum expected growth for our business is 10-12% yoy. We are aiming much higher and we expect to gain market share from our competition but bare minimum should be 10-12%. Having said that, global economy is in a volatile situation so we need to continue to be conscious as we move forward.

Speaker: When we talk about SKF, we will have to focus more on domestic.

Ashish Saraf: Its not actually that straight forward from a perspective that we sell to a lot of OEM's who are actually exporters. So indirectly, it could impact our demand as well. Lets take an example of Bajaj. Bajaj is a big exporter so if their export market tanks, they are naturally not going to buy from us.

Speaker: I agree on that part but I think in this quarter, to a large extent, we have had an advantage in the sense that we have higher exposure on the 2Wheeler side and that industry is something which has been doing much better..

Ashish Saraf: 2023 was good year.

Speaker: So I basically wanted to know that within auto and within industrial, which categories are growing for you?

Ashish Saraf: From an SKF perspective, I will first talk about industrial. We believe that India growth story is going to be infrastructure led. So, sectors like railways, heavy industry, metals, textiles, fluid power, pumps and motors; these are the sectors which will continue to grow and this is where we are expecting strong growth yoy. On the automotive side, 2Wheeler we have been present with all the big players like Bajaj, Honda, Royal Enfield and we continue to improve our share of business with them so we expect the 2Wheeler market to continue to grow. On the cars, or passenger vehicle side, we are working with players like Tata, Mahindra, and we are participating with all the new models that they are launching. With other players, primarily Japanese or Korean players, they typically buy from their local suppliers so its relatively difficult to grow our market share there so that's where our 4Wheeler market share is not going to be as high as the 2Wheeler.

Speaker: If you have to slice the 12% top line growth, would you say industrial will be well above?

Ashish Saraf: I would say, at least long term we do expect industrial to grow at a faster pace than automotive but based on the visibility that I have for the current year, I expect 2Wheeler at a similar pace.

Speaker: Would railway be growing at a double digit?

Ashish Saraf: As I said Railway is going pretty well

Ashish Saraf: I can not give you a specific number but we expect most of our sectors to grow at more than 10%, which is in line with the GDP growth as well. Wind is one business which will probably grow at a much lower pace because we are doing portfolio management.

Speaker: In wind, how much would be the indirect exports based on the portfolio?

Ashish Saraf: I do not have that detail, and I can check with the concerned person. Because, we are selling to OEM's and then OEM's are either selling in India or exporting it so I would not know that breakdown.

Speaker: Last year I had heard a lot about wind and suddenly the pace has come down? Anything in particular?

Ashish Saraf: See , I do not know what you heard exactly but with wind one of the challenges we had in the - business in general is that the market was not giving the right price at which you could make a reasonable margin. As a company we took a conscious decision to look at the products and go to the customers to get a price increase from the customers or exit some of the products that we sell to the customers of the Indian market. So that is some action that we have taken in 2023 which has helped us improve the overall margin and definitely had some impact on your growth numbers. For 2024, you may not see a significant growth in wind business as we move forward but intent is to grow our - margins.

Speaker: Has the market moved to class K?

Ashish Saraf: Not yet.

Speaker: Our railway is predominantly passenger based?

Ashish Saraf: That's right. Currently yes, its not that we do not have products related to the freight business. We have the products, everything is approved, everything is available but we want to ensure that we are getting the right pricing for our products. That is where we work closely with private wagon builders who are working with the government directly on the freight side.

Speaker: In passenger also there is a technology change now since you are going to Vande Bharat etc.?

Ashish: **We are already there with them , Vande Bharat is buying SKF bearings**

Speaker: As Vande Bharat will be using more of TRV's, earlier the portfolio was more of CRV's, SRV's so how does it change our positioning?

Ashish Saraf: With respect to passenger vehicles, we have a market share of around 40% plus, with railways in general and we easily expect it to touch 50%.

Speaker: Do you manufacture TRV's for railways?

Ashish Saraf: I don't know the specific ones that you are asking but most of the railway manufacturing happens in India, though it happens in the other unlisted entity

Speaker: For SKF, the traded goods continues to remain higher than any other player. Is there any road map?

Ashish Saraf: We have 3 factories in SKF India. Their capability is to manufacture small size gears. When looking at manufacturing large size bearings, it requires a different kind of heat treatment and different kind of channel and technical expertise which is not there with SKF India. We should be able to produce a significant amount of volume for us to localise in India. If I don't have such a big market where I can localise or I don't have the capability or right grade of steel - looking at all those aspects, how much time it is going to take, what is the return on investment, capacity utilisation. Looking at all of that we decide whether it makes sense to manufacture in India or to buy from other factories. Otherwise you will be making a significant apex investment and not be getting any return on investment. It will make the financial situation worse.

Speaker: You're saying the demand for large bearings is not much?

Ashish Saraf: It has to have the right volumes. If you look at the India market, and if we are trying to make a certain bearing, we need to have a market and volume for the same, which we currently don't have. The focus is on localisation and Make in India.Our intent is to localise. One of our learning after covid was that there was a significant supply chain disruption so the focus for management is to create a regional localisation environment where we don't have to source from Europe or China. We have, within SKF, India and South East Asia as a business area so our focus is to basically manufacture for this region. Some of it could be manufactured in India and some in South East Asia depending on the supply chain situation but intent is to source locally.

Speaker: In a recent call, there was a discussion that you're closing down Korean plant and scaling down German plant and the intent is to localise more in Mexico, India and China? So is it for the local markets or for exports market and what is the quantum?

Ashish Saraf: Predominantly, its region for a region. Primary focus would be to manufacture in the region. So if we manufacture in India we want to manufacture for India and South East Asia. There could be export opportunities, like if a particular type of bearing relatively doesn't have enough demand to cater to India and South East Asia Market but it makes sense to set up manufacturing and we are looking at closing down say Germany, then we might supply from India for the entire globe for that particular bearing, but our focus is going to be India and South East Asia. It depends on type of bearing. If we are making DGBB's or smaller sized bearing where we have capability in SKF India, we will manufacture in India, whereas if we are making a bearing for wind or railways which is typically large sized bearings, it will get manufactured where there is skillset and expertise for it.

Speaker: In the traded goods segment, how much would be imports and how much would be sourced from another substitutes? How would the pricing vary for both?

Ashish Saraf: There is no difference. Both are governed by transfer pricing regulations. It could be cheaper from cost perspective but from margin perspective as both calculated under the transfer pricing regulations would give you a similar result.

Speaker: How much is the import content as of now?

Ashish Saraf: I can broadly tell you my import content overall around 40% is what is traded out of which 30% is what I import from outside of India.

Speaker: This is for the finishing right? If I see the raw material import line item, that number would be higher.

Ashish Saraf: Component purchase would be relatively small and not necessarily from related parties. We might have suppliers from outside India and we might be importing from them.

Speaker: How big is the large bearings from this 40%? Since my understanding is you don't have the capability to manufacture large bearings in-house so it is outsourced.

Ashish Saraf: Majority of it. Railway and wind is getting manufactured out of Ahmedabad. Rest also, compared to the bearings that we make in SKF India, they are relatively bigger in size compared to what we make for the automotive market, as predominantly we are making DGBB's which are the small bearings. They might be smaller than railways and can be called mid sized which we continue to manufacture.

Ashish Saraf: Its a constant evaluation process where we have to look at what is the capability, where are we going to source the raw material from, whether we have the capability of heat treatment in any of these plants, whether the heat treatment plant exists in Ahmedabad so depending on all those factors, a technical evaluation is done where it makes sense. Then looking at the cost benefit analysis we decide where to invest, there is no one answer that can be given. We are making investment in SKF India also and continue to make investments in the Ahmedabad factory.

Speaker: I was looking at the calendar number of last year and you did almost 147-148 cr for 2023 in the listed entity? You are saying that there is no capability in the listed entity. How difficult is it You can easily do it in the listed entity.

Ashish Saraf: If you are putting up a heat treatment plant, you have to spend a lot of money.

Speaker: You have given a credit line of INR 450 cr to the unlisted co.?

Ashish Saraf: Understand, what the capex investment we have given them is to set up a channel. Along with the channel there has to be a heat treatment plant, which is already existing there so if I were to put up a channel in Pune, for heat treatment I have to send it to Ahmedabad which does not make sense.

Speaker: What is the biggest bearing that SKF India makes and if based on our capabilities of SKF India, how much higher can it go?

Ashish Saraf: I will answer this in a different way. Our manufacturing share is 60%. This share should go up, but it will not become 70% or 80% but gradually go up 1-2% yoy.

Speaker: If you are looking at growing the business, you are looking at plant addition and product addition as well. Product addition happens in the subsidiary part but rarely happens in SKF India part so from capability angle I wanted to understand that if product addition has to happen what can be expected from SKF India?

Ashish Saraf: Predominantly small and mid sized bearings is what is going to get manufactured. We make everything for the automotive side, don't make everything for the industrial side.

Speaker: Since last couple of years, India has been talking about indigenisation here as well?

Ashish Saraf: To do one cycle of capex investment, once it gets approved easily takes 1 to 2 years to actually start producing. You have to order machinery which has a long lead time, install the same, have the supplies in place. The machines ordered are not readily available in the market, order has to be placed to an OEM which manufactures the machine as per requirement and they have a lead time.

Speaker: So the heat treatment plant is in Ahmedabad. The listed entity has enough cash and technology transfer can happen in this listed entity also. As a minority share holder we are trying to understand that why are you not incurring the additional capex in the listed entity so that we can have the benefit of the entire manufacturing capability that you have?

Ashish Saraf: When we look at an investment, we look at multiple factors. We look at the demand, we look at what is going to be the utilisation of the channel, what is going to be the technical requirement, what is going to be the supply requirement. All of those factors are going to be looked at and then a decision is made as to where we want to put up our manufacturing plant. The intent is not that because its a listed entity, we do not want to get the manufacture here, but what makes the most business sense for us is where the management takes the decision, whether to manufacture in the non listed entity or to manufacture in India or the SKF wants to go for region to region localisation so if there is a requirement of manufacturing plant in South East Asia which will cater to the entire South East Asia and India market then we will decide to make an investment in South East Asia. So that is how decision is made but overall intent is to make sure that we are able to cater to the India and South East Asia market from this region itself.

Speaker: From the unlisted entity, how much percent is the export?

Ashish Saraf: I do not have the number but it will not be very significant. The unlisted entity is not very big, it is only 1000 cr. turnover in which we have 2 businesses, which is lubrication and sealss which has nothing to do with this entity which would be close to at least 50 percent so we are talking about a relatively small manufacturing presence which is in Ahmedabad.

Speaker: Going into the raw materials, almost 1400-1500 cr. is related party purchases from SKF entities which would include some traded goods as well as some components. So are there any plans that actually look into it?

Ashish Saraf: I already gave you the answer to this, that these are all the criteria that we look at.

Speaker: But this number is actually stagnant and the traded goods number is going down?

Ashish Saraf: The business is growing. If your number is stagnant that means the proportion is going down.

