“SKF India Ltd.Q3 FY-17 Earnings Conference Call”

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Moderator: Ladies and gentlemen good day and welcome to the SKF India Ltd. Q3 2016-17 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference call, please signal for an operator by pressing '*' followed by '0' on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference call to Vijay Chaudhury, thank you and over to you sir.

Vijay Chaudhury: Good afternoon everyone. Thank you for joining for the call today. With us today we have Mr. Shishir Joshipura – Managing Director, SKF India Ltd. along with Mr. Chandramowli Srinivasan – Director of finance for SKF India Ltd. I will now hand over the conference call to our Managing Director Joshipura who will discuss the highlights of the results, briefly over to you sir.

Shishir Joshipura: Good afternoon and welcome to this call for Q3 Results. To start with this was our best ever quarter in the history of the company, both from the top and bottom line perspective and we are very happy to share this results which is actually a result of all the work that we are doing in both the automotive industry and industrial part of the market. Several initiatives that we have launched and we can see the results coming. This is especially true in the fact that we saw these quarter witness one of the biggest economic changes in terms of demonetization that took place and that drove the market several segments of the markets in very, very different directions.

We saw almost immediate impact on all those segments where, at some end of the chain there was a real consumer cash transaction taking place and they just almost shutdown and nosedived so to speak in a very short period of time. We expect all of these to recover going forward in another three months' kind of time frame, however this had a big impact on the quarter and especially in view of the fact that this event took place in the last two months of the quarter.

I am very happy to share our results with you. We have posted the growth of about 9% compared to the corresponding quarter last year and also about 16% growth in the profit. The announcement is also made by the board for the buyback of our shares for the company for the total amount of 3900 million subject to shareholder regularity approvals. So, these are being the big, big news item out of SKF India and I will be very happy to take your questions.

Moderator: Ladies and gentlemen we will now begin with the question and answer session. First question is from Raghu Nandan from Quant Capital.

Raghu Nandan: Thank you sir for an opportunity and Congratulations for a very good set of numbers. My first question was on the revenue growth, revenue growth was strong given the challenging circumstances, can you please highlight which segments did well that is which segments positively contributed to the revenue growth and which segments are still in the negative?

Shishir Joshipura: As I was mentioning in my opening statement both for the industrial and for the automotive market we saw growth happening in this quarter in spite of the fact that there were big challenges especially for the automotive aftermarket that's one segment where we did not grow in this quarter. Because of the obvious challenges that came around out of demonetization impact and the economic activity that took a different turn at that moment in time. Other than that we have done very well across the segments whether it is cars, trucks, tractors, industrial business and near and very good growth right across these segments compared to the previous year even two wheeler which has taken nosedive post demonetization we were able to actually build a decent business growth there as well. So it has been fairly all around growth for us not particularly fulcrum around one particular segment of the economy with one exception of vehicle after market where we could not cover all the lost ground because of demonetization.

Raghu Nandan: Within the industrial can you highlight how was the performance like renewable, railways, construction equipments, commodities, how this segments have being doing?

Chandramowli Srinivasan: So if I look at business of, overall compared to last year corresponding quarter we have grown across almost all segments in energy where it drives industrial drives, off-highway vehicles railways all across. And these are there have been a fairly decent growth, energy almost, energy off highway, railways all in (+30%) range for us.

The only area where we saw more or less what I would call as evening out of because again this was segment that has some impact of demonetization was the small OEM's and end user market where we saw some kind of levellization taking place because of the demonetization.

Raghu Nandan: This would be industrial after market?

Chandramowli Srinivasan: Yes. The industrial aftermarket was not as severely impacted as vehicle after market was although it was impacted a little bit. But even there we have grown fairly healthy in the quarter.

Raghu Nandan: And sir like the gross margin that is then I take the raw material cost to sales Sir there has been an improvement on quarter on quarter basis what has led to this improvement?

Chandramowli Srinivasan: I think fundamentally it is the sales mix of the business that has been favorably driving coupled with several sourcing initiatives that we were working upon to optimize our cost. So, both of these have contributed to the phenomenon that you describe.