Speaker: SKF Germany is the largest one.

Ashish Saraf: You were a part of the call where we clearly stated that we are looking at making investments in India so isn't that very - clear that we are looking at closing down Germany and Korea. Our strategy is region for region and we have nothing to do with China. Our intent is to manufacture for this region ISEA ,so if the demand is there, the demand has to be big enough to be able to cater to India and South East Asia market. If the demand is not big enough, we will continue to import from either China or from Europe for certain type of products but where we have decent demand in place, where it justifies the investment and pay tag then we will make that investment.

Speaker: From EV side when you mentioned about the customers there was none of the new gen EV customer?

Ashish Saraf: I didn't talk about EV at all. We are working closely with Ola and Ather. These are the two big players on 2Wheeler side. On the car side, Tata and Mahindra is a big player and we are working with them.

Speaker: For a like to like 2Wheeler, what would be your typical realisation for an ICE engine versus an EV?

Ashish Saraf: I don't have the exact number to answer that but basically the number of bearings are going to come down in the EV space so you are consuming lesser but the bearing price is going to go up. Right now the EV share is very -nominal compared to the normal ICE so from that perspective we don't see any significant impact but if I supply the same set of bearings or reduced number of bearings at a price point at which I'm selling versus the price point at which I was selling before, we don't see any impact on our top line.

Ashish: Send mail on investor email id, and will reply.

Speaker: In terms of margins, .**Ashish Saraf::** Look at margins over a period of one year. Our intent is also that the margins do not fluctuate that much but predominantly it happens because of the traded products and the way the margins are calculated as per the transfer pricing. I cannot control the price at which I am selling to the external market and I don't know at what price the product is going to get sold. I have a reasonable idea but not the exact price. When the group looks at pricing our traded products they look at the previous quarter data as benchmark so based on this they price the products accordingly. If there is a gap, which will either create a substantial increase in the margin in a quarter or in some quarter it can be reduced so there has to be a course correction that has to be taken in the subsequent quarter but over a period of 1 year we ensure that we comply with the transfer pricing guidelines and meet the overall operating margin.

Speaker: After market sales?

Ashish Saraf: Around 35 percent is after market for auto plus industrial.

Speaker: If I look at your gross margins, between manufactured and traded gross margins from the Annual report data, I see a trend that manufacturing gross margin has been trending downwards. The best you used to do was 58-59% gross margin till maybe FY21. In fact FY21, you did 60%, FY22 was 48% and FY23 was 49%. What is the reason for this declining trend in manufactured goods gross margin?

Ashish Saraf: I need to go back and look. In one quarter, you might see a blip. But my manufacturing margin should hold good. Maybe the way you and I are calculating is different.

Speaker: We get the raw material purchase, finished goods purchase and also the inventory related data, so we can easily calculate it. That's a straight forward calculation.

Ashish Saraf: If you are looking at raw material, that's only the raw material cost that is coming. What about other costs with respect to manufacturing, you are not considering that. You are only considering the raw material cost and calculating it because as you are manufacturing there are a lot of other value added costs in terms of manufacturing which are all sitting in different lines, so you might probably not be able to calculate the margin because my manufacturing margins have pretty much been holding. There is always cost incurred in case of wage increase etc. Steel prices have been relatively stagnant so I don't have reasons to believe that my manufacturing cost would substantially go up. Based on what I have seen, manufacturing margins are relatively stable. We might have taken a pricing action last year, compared to the pricing action that we have taken this year because we have not seen a significant inflation with respect to manufacturing so to that extent the higher margin that we got because of the pricing action that we took last year versus this year, that could create an anomaly but other than that its the same margins.

Speaker: Wanted to understand about the other income and any particular one off's there?

Ashish Saraf: Other income is predominantly income from term deposits that we do for the access cash. We had a pretty good working capital situation last quarter, but the cash flow was pretty good last quarter and we generated a lot of access cash that we parked in form of term deposits.

Speaker: Industrial is 20% of the business in terms of revenues

Ashish Saraf: Its 50%.

Speaker: The OE part, excluding the after market, industrial OE is…?

Ashish Saraf: Industrial OE for the overall SKF India revenues should be around 25-30%.

Speaker: Do you put wind as a part of this and how big would wind be. Just wanted to understand, the revenues have been declining the past few quarters. Is it more because of wind?

Ashish Saraf: Wind is 4% of the overall revenue. As I said, other sectors have been growing. 2023 Q1 and Q2 was big for us, for wind because wind is also a cyclical business. Q4 the wind was smaller that's why 4%. Wind is actually 5% as of 9 months.

Speaker: What are the other industries that you're exposed to?

Ashish Saraf: As I said, railways, wind.…

Speaker: Do you categorise it separately?

Ashish Saraf: Let me simplify it for you, there are 2 sectors : Industrial and automotive. Industrial is all industries excluding auto which includes wind, railways, heavy industry, metals.

Speaker: Could you also simplify the 9 month split…of railways?

Ashish Saraf: Railways. 7% of overall. Heavy industry is 5%. General machinery overall would be 8%. Auto would be 30%.

Speaker: General machinery would include metals?

Ashish Saraf: No, metals is separate. Metals is 2%.

Speaker: Is after market a better margin than this?

Ashish Saraf: Yes.

Speaker: You were the first ones to get into the AMC kind of format?

Ashish Saraf: That's right. On the industrial front, we do something called Rotating equipment performance where we work with some of the big players. Our revenue model is based on productivity so our intent is to work with them and basically look at the rotating equipment and see how we can improve performance through condition monitoring and adding sensor to those bearings and ensuring that we suggest or recommend the right kind of bearing for the right application to ensure that their breakdowns come down and it helps them manufacture the product they want, predominantly in the metal segment. That is where we work with a lot of end users which will help them improve their productivity and they pay us in terms of production. That helps us gain 100% market share for that particular plant.

Speaker: After market replacement which is 35%, it has not improved?

Ashish Saraf: All other businesses are also growing so if you look at it as a percentage of revenue, it is pretty much similar. The industrial after market is around 25% and auto after market is …

Speaker: Earlier the number used to be 15-16%?

Ashish Saraf: I don't know 2-3 years ago, since the time I have been here they have not done any….

Speaker: What is the 9 month split of Auto in 2 wheelers, 4 wheelers?

Ashish Saraf: So cars is 5%, 2W is 13% and we have something called power train which is 6% and tucks and tractors would be around 6%. Powertrain is basically suspension equipment.

Speaker: This month ICE was 13% … replaced with higher value based ICE to EV conversion, the business which can be…?

Ashish Saraf: Automotive business is around 40%, so, if I take an example of 2Wheeler, which is around 13%. If we are talking about replacement in the long run, in that some portion of 13% will remain in ICE and some portion would go to EV. Similarly you have after market for that which is another 11% so that will be over a period of time.. so around 24%.

Speaker: So entire after market is 2 wheeler mostly?

Ashish Saraf: No, not entire but majority.

Speaker: Can you show where the mix is higher terms of products so we can understand if something sells more from ASP or magic perspective? Lets say auto vs industrial.

Ashish Saraf: The highest margin is in the aftermarket. From a margin perspective, manufacturing will give you a higher margin in general versus traded, because you are a marketing company so you have to share your margin with the manufacturing companies. That's how you should look at it.

Speaker: If 2 wheeler is doing better than...

Ashish Saraf: Automotive is mostly all manufacturing so that's anyway higher margin and it is 95% localised.

Speaker: And industrial currently is only 35%?

Ashish Saraf: 35-40%, but out of that 35%-40%, 10% is happening in Ahmedabad and remaining 30% is happening.

Speaker: Can I understand if you said that industrial 35% is in house manufacturing, 65% is imports and within this 35% also 25% is in listed entity. You are guiding that this 35% would become 60-65% over time?

Ashish Saraf: My manufacturing overall is currently 60% and over a period of time, that 60% will…when I say you see it…

Speaker: Can we break it down? Auto is anyway 95%…

Ashish Saraf: Again, when we look at manufacturing we look at overall..industrial for the listed entity is around 25% and you would see an increase by every year by 1 or 2%.

Speaker: That's it, right. That's helpful. If I look at the annual report, manufacturing was 56% in FY22 which fell down to 49% in FY23. You gave us finished goods in schedule and traded goods so its a very simple calculation. Unless components are imported so it may not be applicable.

Ashish Saraf: Again, the data that I have I can clearly see manufacturing is 59% for the 9 months that have gone by.

Speaker: So, it has increased sharply.

Ashish Saraf: We were earlier at 55-56%.

Speaker: On your top line you are guiding 10-12% revenue growth..

Ashish Saraf: Again, in this 41% as I said 10% is Ahmedabad, 59% is SKF India yeah, that's right.

Speaker: So you are guiding for revenue growth of 10-12%?

Ashish Saraf: We don't give any guidance.

Speaker: But the nominal GDP is that much so it has to be around that, unless we are doing something wrong. I want to understand, the aftermarket, does it typically grow faster?

Ashish Saraf: We expect it to grow faster, we do a lot of investments with respect to improving our range by new products in the aftermarket so that we are able to give combined solutions in the after market thus increasing our range. So because it is a higher margin, our intent is to grow it at a much faster pace.

Speaker: Thank you.

Kotak Chasing Growth, 2024

February 21, 2024

MANAGEMENT: MR. ASHISH SARAF, CFO

Mirae Speaker: So, if I look into 9 months, clearly, we see that growth has sort of normalized quite a bit. I mean, in fact, below normal, right? I mean, I think our discussion, our earlier discussion was always 1.5x of GDP.

Ashish Saraf: That's right.

Mirae Speaker: And 9 months is 5%?

Ashish Saraf: That's right.

Mirae Speaker: So, what is going to might have led to this sort of sudden growth slowdown?

Ashish Saraf: And yes, see, I would say, see the first two quarters were relatively better, right? If you look at it, I don't have the numbers, but Q1 and Q2 year on year were much better. Q4 is where we've had relatively much lower growth of overall 1.5%. And if I look at my Q4 results, right? What has happened is, one is we have had relatively lower growth in the Distribtuon market, right? And second is we also had a bit of an operational challenge in Q4. We basically deployed SAP, right?

So, and that was basically effective 1st of October. So, once we deployed SAP, we had certain operational challenges in terms of systems that are typically the key issues that you have, right? So, in October and November, we're dealing with a bit of that, because of which a lot of customers in general machinery, we were not able to supply on time.

Mirae Speaker: So, the CRP and all that system...

Ashish Saraf: So, we were using a legacy system, we moved to SAP in 1st of October. So, that had a bit... I would not say that that was one major issue, but one of the reasons which kind of impacted relatively growth in this quarter.

Mirae Speaker: Impacted the billing part of the market?

Ashish Saraf: Yes, the billing part of the market.

Mirae Speaker: But if you exclude this much, I mean, how... Instead of 1%...

Ashish Saraf: I would say it would have been... See, one was this, second is distribution. And there was also one more reason, what we did is that we did a lot of customer pruning for the wind business, right?

So, if you compare year on year, you're not... Like our wind business have relatively remained stagnant, right? And one of the reasons is that on the wind business, we're not making significant, right?

We're not making enough money. So, we consciously took a decision to look at our portfolio for the wind business, look at our customers, and basically prune those customers, either exit those businesses or get a price increase. So, because of that, our wind shares relatively dropped in 2023 compared to 2022. We've not had any growth in the wind business.

Mirae Speaker: On Y-o-Y?

Ashish Saraf: On Y-o-Y basis. So, that's where, if you see our

Mirae Speaker: So, wind was like 8% of the business?

Ashish Saraf: Yes. So, it's come down to around 5% now.

Mirae Speaker: That means we were very defensive.

Ashish Saraf: Year on year, yes.

Mirae Speaker: Otherwise, one would have thought this is a promising, reasonably good growth area. So, who else was therefore spoiling this?

Ashish Saraf: Wind, historically, has been like, if you look at it from a market perspective, they've not been paying so well, like in general, the rate at which they were kind of selling energy versus the investment cost, which is more. The returns that the Wind were getting were much, much lower, right? So, that is where...

And we were either manufacturing, even though a good portion of it gets manufactured in India, we still have to import components from Europe, right? So, that is where relatively, from a cost perspective, we're turning out to be expensive. So, one was outward where the pricing was not right.

Second is inwards. So, we're looking at both and we're trying to see how we can kind of optimize and do more localization, as well as going back and asking customers for a better price.

Mirae Speaker: As far as if the industry, if your customer was squeezing you so much, it's also your own manufacturing, whatever it is.

Ashish Saraf: So, it's a mix of both. Mix of both.

Mirae Speaker: So, therefore, there will be some other player, maybe another, who is gaining at your cost. Could be. So, this is also, I mean, like 3% impact on the world, I mean, and then another 3%-4% helping people out.

But still if you adjust for that, I mean, it could have been 7%. So, it looks like, I mean, the industrial aftermarket has taken a lot. But in terms of cement and steel production in India, it's relatively okay still. I mean, aftermarket...

Ashish Saraf: Aftermarket in general, I would say, as I said, on the metal side, we saw, again, to me, it was more of like we were looking at renewing a lot of our aggregate contracts with our end-users. And because of that, we've taken pricing actions with them. So, they've definitely reduced the share of business.

Now, we're looking at taking that share of business away.

Mirae Speaker: But how are you taking it? Others have not. There are also other ways.

Ashish Saraf: See, again, see, the way these OEMs work is that they sign annual rate contracts with all the suppliers. Right? And whenever there is a delay, we're asking for a higher price and all that. So, they said, okay, we have something in place to do. Other suppliers, they will go and procure it for the time being. And now, once you have the agreements in place, you can go back to the...

Mirae Speaker: So, industrial aftermarket was around 25% for us?

Ashish Saraf: That's right.

Mirae Speaker: And now, it is... It is similar. And Q3 might have seen it. Q3 is... Q3 financial year or Q4?

Ashish Saraf: Q3 financial year.

Mirae Speaker: Autos, right?

Ashish Saraf: See, autos also on the aftermarket side for auto, we've also seen. So, for Q4, I'm talking about that. That's right. So, that is where we're realizing is that the competition is putting a much lower price. They have kind of reduced their pricing and all that. So, that is where we are focusing on how we can kind of gain market share.

You introduce a better way to gain... To overreach, to find more distributors. So, we are focusing more on that, creating a much more lucrative incentive programs for our channel so that we can kind of improve for the market share there.

But these two areas, I would say, distribution and aftermarket... Sorry, aftermarket for automotive. These are the two which didn't do so well compared to what they were doing. Q3, I would say.

Mirae Speaker: So, last time when we spoke about... Like as we mentioned that clearly we are trying to increase the reach, range of delivery and the coverage in distribution has almost jumped up to 70% of the touch points and all. So, despite of that, I think the segment has not done well. And ideally, some of these...

Ashish Saraf: See, I would say Q4 is a blip. We have not seen that impact. Again, as I said, this is one of the impacts because of the city issue, because of federal rate contracts, renewals, and some of the market challenges that we face on the BSM. It was not so much because we didn't have the reach and all. So, that is something that we are course correcting as we move forward in this. Sorry, what did you say? Sorry, just automotive aftermarket. We basically call it as vehicle service market also.

Mirae Speaker: So, competition I guess is rising. It is relatively a fairly consolidated market X of China. In China, ideally, unless it might have come back in a very big way because of COVID and now it looks like a fair bit of a market share for UMNC companies. So, that thing is now sort of reversing. And when you say it is rising, is it by the Chinese player or is it by X of Schaeffler or someone else?

Ashish Saraf: So, it is more of... Again, our biggest competition in the automotive space is Schaeffler. So, that is where...g

At least that is what the news that I keep on hearing from the team is that they have like... The reason why we didn't prove is that we didn't have a very strong incentivizing program for our channel. So, that is what we kind of corrected.

Which is some of it is price play and some of it is what we pay. Because a lot of distributors in the automotive space are not single, but they are basically multi-brand distributors. So, they will push a product where they get a higher incentive. So, that is what was one of our thing

Mirae Speaker: If you think of your quarterly 3Q versus last year's 3Q or your 4Q, you had no flattish sales growth. I would have thought that there was clearly a tailwind on your raw material and yet your gross-margin shrank. So, this is meaning you passed on some pricing or you didn't and yet you couldn't grow and those guys were even more aggressive or how did you do it?

Ashish Saraf: See, again this quarter year on year our margins have been flat, right?

Mirae Speaker: As it is at the gross level.

Ashish Saraf: Okay. See, when you look at gross level, I would say because you are only looking at raw material costs or traded costs and material costs and you are kind of calculating that. Whereas, in case of manufacturing, there are other value-added costs also which we incur in a regulatory way.

So, I don't think you would be doing the right comparison. Rather than that... See, because our manufacturing margins are... Did slightly went up because of higher value-added costs that we had in this quarter, right? But it was not very significant. Our traded margins improved quarter over quarter.

If you look at second quarter versus third quarter. But compared to last year, our traded margins were relatively lower. So, that is where our margins are relatively slightly lower than last year.

Mirae Speaker: Again, just pressing a bit on this replacement side of it. I mean, if I am understanding it, it is such a steady, stable, most profitable business and some of these tactics by let's say competition and all and our inability to really react accordingly. It looks very, very weird in that sense, right?

Ashish Saraf: That's what I am saying. See, for this quarter, in the auto distribution space, that is the input that we got from our sales team to look at our incentive programs. Kind of look at it this quarter and try to do a prediction.

On the industrial aftermarket, as I said, there was a one-off because of contract renewals with some of the end customers, which impacted on the volume that we were expecting that we would buy. So, that should post-correct naturally this quarter.

Mirae Speaker: In nine months, what would have been the volume growth? Let's say sales growth is 5%.

Ashish Saraf: Nine months, what would be the volume growth? Nine-month data, what would it be? I won't have. But last quarter, the volume, there was an overall, last quarter, there was a volume.

Mirae Speaker: And on industrial OEM side, what is the growth rate?

Mirae Speaker: No, no, industrial OEM side. And also, maybe nine months of full calendar year if you can just again help us understand the breakout process.

Ashish Saraf: Sorry, your question was, what is the year-on-year growth of the OEM, industrial OEMs, right? Industrial OEMs would be much higher. The overall growth for industrial was 5%, right? For the nine-month period. All of which, my distribution has grown by 3%. So, distribution was almost 50% of your business.

Ashish Saraf: That is 7%.

Mirae Speaker: So, 7% is what would be yours, for the nine months period. But after considering wind

Mirae Speaker: That is like more than 10%. And same for auto, that's 9%.

Ashish Saraf: So, for auto, again, it's similar, 4% plus. And distribution has grown by negative 1%. Auto OEM has grown by 6%.

Mirae Speaker: And exports?

Ashish Saraf: Export year-on-year has grown by 8%.

Mirae Speaker: In exports, is there some mint or market, whatever you are getting to supply to the chain?

Ashish Saraf: We supply to other SKF companies

Mirae Speaker: And are you replacing some Chinese firm in?

Ashish Saraf: See, exports, again, our focus is predominantly the Indian market. Exports are purely dependent on what the, like we don't really manufacture for exports. We manufacture or we build capability to get address to the Indian market.

Indian market, and I would say to a certain extent, now the investments that we are making in India also look at Southeast Asian market because our strategy is region friendly. So, because of that, there could be some exports happening to Southeast Asia. Or, in case there is a requirement that comes in from Europe or America, then we export them.

Like, for example, railways. But again, that's not the same thing. So, I would say mostly exports is to Southeast Asia.

Mirae Speaker: So, that's anyways what you articulated. I was just wondering, if I agree, I have heard Manish I thought saying that. There is always something between parts. And he was also, I mean, overseeing the Southeast Asian market.

Ashish Saraf: That's what I am saying. How will we look at our manufacturing capability for the existing capability that we have or any new investments that we make, say. We always look at not just Indian market, but we also look at Southeast Asian market.

So, because of that, if you are putting in an investment, we are putting in an investment not just for India, but for Indian Southeast Asia. So, that could have an impact on the exports or the things that we are exporting. And vice versa.

Like, if we have a manufacturing which is happening in Southeast Asia, and that can cater to the Indian market and it makes business sense for us to import, then we can import to Southeast Asia.

Mirae Speaker: And this rotating thing, is it?

Ashish Saraf: Rotating equipment performance.

Mirae Speaker: Yes, how is that?

Ashish Saraf: I think, see the way we are looking at the entire business, right? One of the things that we have realized over the years is that one is that we are a bigger brand in this sector. Our customers are buying us for critical applications, right? We ask customers because of that; we ask customers to pay us. So, most of our products are priced higher than our competition.

The question is, why will our customers buy from us? So, we focus on doing a lot of value selling to our customers, where we make sure that we engage our application engineers to work closely with our customers, with our distributors, and with the OEM partners to make sure that we are able to create value. So, one of the ways is doing this rotating equipment performance, with especially customers in metals and pulp and paper, which are basically having big manufacturing plants, where that is where we go and put in that, where we get our application engineers and help them drive productivity, which in turn, they will have to also compensate us for that product.

So, but the way I would put it is that rotating equipment is one of the solutions. The way we are positioning ourselves is to create value and ask customers to pay us for that value, rather than the price.

Mirae Speaker: I mean, if it's salience in the world, the whole world should become larger.

Ashish Saraf: So, again our overall services business is growing in general. So, typically it's around 5%.

Mirae Speaker: Rotating equipment?

Ashish Saraf: I would not say rotating equipment, I would say generally services business, which includes railway remand, which includes REP and all that, and that share is constantly growing.

Mirae Speaker: On the wind side, I mean, some of the OEMs in India, they are getting a lot of bonuses. We have, I mean, our salience has declined over time, but what is output going forward?