Raghu Nandan: Can you elaborate on that sourcing initiative sir? You have talked about the distribution center which would be set up here which would further benefit from any…

Chandramowli Srinivasan: Yes, so the distribution center is up and running but that distribution center is no so much about sourcing that is more about improving our service level to our customers, because now they don't have to wait for our part to be imported from some factory in Europe or America wherever we get it from, which is now locally available to them. So it cuts down timing for other end for us it is advantageous we can plan the inventory, therefore we don't have to keep lifting by air we can get it from more economic mode of transport and more plan session etcetera. So distribution center is for reaching our product lines out there. On the other end when I was saying sourcing I was saying that we have very good development with some of our suppliers in terms of the product lines that we are developing and sourcing initiatives for that. That in addition to price mix ratio is what is reflecting.

Raghu Nandan: My last question was on the revenue mix, which you share every quarter between auto OEM and auto OEM replacement industrial OEM and industrial replacement and exports?

Chandramowli Srinivasan: So basically Auto-OE is about 28%, Auto aftermarket is about 11% so that is totally automotive is 37%. Exports which is primarily automotive about 8%, so if you add that together the total automotive is you could say is about 45% and 55% is Industrial which is equally split between OEM and aftermarket.

Raghu Nandan: And sir between traded and manufactured?

Chandramowli Srinivasan: Between traded and manufactured we were this quarter about 45% traded and 55 % manufactured.

Raghu Nandan: If I understand correctly versus the last quarter on the quarter on quarter basis actually the trading has slightly increased from 34 to 45, but still we had an improvement in the gross margin going on?

Chandramowli Srinivasan: It is because of the sales mix we had more of the aftermarket sales within the traded compared to the OE, the OE grew but aftermarket even grew more for us in this quarter. So that's why.

Raghu Nandan: Relatively.

Chandramowli Srinivasan: Yes.

Moderator: Thank you. The next question is from Lakshmi Narayanan from Catamaran.

Lakshmi Narayanan: I have couple of questions for instance if you look at it, I guess this year your internal performance here also in terms of one year so if you can just elaborate what kind of salary increases have been affected for the employees and how is it being trending in the last 3-4 years because just trying to see whether we are looking at our brighter picture going forward. And second is related to distribution in terms of our aftermarket distribution outlets of distribution partners, if I look at in the last 3 years what has been the progress broadly and also three years what has been the key business mix changes that has been affected. Because three years have been a quite a good kind of the inflection point for the company from economic stand point and lot of initiative we have taken. And third is related to if possible throw some light on how the SKF technologies is actually doing in the last three years. And any thoughts on what has been what are the growth prospects out there? So I think these are three questions first in terms of employee wage increase how are we thinking about it, given that we have done very well and second in terms of how the client, distribution mix has changed the business, business change in the last three years and the third is related to SKF technologies.

Chandramowli Srinivasan: I think there are three on the salary part let me break it up to you in two or three dimensions actually. The blue-collar salary is a part of negotiated settlement for which have four years, we reached to our unions in each of these locations so Bangalore and Haridawar and Pune and all that. So those are running as per those agreements. So all those costs for blue collar are already reflected so there is no change likely going forward like it is already there.

Laxmi Naryanan: And when is the remuneration in blue collar coming off?

Chandramowli Srinivasan: It is different for different factory so Pune we just signed last year an agreement so it will now come up after three more years. So Bangalore would probably come up in 2018 sometime. Because each has a different union there, this is not a common union that sort of negotiations for each factory and each location there is a different union. But the blue collar side there is no change, any appreciable change for the cost likely at least for 2017.

On other hand if we look at white collar then there are again two elements the way our salary structures are so there is one component of salary which is the variable salary which gets linked to the performance in the calendar year for the company because that is how it has hooked everybody and those are already reflected into our numbers that are already in front of you for December 2016 provisions are already carried forward.

And third is on the element of salary increase on the fix bases for the employees that is the cycle that runs for April to March because we need a quarter to evaluate and arrived at right numbers etcetera. So that is the process which is underway as of today in this quarter as we discuss there is more affect likely it will only go plus within the cost that you have seen there are some Mouli is pointing out to me that we change our leave rules a little bit so and the discount rates for the leave encashment provisions, there is minor change in the market from the discount rate of 7.6% odd to 7.1% odd so those kind of changes are being reflected in the actual evaluation of the that's what. Nothing ground breaking there. So, that's on the salary part of the employees.