Ashish Saraf: See, again, as I said, that from SKF perspective, we would like to do profitable business as a company, right? So, there are certain products or product ranges where it actually doesn't make sense for SKF. We would either ask customers to give us better pricing, or we would be happy to kind of exit that particular business.

Mirae Speaker: So, just to clarify, you know, in the wind, as you say, there is traction, and the bearing would be so critical, you know.

Ashish Saraf: Yes, but the customer should be willing to give us better pricing.

Mirae Speaker: Who is spoiling the market? Yes.

Ashish Saraf: So, there is a schaffler which is there, they are selling at a much lower price, I mean, I wouldn't know exactly, but to me, it's pretty much the same competition. So, they are selling at a much lower price.

Mirae Speaker: So, this trade-off is still not completed? From our portfolio perspective, mostly we are done with it, right? Now, basically, this is the, like if the number that you are looking at is probably the bottom, right?

Ashish Saraf: From here we go up. But we will be choosy, that's what I am basically saying, that we will not take on any business that comes our way. We want the business to be profitable, and based on this, we will take it.

Mirae Speaker: But is there some circular advantage? Maybe they are manufacturing completely, they are more backward integrated.

Ashish Saraf: I have no idea, but at least what I have heard is that they have a lot of manufacturing happening in Eastern Europe, right, which is relatively lower cost , compared to we have in Europe . That could be one of the reasons.

Mirae Speaker: So, you guys make bearings?

Ashish Saraf:: See, we make a lot of bearings in Ahmedabad, for the wind, but we have to source the components still from Europelot of components, right, so that increases our cost. So, that is what is our journey to see how we can do it.

Mirae Speaker: I mean, but at the end, they are making a decent amount of those, some of those components, I would say they might be sourcing from a low cost.

Ashish Saraf: We really don't know whether it's this competitive pressure is here to stay, or whether, you know, I don't know, but if you look at our competition profitability and all that, their margins have also kind of declined, right, it's not that their margins have significantly improved. So, maybe they are taking a lot, they are taking a loss.

Mirae Speaker: So, we have to step back a bit. From here, where we are, you know, if we have to go back to that equation of your growth outlook related to system growth, what are you guys confident of seeing?

Ashish Saraf: See, again, our intent from our, I mean, I can't give you an outlook, but what I can tell you, our intent is to grow the GDP plus inflation, right. So, in terms of internal plans, we have plans to grow at a much faster pace than GDP plus inflation, right? So, anything lower than that could be a blip, right, but our long term or mid-term intent is to minimum grow GDP plus, and that kind of continues to remain.

We are not seeing that changing, at least, like, for a forthcoming year. Again, the global environment remains volatile. A lot of OEMs who buy from us, they are also exporting, right? So, what you see as exports are only direct exports, but there is a lot of indirect exports that happens. So, if their demand shrinks, because globally except India, everybody is in a kind of regression, So, naturally, we will see some impact of that coming to us.

Mirae Speaker: And from the margin front…We were surprised.

Ashish Saraf: Yes, very surprised. I know, one is, again, this transfer pricing.

Mirae Speaker: We are never able to understand certainly in a quarter what exactly you are trying to say. So, that is one. If you can just help us understand, what is the right thing to look at?

Ashish Saraf: See, one is that don't look at margins, right, on a quarterly basis. Sure. Look at it on a yearly basis.

Mirae Speaker: Right.

Ashish Saraf: Second is, because what happens is that my cost of the products that I get from the groups or from the trading companies of the related party companies, right, is based on the previous quarter margins, right, that the companies make, right. Now, if my pricing changes, right, because I'm going to get to know the actual pricing only once the material arrives and I shift to the customer. But I have already the input cost of the product is already based on the projections of the last quarter.

So, if there is a variation because of that, right, you will see a sudden change in the margins, right, because the group looks at the trend, right, the person who's doing the transfer pricing management, you look at the trend, okay, what is the price increase, which has happened quarter over quarter versus what is the cost that I'm paying. If the price increases, right, the price increase trend continues, then my cost should be X. Now, if the price increases relatively flat that quarter, but it has increased the cost, my margins will dip in that quarter.

Then in the subsequent quarter, we will post-correct the cost. So, that keeps on happening on a month-on-month basis, right, which we keep on doing to make sure that we maintain the adequate margin under the transfer pricing management. So, from a full year perspective, you will not see a significant change in my margins.

One year could be a blip, right, like for example 2022 was relatively a blip where you had a very higher margin, right, because there were a lot of pricing actions that were taken. So, there was a constant catch-up which was happeninhg quarter over quarter, but we're still maintaining a much higher margin of 75%, right? But this year, that like, relatively the pricing actions have stabilized because you don't see so much inflation happening, right?

So, the catch-up has happened and one quarter, more catch-up happened than what should have happened because it relied on the trend. So, it's kind of subsequently post-corrected.

Mirae Speaker: So, what does that mean? There's 15, 16 rather than 17?

Ashish Saraf: Yes, yes, yes, 17 is a, is a, is a, I would say a lot better, better sense of the trend.

Mirae Speaker: So, what if I look into my last year notes again from our last meeting, you called out that we have been culling out a lot of unprofitable customers as well as the products. So, to that extent, the margin range has to be 17 to 20.

Ashish Saraf: I don't think I ever said 17 to 20. But, see, definitely, if you are, see, on the traded markets, you need to understand that portfolio management not necessarily will see between trading markets because you are making marketing margins, right? So, portfolio management doesn't have so much of an impact with respect to traded products. With respect to manufacturing products, definitely, if I'm improving my margins, it will improve.

Mirae Speaker: So, again, let's say if I look into purchase of stock in trade, right? I mean, so purchase of stock in trade, which I presume is typically the sourcing piece, right? Which is there in the P&L, right? I mean, which might be occurring from group entity either SKF technology or maybe India. So, that is around 35% of sales, right? Purchase of stock.

So, we only do make marketing margins, right? So, that is what the gross profit on that 35% of sales might be worth then.

Ashish Saraf: See, we don't look at it from gross money, we look at it from net margin.

Mirae Speaker: Yes, let's say with the margin on that.

Ashish Saraf: So, net margin typically based on the, see, every year, what happens is that there is a comparative study, which is done, which one has to perform under the tax office, where you look at if you are doing selling a similar kind of product, what is the typical margin that you would make and based on that study, a certain margin would come and that is a margin that would have to be taken. But that, again, to answer your question in simple terms, my traded margin would be lower compared to manufacturing margin. Typically, my traded margin would be a single digit margin. At a PBT level? At a PBT level.

Mirae Speaker: The definition is not there in that. Because you will not be having that definition.

Ashish Saraf: But again, I am saying PBT to PBT, if you compare manufacturing versus traded, my traded margin would be single digit, whereas my manufactured margin would be higher.

Mirae Speaker: Again, looking to, I mean, let's say globally, SKF makes more tilted in favour of industry. We are still 53% globally. Now, with all these, India also, all this manufacturing thing going on, all that.

But do you think any other sort of incremental opportunity coming in from, let's say, global portfolio, which we might not be having at this point in time? Yes. Particularly on the, basically, on the industrial side.

Ashish Saraf: See, we are, we are heading to the India market. So, the market is there already, right? So, the focus is predominantly that India manufacturing sector is growing. So that should be, and there's a lot of investments happening on the infrastructure front. So that is going to trigger the growth for the industrial business. And industrial business will grow at a much faster pace because there's more investment happening in the industrial sector compared to the auto sector.

Right? That's why, and SKF has been traditionally very strong in the automotive space in India. That's why we have been having a higher, if you look at the mix, our automotive mix has been higher.

So, because of that, the mix is always going to be a bit skewed when you compare it with the industry. But we expect the industry to grow at a much faster pace compared to the auto sector. Because of the sheer investments which are going in and the focus which is there on manufacturing.

Mirae Speaker: But then higher industrial mix is bad for the margins.

Ashish Saraf: See, over a period of time, you have to also look at it from a strategy perspective. Our strategy is region for region. Right? So purely you look at it from an SKF India perspective, I also expect that over a period of time, the mix should get better. Actually, it should continue to get better.

It may not improve significantly in a short period of time, but you should continue to see a couple of percentage points improve and it doesn't move forward.

Mirae Speaker: Is that has happened? Let's say in the last year.

Ashish Saraf: So, say for example, right now we are at 60%.

Mirae Speaker: 60% as a company or…

Ashish Saraf: 60% which we are manufacturing.

Mirae Speaker: Just for industry. Or for others

Ashish Saraf: And earlier it was around 56%, 57%

Mirae Speaker: 58% was last year’s report, 60% is local manufacturing.

Ashish Saraf: So that's why I am saying 1% or 2% is again, you will, you should see because there are KFX investments happening in this entity also. That should over a period of time and with the make in India group calling out India especially that they want to invest more in India that would help.

Mirae Speaker: This means that the world group was a task to increment the money more aggressive.

Ashish Saraf: See the thing is again when you do localization there is an again from SKF India 16% there is non-listed entity

Mirae Speaker: So, I mean on a normalized basis from Q4 onwards, can we expect the double-digit growth in revenue, because there were certain

Ashish Saraf: See, I can't give you an outlook, but I can tell you internally we have plans to grow double digit. That's -- we are naturally, as I said, GDP growth in 2024 is expected to be 6%-7% in case it's 4%. We're not really growing.

But if you're not growing at 11%-12%, then you're not justified. Again, having said that, we are also operating in a volatile economic environment, right? India is an outlier. If you look at how exports will play out for our OEM suppliers and all that, that is only the time will tell. We don't have that visibility. In terms of our plans, we have plans to grow, at least at that pace.

Mirae Speaker: If you snap your industrial portfolio versus the opportunity set in India, where is it that you need to spend the net? Do you think you're covering more through manufacturing?

Ashish Saraf: See, from a market perspective, we are covering all the sectors. I don't think that's an issue, right? Definitely, we can gain more market share if we can be more, like say for example, in the freight business, we can be a lot more competitive and we can gain a higher market share, as long as we get the right pricing for the product.

Mirae Speaker: Again, is there some issue there?

Ashish Saraf: See, we are maintaining a reasonable market share there, but we are not very aggressive in terms of gaining a higher market share, because it has to really give us good returns, right? If it's not giving us good returns, then we are okay with that share going to our competition. So, like this way, there are certain pockets where internally we are focusing on how we can improve our operating efficiency before we gain a higher market share.

The market is available, but we're not going after it financially, it will not make sense.

Mirae Speaker: When you say, I mean, for the rate, for instance, this is manufactured in your own estate? It's just manufactured in the estate. Does it mean you get just the trading margin?

Ashish Saraf: We get the trading margin, but the point is that, okay, even if I get the trading margin, overall, my profitability, you might say the 1% points are coming down, but there is a top end addition, t

Mirae Speaker: But if you are leading in India versus whoever it is, how can you be so uncompetitive? What's your market share? I mean, how much are you targeting it? There is no top down?

Ashish Saraf: No, no, no. So, we have a market share of around 10 to 15%. We can gain higher market share, but the price points are not very lucrative. That's what the current situation. So, we are trying to see how we can kind of bring in more cost efficiency in the product in terms of sourcing components, changing designs, things like that.

Mirae Speaker: And in the passenger?

Ashish Saraf: Passenger and all, we hold good market share.

Mirae Speaker: Again, it's made by your...

Ashish Saraf: It's made by our... But typically, we have a market share of more than 40%, which is a good market share.

Mirae Speaker: The prospects say it should be equally good, right? The prospects say it should be equally good for passengers.

Ashish Saraf: Yes, yes. With plane 18 and all that, we're all there, so the prospects are all good. And even as a sector, we expect to go in that direction.

Mirae Speaker: Well, we didn't, you know, we've got this positive virus and all that, you know, the difference in localization, etc. But I'm sure they also have the cognizance of where is it that they're losing out in terms of cost structure.

Ashish Saraf: Yes, yes. That's what I'm saying. So there are a lot of internal initiatives which are ongoing, right, in terms of ensuring that we get a right costing for our firms, right? And secondly, as I said, the focus of each and every region, they also realize that for us to serve the market better in India and Southeast Asia, it makes sense to localize. So, over a period of time, automotive is almost 95% localized. Industrial, you will see a significant localization.

Again, some of it might happen in certain entities, some of it might happen in the other entities. But from a region-to-region perspective, there's a significant focus on localization and improving productivity and improving the cost efficiency so that we are better placed in the market. But having said that, we don't want to focus, we don't want to drop our markets, right?

So, there is a constant focus on constantly looking at our portfolio, looking at our returns at a product level, at a customer level to see how we can further rationalize it, ensure that we are getting the right price from our customers to improve our markets.

Mirae Speaker: So, in terms of just localizing, that would also improve backward integration. Your magnitude of capex versus competition, I think, would be lower. So, should we expect to see a step-up? And then we look at that positively, given the circumstances.

Ashish Saraf: So again, what we see in the capex investment is only SKF India, right? There are also capex investments happening in the SKF engineering entity. So, I don't know, I mean, I'm not looking at specific competition data in terms of how much capex they are investing.

But we have made, in terms of capex decisions, we have made a lot of capex decisions for this region, right? Especially in the last one year. A lot of those investments are in pipelines, happening through the listed entity or through the non-listed entity or happening in Southeast Asia to cater to this market demand.

Mirae Speaker: They are all in the public domain or we should expect to hear more from SKF?

Ashish Saraf: Again, I don't think, I mean, these are investments, there is no big one-shot investments that can make a decision, right? It's more of, okay, we evaluate a product, we look at what is the market demand, we look at whether it makes sense to manufacture, and then we take a decision on that. So, considering all of that, there are a lot of capex investments.

Decisions have been made. It's not one single specific region, okay, we're setting up big manufacturing. So, there's not, I don't think there's going to be any specific communication around that. But in general, then actually the focus is region to region. So, we are constantly looking for...

Mirae Speaker: Do capex, announced capex per annum is...

Ashish Saraf: For the listed entities, around INR150 crores. If you look at calendar year, we've spent INR150 crores this year. So, we kind of expect that...

Ashish Saraf: That range should...

Mirae Speaker: That range should run. So, this region-to-region strategy, export, can it go?

Ashish Saraf: We see, any investment that we are making, we are making for India and Southeast Asia, right? So, if an investment is made in the listed entity in India, we will look at the entire India and Southeast Asia market, and then accordingly, basically decide, right? So that could trigger some improvement in exports.

Mirae Speaker: And how should we look at this leadership, right? Like Manish now is...

Ashish Saraf: So, Manish continues to be the MD for SKF India, right? He was also India and Southeast Asia president for the industry business, right? So that role has moved out and has become America president, right?

So now we are basically hiring a replacement for him. The replacement is expected to join sometime in the second quarter of this year. So, when I say second quarter, it means calendar year second quarter. And once that then basically... Once the person joins, then it's a decision about what will happen, whether Manish will continue or disperse.

Mirae Speaker: So, it's a decision-making when Manish is taking the call, because he continues to be the MD for SKF. He still continues to be the MD until you buy it. Or like.internal or external

Ashish Saraf: I guess that is something that I don't really appreciate.

Mirae Speaker: Generally, I mean, it seems to happen that on a vocational basis, people keep on moving out, being exposed around. But overall, I mean, I think to understand that some of it might be one of, let's say, two, three... But in general, how should we look at three, five-year picture? I mean, given their country...

Ashish Saraf: From a future perspective, I mean, you know as much as I do, right? In a sense that we know Indian economy is overall doing well. If it continues to do well, I don't see a reason as to why we will not do well.

We have our strategies in place where the group focus is on India or India Southeast Asia. India Southeast Asia continues to be the best performing. If you look at the group results, India Southeast Asia continues to be an outlier compared to Europe and America, right? There, they've actually had a volumetric lag, right? And most of the growth has come from predominantly pricing actions, right? Whereas India Southeast Asia has been growing, right?

So, there is a lot more focus and that's why more investment is coming in from a group perspective. And I don't see that changing unless the global environment changes or changes in India, for instance. Otherwise, the overall story continues to remain the same.

Mirae Speaker: And when we look into the margins, on a four-year basis, given Q2, let's say Q3, let's say Q4, this year, whatever additional we might have in the last calendar year might not be there.

Ashish Saraf: See, I would say the way you should look at it is the last year was a blip. Blip on the positive side, which is now. Which is getting normalized.

Mirae Speaker: 15-16 is the number?

Ashish Saraf: That's a reasonable prediction.

Mirae Speaker: But 15-16 is after letting go of a lot of business ventures?

Ashish Saraf: I told you, right? The portfolio management is relatively... If you are trading on that product, you continue to trade on that product, right? So, portfolio management has relatively no impact because your margins are the same. It doesn't matter. Even if I make a wall-to-wall loss on a particular product, SKF India, another traded margin occurred, we'll have to make a certain marketing margin, right?

So, if I do portfolio management and improve my margins, I will still continue to make the same margins. So, the risk is less, right? On both the fronts. So, if you make more money, you still make the same money. If you don't make any money, you still make the same money. Right? That's how it is.

Mirae Speaker: No, no, sorry. This is the last sentence. I actually got confused. Sorry. So, I am saying that for the traded business, you are a marketing company. Right? Since you are a marketing company under the price pricing rules, I have to make a certain margin irrespective of whether wall-to-wall margin or not.

Ashish Saraf: Whether the parent is making money or not. That's right. So, if a parent makes a higher margin, SKF India is indifferent to it. If a parent makes a loss, SKF India is indifferent to it. That's what I said.

Mirae Speaker: So, the decision is taken by the parent, I think?

Ashish Saraf: Decision for what?

Mirae Speaker: To prune out certain businesses?

Ashish Saraf: We have to take a decision because it has to make money for SKF, right?

Mirae Speaker: Group alone?

Ashish Saraf: Not just for the resident because group is just artificial margin, right? We don't look at when you are taking a business or not taking a business, you look at the overall margin.

Mirae Speaker: But ideally, pricing on traded products is anyway defined by the cost structure of the group. Because it is anyway cost. So if their cost of manufacturing goes up, you are still making the same sort of a loading on that. And as a result of this, if you become uncompetitive in the market.

Ashish Saraf: You never price like that. That's what I am saying. We look at wall to wall margin. We don't look at SKF India margin.

Mirae Speaker: It is group plus. Can exchange rate also make a difference? Does it make the calculation very volatile in a quarter-to-quarter ratio?

Ashish Saraf: See, on our imports, Understand, on the traded products, the FX risk is not borne by the listed entity. Right? The FX risk is borne by the manufacturing entity. So even if the FX goes in the negative direction, which it has gone in the last quarter, I will still be making the same margin what I was making earlier. So, they will have to pay me for the higher cost. Or reduce the cost. Constantly affects the lower cost.

Mirae Speaker: So, Ashish, just one more thing again. One thing you are saying, wall to wall margin. And second, at the same time, we are saying, India entity margins are indifferent of what let's say parent is. We will still keep on earning certain percentage.

Ashish Saraf: That's what I am trying to say.

Mirae Speaker: But then both things are in a way contradictory?

Ashish Saraf: No, it's not contradictory. When you take a business decision, you don't take a business decision, you take a business decision in a coded manner looking at wall to wall margin as to whether the company would be making money.

Mirae Speaker: So just let's say in a very plain hypothetical number, let's say 15% is the markup by the parent entity while supplying. So, if they are making 15, they are letting you make 10. So, world-to-world is 25.

But at the same time, because of their pricing, costing and all, suppose 15 becomes 10, maybe for a quarter or maybe in the interim, they are ready to process it on and on. Yours will still remain 10.

Ashish Saraf: Mine will remain 10 even if for them it becomes minus 10.

Mirae Speaker: But then wall to wall margin will change?

Ashish Saraf: Wall to wall margin will always change because it is dependent on the market pricing that I do. That decision is with me in terms of what pricing I sell the product to the customer. Now if wall to wall margin becomes negative, I still make my 10 and the group makes minus 15.

Mirae Speaker: Well, the group shouldn't trade in that. Then you have to raise the price entirely still. If it works, fine. If it doesn't, it doesn't matter.

Ashish Saraf: Because at the end of the day, it has to make business sense.

Mirae Speaker: So, if you make your 10 and the group still makes 0 because it is minus 10 in the group.

Ashish Saraf: Because it still makes sense for SKF because we are still making 10.

Mirae Speaker: You are making 10. It doesn't matter?

Ashish Saraf: As SKF, we are making 10. We look at wall to wall. That's what I said.

Mirae Speaker: You are making 10 but it is minus 10 in the period?

Ashish Saraf: Then it doesn't make sense because SKF as a group is not making anything.

Mirae Speaker: SKF as a group has to make. If it is 10 in total, which is your 10 and group's 10?

Ashish Saraf: It doesn't matter which company makes what money. The bigger question is, are you making money? If you are not profitable, then you don't do that business.

Mirae Speaker: And this quarterly lag in passing on and on is a function of?

Ashish Saraf: It is a function of all of this.

Mirae Speaker: What is the threshold for wall to wall ? Do you have to make without letting go of business?

Ashish Saraf: As I said, we have to be profitable. We want to do profitable business. [If it is a long-term benefit associated with it. So that is a strategic call that you make. But broad guideline is that it has to be profitable.

Mirae Speaker: Just one last question for me. Which is on the EV side. I think your parent does some work for some other global players. How is the positioning there?

Ashish Saraf: On the two-wheeler predominantly, there are two big players, Ather, and Ola. They are already constantly engaged. They are already buying from us.

Mirae Speaker: What about Bajaj?

Ashish Saraf: Bajaj is also buying from us.

Mirae Speaker: TVS?

Ashish Saraf: TVS, I am not sure. I will need to check. But we are engaged with all the EV players.

Mirae Speaker: The response is satisfactory?

Ashish Saraf: The response is satisfactory. We don't have any issues. In fact, that is going really well. Is there any competition? There will be competition. But that is going well. Similarly, on the four-wheeler space. Against four-wheeler, the scope is relatively limited. Because predominantly Tata, Mahindra and some other Maruti.