On the distribution side of the business I think over the last three years if we see we have worked on two very clear paths one is to increase the reach and depth of our network. So the industrial retailer program on the both automotive retailer programs, the distribution network, themselves so that's on the reach part. Know in terms of number and where are they physically located away from cities closer to industrial towns kind of situation. On the other hand we have also worked on improving the capability of these networks so for example we worked a lot on improving the service delivery capability of our distribution network so they are not only product, distribution and inventory management outlets but they are also able to serve the customers in terms of providing a set of services around our products to improve the value for the customers, so that's something that we have worked on very diligently over the last two three years, to increase this capability into our distribution organization over a period of time.

And if I say so there is a capacity improvement and capability improvement and both of them put together have led to a situation that we have become reasonably strong, we would like to much more of it. But we have become reasonably strong in terms of how we are approaching the market place as I have said in my earlier calls as well imitation is the best form of flattery so we know one of our competition has gone ahead and copied our program for the distribution network that we launched very, very successfully for creating sales force on the ground. So, different programs different strokes but that's broadly around distribution.

Lakshmi Narayanan: And broadly in that if you can just put into numbers if you look at it what has been the number of distributors in 2014 and how it is now, if you can just elaborate?

Chandramowli Srinivasan: I don't have it in front of me right now to tell your number of distributors that have changed but let me give you a broad idea one parameter it will probably tell you so we have made sure that number of sales people in our distribution organization which are employed by our distributors have undergone an substantial change by factor of almost 4.

Laxmi Naryanan: So there are on the roles of your distributors but trained by you.

Chandramowli Srinivasan: Trained by us and we have done many things with them to make them very capable to use the technology you know the internet and the pads and the notebooks and stuffs to actually create a replica of SKF sales guy out in the field but at no cost to SKF. What was the third question?

Laxmi Naryanan: On the SKF's technology part how the growth contributes…

Chandramowli Srinivasan: You know that company has many elements to it so, I would not discuss the results of the company but per se let me say that what's relevant for our business in terms of two dimensions so our steel business is continuing to do well out of that entity and it is future strengthening itself to help us in grew our offerings to railways and segments like that. On the other hand the large factory in Ahmadabad which is making large scale. That's doing very well, we have beginning to use more and more of Ahmadabad made products to improve our sales pitch in India so, and both of them are going at a fair cliff.

Moderator: Thank you. Our next question is from Puneet Gulati from HSBC Securities.

Puneet Gulati: Just a few things to understand what proportion of your traded products now come from Ahmadabad versus what it is use to be a few quarters back?

Chandramowli Srinivasan: So it's gone from the factor 0 to 30%, let's put it like that over the last three four years.

Puneet Gulati: So 30% of the traded products are now from Ahmadabad.

Chandramowli Srinivasan: Yes.

Puneet Gulati: And does it add anything to margins or in any other way?

Chandramowli Srinivasan: No it is still arm's length transactions so that, but it helps us to be more competitive it helps us to reach our customers quicker compared to an imported product. It helps us to discover some new markets create some product lines, some offerings from here which otherwise you cannot; so it was a different kind of capability in the hands of SKF India.

Puneet Gulati: Does it improve pricing power at all?

Chandramowli Srinivasan: Well let's put it like this if you had to import the same bearing then I end up paying a duty on it and freight and handling charge you know which I don't have to do here. So, the gap between the two is the power.

Puneet Gulati: Okay. And similarly, you have set up a distribution center so it is also adding similar benefits?

Chandramowli Srinivasan: Early days yet but that is our plan, that the distribution center must make available in the manner speaking yes. What we don't make in India but we make in rest of the world those products are available to customers much faster and in a much better planned fashion without incurring cost that they don't have.

Puneet Gulati: So will it also be run as a profit center or more of …

Chandramowli Srinivasan: No it is not a profit center.

Puneet Gulati: Okay. And any update on the new car line which you were intending to launch in last quarter?

Chandramowli Srinivasan: Yes so as I said it was little delay and we are now as I speak with you the machines half the machines are already installed and the trial runs have begun. We have already supplied the prototypes samples and everything to the customer. So we expect that somewhere around in the next 90 days we should be able to see a regular production done.