But we are working closely with them. All the product development. We will be part of that overall.

Mirae Speaker: You can participate?

Ashish Saraf: Yes. We don't see it.

Mirae Speaker: This is coming from the listed.

Ashish Saraf: The automotive is entirely...

Mirae Speaker: This was a new age. Maybe a differentiated product?

Ashish Saraf: Yes. Sorry. Yes.

Kotak Chasing Growth, 2024

February 21, 2024

MANAGEMENT: MR. ASHISH SARAF, CFO

HDFC speaker: You said that we will be finalizing this MD, the new MD, declaring from the board meeting, but I think most of it is...

Ashish Saraf: No, no. I think the change in the MD only happened after the board meeting, right? So, basically in the second quarter is that problem. So, Manish continues to be the MD for SKF India, as I said. We are trying to onboard a new person. That person should hopefully come on board in the second quarter. When I say second quarter, calendar year second quarter. And then hopefully the transition will happen.

HDFC speaker: Two more quarters is...

Ashish Saraf: This quarter definitely is here, next quarter some part of it is there.

HDFC speaker: So, how do you look at the market? I think there has been some sluggishness in the market for us. So, any specific segment or...

Ashish Saraf: See, one was -- See, especially if you talk about Wind before, right? One was, basically we did a lot of customer pruning work, right? In the calendar year 2022. We started it off in 2022. But in 2023 is where you see an impact. Where we decided to not do certain business, which didn't make financial sense for us. Right? So, because of that, Q4 was a bit lower, right? Because H1 was much heavier, because we still had orders in place from last year.

Whereas H2, since we exited Wind -- Second is, we've seen some slackness in the distribution market, right? One was because of -- Like we were in the process of renewing contracts, there were big contracts with some of our big, large customers. Which took us some time, that impacted the volumes, right? So, that had a bit of impact. Then on the automotive side, we had some impact. The automotive -grew very well. But on the aftermarket side, we saw a drop in the volumes, right? So, that is where we've seen some drops. But I think we are already taking course-corrective actions.

HDFC speaker: So, there are 2-3 impacts. One is the pooling of customers. So, how much -- what is the wind percentage?

Ashish Saraf: Wind percentage earlier, it used to be around 7-odd percent. It's come down to around 4.5%-5%.

HDFC speaker: How this will be steady state?

Ashish Saraf: It will be steady state. Again, we may not expect wind to grow at a very, very good pace. The other segments will grow at a much faster pace compared to that.

HDFC speaker: Is it? I mean, a lot of other competitors are still betting big on wind. So, is there some issues internally? I think the volume, efficiency, productivity, etcetera.

Ashish Saraf: So, again, there are a lot of projects ongoing internally, next year also. So, we'll see how we can make wind business more profitable. So, again, I don't know what is the competition strategy.

But from our perspective -- see, one of the challenges of the wind business that we have had is wind business traditionally with us , right, for the OEMs, as well as for the Tier 1, Tier 2 suppliers, that we have not made a substantial amount of money. So, this is like a challenge from an overall industry standpoint.

From an SKF perspective, in the past, we were probably to continue to grow the business without really looking at our margins for Wind business. That is, in the last couple of years- there's been a lot more focus on looking at product margins, looking at customer margins, and then ensuring that we are doing profitable business for the company. And that is where we are moving and kind of going back to our customers and asking for a higher price.

So, in some situations, customers are giving us better pricing , in some situations, customers are asking us to exit - We are also looking at how we can, let's say, for example, for the wind, we have a significant amount of localization, - But we still continue to source a lot of components from outside of it. So, we are working on how we can further localize that and so that we can kind of further improve our costs.

Ashish Saraf: Again, I don't know the specific number of winds, but wind localization is good overall. At a product-finished goods level, but at a component level, there are components that we continue to localize. And so, especially in Europe, because of cost escalations, in the last couple of years, that impacts us.

HDFC speaker: So, how will you compensate this 2.5%-3% cost in the top line?

Ashish Saraf: So, again, other segments are growing pretty well. So, again, overall, again, we are not allowed to give it, we don't give any formal forecast on that, but our intent or our objective is to grow GDP plus inflation, plus in some markets grow faster. So, that is what we generally strive as a company to do our job right now. That kind of remains as is, provided the demand continues to remain strong in the Indian market.

You also have to realize that a lot of OEMs are exporting out of India. We are seeing that the global demand is shrinking, especially in Europe. So, if that will have some impact, then naturally it will have an indirect impact on this area. But from a brand perspective, given the current situation where we are, we expect to be growing around 10% to 12%.

HDFC speaker: Because your global growth forecast is not the opposite. For the next 5-6 years, that is what the world has given us. So, I think we are really emerging markets.

Ashish Saraf: Should be higher.

HDFC speaker: Anything which is scaling back in this course of time, which has some segments like that?

Ashish Saraf: Two -wheeler is doing really well. We see that it will continue to do well. Our share of business continues to improve in the two-wheeler segment. So, we have high expectations for the two-wheeler segment.

HDFC speaker: What do you mean by broadly? What is your market share?

Ashish Saraf: Two-wheeler, our market share will be close to 25%-30%.

HDFC speaker: This is across most of the OEMs or some OEMs?

Ashish Saraf: Some OEMs, we don't have a good market share. But with some OEMs, we have a very good market share. -, Bajaj -Enfield -Honda.

HDFC speaker: I think you have a plan in also as well. TVS, do you have some knowledge about expanding market share?

Ashish Saraf: No, not very significantly. Bajaj, I mean, typically they -- the way I understand it is that the suppliers were kind of aligned to a particular OEM. And from an SKF perspective, the price points at which we want to sell, the OEM should be willing to pay us that price. So, that relationship that we have with Bajaj, is pretty close to where we are in turning and all that. Whereas with other OEM suppliers, it's not like they have relationships with other suppliers.

HDFC speaker: Manish has talked about the proper focus on the EV side as well.

Ashish Saraf: I think that continues to be there. The EV continues to do well for us. We have strong relationships with Ola and Ather. These are the two big players on the automotive side. On the four-wheeler side, it's Tata and Mahindra. And in there, we have two -- so, all these four players, they continue to work in terms of key product development and participating in all their new products.

So, from a positioning perspective, we are well placed. The market share in terms of volume still remains very small. Right now, when you compare it to the overall ICE engine market. So, that is not something which is kind of significantly impacting or we're seeing a significant shift in volume.

HDFC speaker: With Bajaj's export start picking up, then?

Ashish Saraf: The volume should further pick up. So, that's where, as I said, if exports, all of our OEMs are dependent on exports. We don't directly see, because our export numbers are relatively small, we don't have direct export numbers. But a lot of these OEMs, both on the industrial space as well as on the auto space, they do well. And India continues to do well.- then the growth numbers that we talked aboutshould happen.

HDFC speaker: So, what is the industry overall now? Right now, this, as an aspiration to grow industry is around 2% higher.

Ashish Saraf: See, industrial is 50%. Auto is around 40%-41%. And exports are around 8%-9%. That's the stat. Currently. Industrial growth was not so great in the last quarter. Automotive grew at a much faster pace compared to industrial. But I would say that was more of one quarter. Our growth should be higher in industrial, as we move forward.

HDFC speaker: Within industrial, what are the process industry distribution?

Ashish Saraf: Distribution is around 50% of industrial, right? So, again, we are looking at growing our aftermarket at a much faster pace compared to the OEM market. So, I don't see any change there.

HDFC speaker: So, the 1%-2% incrementally every year we are targeting industrial sale to go up. So, that would be predominantly from the aftermarket?

Ashish Saraf: It should be from both, right? Because for a long-term growth to sustain, the growth has to come from both. Because once you sell in the OEM, then only you will get a replacement market. If you don't sell in the OEM, you are not going to get a replacement market. So, we have to drive growth across both. Both the sectors. Barring wind, all segments as such, you should see good growth as we move forward.

HDFC speaker: Railway, what is the contribution right now? How do you see the market?

Ashish Saraf: So, railway, overall, is a lucrative market. So, railways, if I look at my market share or my overall 100%, my railway business is around 7-8 percent. That should continue to grow. We are, in terms of railways, on the passenger side, we are very well positioned, and we have a good market share of 40% plus. So, we continue to maintain our growth. On the freight side, there is no issue on the product. The product is available. Everything is approved. However, relatively, our market share is relatively lower.

Because the price points are not so great. So, we are working on that to see how we can further improve our market position and make sure that we get the right pricing for our products.

HDFC speaker: Now, we are on a conditional vendor. Because earlier, I think…

Ashish Saraf: So, there are no issues. We are -approved vendor for Class-E . We are actively working with all the private wagon builders as well as for the railways, trying to find replacement bearings. That's not an issue. It's more of, are you able to command a good price? We are well positioned. We are already part of it. We are already supplying.

HDFC speaker: So, is there a possibility that this 7%-8% because the way the effects of ordering on the railways happen, I don't know what is the pace of production, but in terms of ordering, I think they are giving 90,000 to a company…

Ashish Saraf: Yes, but as I said that freight is, we are being cautious, right? Because we don't want to do, we are maintaining a reasonable share there as we internally get our costs right, work with our customers to get the price right and then gradually increase the market share.

HDFC speaker: And coaches may also grow, right?

Ashish Saraf: Yes, yes. So, that all is, we are in a good shape that we continue to, if the market size grows, so whatever minimum 40%, typically the tendering process is there, so you are likely to get 42, whatever, 40, 60, max is what you can get.

HDFC speaker: So, as of now, there's two vendors or three vendors?

Ashish Saraf: I don't know the specific, mostly it's two, right? There are some areas where there are three vendors.

HDFC speaker: Metro, how they are positioned?

Ashish Saraf: Very well-positioned. They have a similar market share. But market itself is relatively very small, right? It's not going to; it will take some years once all the metros come back.

HDFC speaker: How is the market, how big is the market as a whole for metro area?

Ashish Saraf: Metro, I don't have the specific number. Overall, the rail market, the last I saw was around INR1000 crores. Overall, freight plus passenger plus.

HDFC Speaker: How are the investments going in?

Ashish Saraf: Again, annually, annualized 15%.

HDFC speaker: And now there are a lot of steel plants, etcetera, so how do you see…

Ashish Saraf: Again, a very good market. They're very well-positioned. They're working with all the OEM players to gain share there. So, no issues on that front. Going very, very well. Last year, we already, like our metro business group, worked closely wihth all the metro OEMs, to get a good share. And again, this year also, we continue to expect much higher profits. So, as I said, infrastructure-led, if the environment remains as it is, and exports improve, we expect that this growth to continue. .

HDFC speaker: So how big is the metro market?

Ashish Saraf: See, metal, the way we are posing, see metals has got a very big aftermarket. So, if I exclude, because I don't have a specific aftermarket number, but in terms of the direct business that I do, which is initial investment, that itself, overall revenue size is almost 2%-3%. Pure, only metals. Only metal only.

HDFC speaker: That is steel and aluminum?

Ashish Saraf: Only steel. Predominantly steel. The aluminum, there is a small, but relatively, compared to metal, compared to steel, it's relatively moderate, 5%-10% or more.

HDFC speaker: That's it. How do you see, I'm just trying to understand the market. if the new plant is commissioned, so how, so initially there will be some...

Ashish Saraf: See, initially, like whenever a new plant is getting set up, right, like say for example, the JSW is setting up a new plant, right, so they will work with an OEM, who has to supply machinery. So along with that machinery, there will be bearing suppliers, which will happen. we will work with OEM team, with the Tier 1 supplier, and we supply it to the Tier 1 OEM manufacturer, who will supply it to the end user, which is JSW, right, and then JSW already has a contract with us, say for example, and they will buy from us, and in the aftermarket, once they start using, or once they start, by like basically manufacturing steel, out of that plant, right, so that's how it works.

So, when I talk about OEM, that's the initial supply that we need to be, when the new equipment, equipment comes, then you need the new equipment. And that is where, I think last year, there were a lot of investments, which we can continue to talk about this year as well. So that is where we, like, we continue to do pretty well. And that will have a natural effect on the aftermarket, I want to go and change the gear. Yes, that's it.

HDFC speaker: How fast is the manageable going to do that?

Ashish Saraf: I mean, it varies from bearing to bearing, right, like some bearings will have a life of, one month, some bearings will have a life of three years, depending on the size.

HDFC speaker: So, suppose, in a 10 million plant, two-year-old, or three year, four-year-old, how much bearing metal consume?

Ashish Saraf: Iwill need more data, but see, it's consumable, right? So, they keep on, see, typically all these big players, they will work with our distributors. The distributors will stop all bearings. They will either go and go VMI, right, or, they will have close relationship, with, so they will supply, as it may be needed. So, most of our sales, then, it goes to our distributor network. They will understand what the pattern is, and they will kind of source it from us.

HDFC speaker: Where do you have direct contact, let's say, with the servicing part as well?

Ashish Saraf: So, that is where we basically work with, the end user directly, where basically the promise is that we will help them improve the product, reduce the breakdown time, right? Which will help them, as their production. And the way we price our products is based on production, right? So, if there is a steel plant, we will say how many steel, like you're producing, it's good steel, and this is the rate that we would like. If we improve it, we will get better value.

If we do not improve it, we will still incur the same cost, or similar cost, or more cost, we don't make. So, higher the risk, higher the return, basically that's the concept. And, in that way, the end user, or the steel manufacturer, is able to get a better return on the repair and maintenance of the consumables, right?

That we are, you know, that they are spending. Plus, they are able to improve, the overall efficiency, they are able to use our technical expertise, give them the right guidance, in terms of right, kind of, maintenance.

HDFC speaker: How many sites do you have, as of now? Okay, I don't think, in terms of revenue, is it around 1%?

Ashish Saraf: See, overall, the way now, we've started looking at, is that, we look at, overall services revenue, so that's 5% plus, right? Additionally, what we're focusing on, is, ensuring that we do, a lot of value selling, with the existing network, that we have, along with the application.

So that, customer understands the customer selects the right product, that it needs, right? So that the customer sees value, and is willing to pay, a higher premium to us, compared to competition.

HDFC speaker: So, this 5% service revenue, is predominantly, network or…

Ashish Saraf: No, it's a mix of, such as, REP , railway Reman so it's complete, services there.

HDFC speaker: And now, what about the other, processes, maybe, cement, etcetera?

Ashish Saraf: You know, as I said, these are all infrastructure there, we have a woodshed there, we continue to build, woodshed, we have well positioned, both the aftermarket, as well as with the OEMs. So, barring wind, as I said, all sectors, again, we see some challenges on the textile sector, because of, I think, they are expecting, the new government, to form, and sort out, some of the challenges that the sector itself is facing. But barring that, we expect, all sectors, for all segments, to be distributed, barring this, and as I said, wind is one sector, where we are constantly, deciding, the sector is growing, but…

HDFC speaker: So, apart from metal, what are the bigger segments, in industrial, in the OE side, of distribution?

Ashish Saraf: See, on the OE side, as I said, one is general machinery, which is part of, it's a combination of, a lot of sub-segments, which is, sorry, which is, fluid power, drives, pump and motors, textiles, agriculture, all of that is, basically, part of, general machinery. So, that's a pretty big, I think, almost 8% of our total business.

HDFC speaker: 16% of your, industrial business…

Ashish Saraf: 16% of the industry.

HDFC speaker: That segment is, based on, sluggishness, as I found.

Ashish Saraf: So, there are sluggishness, in pockets, as I said, textile is one area, where we have issues, or we continue to see, some issues there. A lot of, these companies, sometimes, depend on exports. So, they have sluggishness on the export side, because of the global economic situation. Then, that impact will come to us. So, it's a weeks back. I cannot say, okay, all subsectors, within that. But, overall it's a relatively, okay, not alarming, or anything concerning.

HDFC speaker: So, as I want to join, maybe, so, just want to get, an overall sense, on the industrial side, because there is, much activity, etcetera going on. So, how are you…

Ashish Saraf: This position, as I told them, right, we see, typically, the industrial is,

HDFC Speaker: roughly, 50% of the business.

Ashish Saraf: Roughly 50% of the business, That's right. So, barring wind, we expect all segments in the industry will distribute, right. And wind also, is consciously, decided, because, of the customer, exercise, that they have taken, last year. Right. So, it should grow from last year, but you will not see a significant growth, because we have been, consciously, taking on a profitable business. Right.

Other sectors, we expect, that the way, the Indian economy, is performing, we should continue, to grow, our minimum, and GDP plus inflation, as we should create, some market share.

HDFC speaker: Overall, or in industry?

Ashish Saraf: In industry. Automotive is also, pretty much, on the same lines, but automotive, I would say, 2-wheeler should grow, and aftermarket should grow. Right. 2-wheeler aftermarket. Whereas looking at commercial vehicles, and tractors, and all, that market, might remain, relatively, stagnant.

HDFC speaker: When you think about it, over the next few years, so not really this year, as such. Is it fair to say, of course, you'll have some years, with volumes, you'll have a better years? So, two questions, in this. One is, in the next 3-4 years, will the industrial segment grow faster than auto? Is that a fair statement to make?

Ashish Saraf: That's a fair assessment.

HDFC speaker: And margins are, better, in industrial, versus in auto?

Ashish Saraf: See, wall to wall margins are better, in industrial, compared to auto. But, from an, SKF India, perspective, your manufacturing margins, are better, compared to, traded products. So, your traded products are more in industrial, currently, compared to, automotive products.

HDFC speaker: But, when you put the whole pie together, then industrial margins, look, because as you said, industrial component, is much higher. So, when you look at it, 50% of the business includes, obviously, trade business. 50% is non-trade, which is the auto business, and the export business, and so on.

Ashish Saraf: So that's something, automotive makes high margin, from a, from a local, standpoint. But wall to wall margin, as a company, is better, in industrial.

HDFC speaker: When you say, wall to wall…

Ashish Saraf: At a group level.

HDFC speaker: No, I mean, at an SKF India level…

Ashish Saraf: At an SKF India, manufacturing will make, a higher margin.

HDFC speaker: In industrial, versus auto?

Ashish Saraf: That is right. But the mix of automotive and manufacturing is much higher, compared to industrial. So, if you look at it from that perspective, your margin, in auto, will be higher, compared to, industrial.

HDFC speaker: How much will be, manufacturing output?

Ashish Saraf: 90% plus. In industrial, localization is around 35%.

HDFC speaker: So, 65% is, trade.

Ashish Saraf: 65% is trade.

HDFC speaker: Is this going to change, in the next three, four years? Sorry, just one question. When you just look at it, the aftermarket is a relatively stable business. Both, in both segments.

Ashish Saraf: That's right.

HDFC speaker: So, on a steady state basis, what should, aftermarket do? Because that doesn't change much. Because you've got a backlog of installed vehicles, which drives the demand.

Ashish Saraf: That's right.

HDFC speaker: So, normally, aftermarket grows at what pace?

Ashish Saraf: So, more than double-digit. Now, that is what we expected to grow. Right? We expect aftermarket to grow, at a much faster pace, compared to, the OE. Because OE will grow, depending on the capex investment that that one is making, and how the market is behaving.

Whereas, as you said, aftermarket will grow, based on the installed pace, and it's also dependent on what is your reach, what are the products, that you're introducing, what is your range, and all of that. So, we continue to focus on that. So, that we can grow, at a much, typically, our expectation is, aftermarket should grow, at a faster pace.

HDFC speaker: Last few years, I think, we have also focused on this aftermarket growth. So, is there some effect of this visible to you?

Ashish Saraf: Yes, I would say, but again we continue to make further inroads, right, in terms of, like in the automotive space, we continue to enroll mechanics, retailers, increase our reach to gain market share, right, as well as driver growth. On the industrial side, we are focusing a lot more on value setting, where we - engage with our distributors to build capabilities so that they can kind of suggest or recommend the right solutions. So, they become solution sellers rather than just being distributors to the large end customers. We saw some positive results of that in 2023 and we expect that to continue to make investments in that area.

HDFC speaker: And how is Railways doing now?

Ashish Saraf: Railways is doing pretty well.

HDFC speaker: Railways is housed, within industrial ?

Ashish Saraf: Railways is housed, within industrial.

HDFC speaker: Railways is 7% of industrial . Or 70% of Railways?

Ashish Saraf: 7% of Overall

HDFC speaker: So, again 60% of industrial. If you just, specifically market-share…

Ashish Saraf: No, we covered that.

HDFC speaker: So, this has a good market share with passengers, but they are struggling with freight because of the pricing. Is there a chance that the government is now spending more on the passenger side versus the freight? I mean is there any?

Ashish Saraf: No, I think it was, you know, they just want to change the entire sector, right? So their first focus was freight because they wanted to make sure that there is hardly any commercial which was happening on freight, right? Commercial was being overpriced and passenger was being subsidized, right? Whereas globally if you look at, commercial is priced correctly and passengers are where you charge more to the customer, right?

So, in India the market was different. So now they are more selective, and they have more investments from the passenger side as well so that they can drive the right pricing from the end users, right? So now that because of that they must do that. To me both are separate. I don't think they are equally good.

HDFC speaker: And how should one look at profitability because there's been a lot of variance across supporters for supporters' goods and supporters bad or supporters for some improvement. So, it's been, I mean partly RM impact, billion impact, inventory impacts…

Ashish Saraf: See predominantly the impact on the traded goods, right? Manufacturing you might see like quarter-to-quarter differently on the cost of goods and the prices, pricing. You might see some impact like one or two, 1% here and there, but predominantly the impact was from the traded products, which is purely a function of your transfer pricing, right?

HDFC speaker: Is it transfer pricing or is it mixed?

Ashish Saraf: Transfer pricing.

HDFC speaker: Transfer pricing has it changed in some way?

Ashish Saraf: Transfer pricing over a period of one year will not change. But quarter to quarter, you might see impact because the way we do our pricing, the way we do our transfer pricing is based on a Transaction net margin method, right?

HDFC speaker: Okay.

Ashish Saraf: So, under which basically what happens is that you have to maintain a certain level of margin because you're a marketing company. I don't know what price I'm going to send to that customer, right? I buy the product looking at the previous trend of my pricing as well as the previous trend of the costing. And you look at what is the price increases that you are taking now.

If your price increasing actions do not come in line with the cost actions, your margin might drop. Or your pricing action might be higher than your cost actions, then your margins might improve in a particular quarter.

HDFC speaker: And then you have to adjust it?

Ashish Saraf: And then I have to adjust it in the subsequent quarter over a period of time. But over a period of one year, we make sure that we maintain the right margins for the product.

HDFC speaker: So, over the course of a year, transfer pricing doesn't change much.

Ashish Saraf: Over the course of a year, transfer pricing.

HDFC speaker: Or quarterly, depending on like you said.

Ashish Saraf: Because it's a month-on-month transaction. And I don't have visibility of the external pricing, right? External pricing is what it will be depending on what you will do.

HDFC speaker: Yes. But when you do your costing, do your costing based on the historical trend, right? In terms of how you're pricing this?

Ashish Saraf: This happens every 2-3 years. See, again, I would say 2022 was an abnormal year. If you look at our margins, our margins were very, very high because we were taking a lot of pricing actions. Whereas the cost was relatively increasing. Even though the actual cost was much, much higher because we were dealing with significant cost increases in 2022.

So, there was a constant increase in the input cost or the traded cost. So, over a period of a year, the pricing actions have slowed down as we move into 2024. But your cost actions have maintained. So that's when you see that you reach a line where it doesn't make sense. And then you remain post-corrective. So now it's post-corrective.

HDFC speaker: At a company level, how should one think of margins?

Ashish Saraf: See, I would say you should look at margins between 50%-60%.

HDFC speaker: What was it?

Ashish Saraf: PBT.

HDFC speaker: Yes, PBT.

HDFC Speaker That was one of our pre-assumptions. I think EBITDA and EBIT doesn't change too much, right?

Ashish Saraf: See, we hardly pay any interest, right? Only depreciation.

HDFC speaker: Only depreciation is how much?

Ashish Saraf: Depreciation, depending on the investments, right? Investments are not significant at least. So, it's more or less the same. Other income will go up because cash accumulation…

HDFC speaker: So when you look at PBT, you improve other income or you don't? When do you look at PBT, your other income improves?

Ashish Saraf: Yes, PBT is what you see as PBT. It's not operating profit.

HDFC speaker: I think EBITDA level, it should translate at 17 or something?

Ashish Saraf: Yes. I don't the calculation because generally we don't look at EBITDA…

HDFC speaker: So when we talk about the industry, we said around 65% is still traded. So, can we see in the next 3-5 years?

Ashish Saraf: See, it will happen, but it will not be like – see one is, from an STL strategy perspective, we have a strategy of region for region, right? And our region is India and Southeast Asia. So, when we take an investment decision, we take an investment decision based on business requirement for this region, right? Now, once we take a decision, then we say, okay, where do we have, where does it make business sense to make that investment?

So, in terms of demand, we look at Southeast Asia demand and not just India demand. And then we decide where the demand is. If the demand is more in Southeast Asia for that particular product, then in India, the supply chain network is better placed in Southeast Asia. The cost input is -- so then we would set up a manufacturing in Southeast Asia, right?

If it is a relatively large size, where the capability is lying, and the manufacturing, which is the other unlisted entity, then the listed entity here, then we might decide to make an investment in that factory, because we already have the infrastructure to support that additional channel, right? So, looking at all that, we will make an investment.

So, from an overall perspective, our localization will -- there's a specific focus region for region, our localization will increase. However, from an SKF India perspective, which is a listed entity, you might see small percentage point improvements, right? Because not all investment is going to SKF. A part of it might go to SKF engineering, a part of it might go to the entities in Southeast Asia.

HDFC speaker: Last year, if I'm not wrong, I think it's January, Sylvia Richie, your global CEO said, you might have 16 or 18 grand in India in the next decade.

Ashish Saraf: That was the ask of a politician. You were there?

HDFC speaker: Yes, I was there. Do you have a change in the show China thing? Is it impacting India at all? In any way outsourcing, is it a change or is it just business?

Ashish Saraf: No, no, definitely there is a significant -- at an SKF perspective, as I said, we are focusing more region for region. So, we are not looking at importing stuff from China. We might import...

HDFC speaker: No, I'm looking the other way. As opposed to importing from China and other geographies, we are importing from India because that's a more stable environment.

Ashish Saraf: See, the way the group is looking at, this is more of a group question rather than -- that's not a decision that...

HDFC speaker: How they are thinking.

Ashish Saraf: How they are thinking. So, the way they are learning was post-COVID that they need to have a regionalized supply chain. Because globally, post-COVID, because of the constant lockdown, because of the escalate like subsequent wars and all that, which has happened in Europe, energy prices going up, they realized that in order to be competitive and be able to kind of serve the market better, they need to have region for region strategy. That's where we have four regions. America, Europe, China, and India. India and Southeast Asia, right? So, they said that right now...

HDFC speaker: So it's a region for region. It's not seen as India for India.

Ashish Saraf: It's not seen India for India. It's some region for region. That's what I said that the decision is based on the demand for India and Southeast Asia region, right? Because there has to be ample demand for me. Like if I look at India, India market is relatively very small, right? Compared to -- see, if I'm comparing it, like America market is four times the size of India and Southeast Asia market, right? So, if I have to make that investment, it has to make financial sense for me to get a-- give me a payback of at least five years, right?

So, if I'm only looking at demand for India, then it will not make sense. So, it has to at least make sense for India and Southeast Asia. That's how we have kind of positioned it. Considering that it's a growing market and we're playing back with cash.

HDFC speaker: Can you highlight management changes?

Ashish Saraf: See, basically, Manish was doing two roles. He was MD for SKF India, plus he was Head for the India and Southeast Asia industrial business.

HDFC speaker: Industrial business, okay.

Ashish Saraf: Right? So now he continues to be the MD for SKF India till the replacement joins in. And he’s going to give up the role – he’s given up the role of India and Southeast Asia industrial business and he’s taken on the role for Business Head for America’s industrial business. Right? So, in the next quarter once the new person joins in...

HDFC speaker: So, this person is joining. He’s going to be an external individual.

Ashish Saraf: Most likely, external.

HDFC speaker: I’m just surprised why there is a company of this size, capability, engineering talent, management bandwidth. You know, both the next CEO and the last CEO have come from outside. Manish came from outside as well. It’s actually a great plot. We don’t look at that in a positive way at all. People – have you seen management changes happening?

Ashish Saraf: See, again, I mean, you are purely looking at it from an India perspective.

HDFC speaker: Yes.

Ashish Saraf: But if you look at it from a group perspective, there are people who are going from India and taking on larger roles outside of India within SKF as well. Again, by chance it happens that we are getting a Managing Director, or we could get a Managing Director from outside of India. But you're equally promoting a lot of people who are moving from India. Like Manish being an example. He's moving to the US. We had an CHRO who's moving to Sweden. Right? So, there are people who are going on and taking on bigger roles.

The group is significantly valued in talent, which exists in SKF India. Like India business, if you look at our share of business, would be about 5% of the global revenues. Right? But in terms of talent base, they're more than 20%. Right? So, from a pure talent perspective, they are leveraging. This happens to be a role where we are moving and hiring from outside of India. But the group continues to import a lot of good talent from India to other regions.

And just to give you an example, India and Southeast Asia was one of the best performing regions out of all the four regions that we had. So that is where they want to kind of drive the culture that they've seen in India and Southeast Asia and other regions. And that's where a lot of senior people are from India moving to other regions.

HDFC speaker: I'll have a heart stop at 5 o'clock because I have a flight to catch. How much is the aftermarket?

Ashish Saraf: Sorry?

HDFC speaker: How much is the aftermarket?

Ashish Saraf: See, predominantly, my aftermarket is around 11% of the total business. Auto aftermarket. Predominantly, it's 2-wheeler Direct too is 13%.

HDFC speaker: Of total again?

Ashish Saraf: Of total again.

HDFC speaker: And CVs and tractors respectively?

Ashish Saraf: CVs and tractors, CV is around 4%. And tractors are around 2%.

HDFC speaker: I understand. So, aftermarket is 13. Sorry, it's 11.

Ashish Saraf: See, overall, it's 41%.

HDFC speaker: Yes, 13% of it is 4. Plus 4, that's 26. Plus 2, that's 28.

Ashish Saraf: So, passenger vehicle is 5%. And you have something called a powertrain which is like suspension and all that. That's another 6%.

HDFC speaker: And then you have exports.

Ashish Saraf: Export is separate, export is another 8%.

HDFC speaker: 15, 41 and 9. 15, 41 and 9, 15 is industrial 41 is auto 9 is export, which is mainly -- It's mostly for passenger products.

Ashish Saraf: Sorry?

HDFC speaker: It's mostly for passenger vehicles. Export, export.

Ashish Saraf: No, no, no. Export is everything. But predominantly, automotive. Because we are manufacturing for automotive. But it will be a mix for industrial. Like, the products are... Like, they are common products, right? So, it will be a mix for both industrial and automotive.

HDFC speaker: How much is, how is wind? When there was 8%, I don't know what happened.

Ashish Saraf: So, this, the shares come down because we have purchased the engineer and customer which has come down to 5%.

HDFC speaker: Of total?

Ashish Saraf: Of total.

HDFC speaker: And this used to be 2 years ago 8%, is that right?

Ashish Saraf: I think 7%, it used to be 7%.

HDFC speaker: Industrial engineering is 16%. Eight is general.

Ashish Saraf: Eight is general. After-market, industrial distribution is around 25%. Wind is at 5%.

HDFC speaker: Sorry, aftermarket is 25% of industrial.

Ashish Saraf: No, of total.

HDFC speaker: Of total, sorry. Of total, yes. That's 50%.

Ashish Saraf: General machinery is 8%. Wind is around 4.5%, heavy industry is another 5%, metals is 2%, heavy industry is 7%.

HDFC speaker: Sorry, metal, heavy industry how much?

Ashish Saraf: Heavy industry is 7%. 7%, okay.

HDFC speaker: Sorry, I'm just going to break it up for you because I'm just a little confused. EFM is 25%. Sorry, aftermarket is 25%.

Ashish Saraf: Yes.

HDFC speaker: You said general machinery is 8%.

Ashish Saraf: That's right.

HDFC speaker: Okay, then you have wind which is 5%. You have railways which are 8%.

Ashish Saraf: Railways which is 7%.

HDFC speaker: 7%. Metals is 2%. Heavy engineering is 7%.

Ashish Saraf: Heavy engineering is 5%.

HDFC speaker: Heavy industry is 7%. Very good.