Puneet Gulati: And you know obviously, you have done extremely well it appears, have you gained any market share here in the two-wheeler business, and in your car, truck business?

Chandramowli Srinivasan: Yes. We have built our market share in all the segments that you have mentioned, at the back of the some of the offering that we have made to bring a lot more technological changes for the customers, some of them are only preparing for new norms, some of them are being to look at a higher performing vehicles and some are sheer relationship based where you know we are able to leave it our relationships deep relationships, to drive our shares up.

Puneet Gulati: And any color from whom would you have gained this market share?

Chandramowli Srinivasan: From whom I know it's a mix bag, it's all kind of fellows yes. There are Indian makers there are foreign companies. I would not say I have gained because if they have done something gained from somebody else, they will say they don't know what you are talking about so generally speaking our share has gone up with several leading manufactures across their, one of the mantra's that we work on is, we try and understand which of our customer's platforms are winning platforms in the market and how we can help them win with those platforms. And I think we have made some very good calls on that one in terms of we have bet on the right winners and that's what is reflecting for us.

Moderator: Thank you. The next question is from Mukesh Saraf from Spark Capital.

Mukesh Saraf: Sir first question is on the railways segment, could you give some color on what is happening there with respect to sudden new orders expected for the Class K bearings and if at all any orders on class G as well?

Chandramowli Srinivasan: As of now the K class and the K- class bearings order that came last year will now go into the field because that is still what I will call as a switchover phase in Indian Railways so they have to decide what proportion goes to K but increasingly more and more that direction is clear. On the freight side they have normally they should have by now but they have not come up with any tender so far, we expect them to come out any day now this quarter it will start to build from there. So on freight side of the railway business there has not been much progress yet because they have not come up with the necessary tender so far.

Mukesh Saraf: And any on the class G on the locomotives? That is also something…

Chandramowli Srinivasan: On the locomotives as you know that they are two big contracts that are being awarded out there, we have concluded our discussion with both and we will make an appropriate announcement at an appropriate time.

Mukesh Saraf: And sir we are also hearing a lot you know on the passenger railways there are willing to LHB the coaches which would eventually be to TRB may be Class K or maybe something else but do you see this as an opportunity in the near term, medium term or extremely far away now as the opportunity?

Chandramowli Srinivasan: No as they start to move to more and more of LHB coaches we are very happy because as I have mentioned earlier also that on the passenger side of business we have very strong presence in shares so as they move more and more modern coaches we are happier of the K class or E class, etc., will probably apply more to the freight part of the business.

Mukesh Saraf: Okay. But on the passenger side do you see this as a near-term opportunity sir? Do you see some discussions happening as to sourcing more and more LHB coaches or something like that?

Chandramowli Srinivasan: Yes, but one is the discussion and second is how much how fast they can roll out because they have started making them and create the whole infrastructure to make that coaches as well. So it is moving in the right direction to improve and increase the LHB coaches which is good for us.

Mukesh Saraf: And sir my last question is on the revenue breakup like you mentioned OEM is 26% would you be willing to just give a broad breakup within that house, two-wheelers passengers vehicles series?

Chandramowli Srinivasan: It is almost 50-50 between two and four wheelers.

Mukesh Saraf: Okay. And on the industrial OE which is say about just under 30% any breakup there you know cement would how much and paper and packaging or any rough break up that you can give there as well?

Chandramowli Srinivasan: In the industrial OE breakup of the if you take 27% of the total of the industrial OE so out of that renewable is 5, drives is 8 railways is 5 off highways is 2, the rest of the small OE is 6.

Moderator: Thank you. The next question is the follow up question from the line of Raghu Nandan from Quant Capital.

Raghu Nandan: Sir just wanted to understand was there any FOREX gains in the quarter?

Chandramowli Srinivasan: 45 million.

Raghu Nandan: In which line item sir?

Chandramowli Srinivasan: 51 Million. There is a line item called other income where 245 million it is included there.

Moderator: Thank you. We just got a follow up question from Mukesh Saraf from Spark Capital.

Mukesh Saraf: Sir if you could also comment on relend bearings for commercial vehicles, how is that going probably for you because as earlier you mentioned that there was large OEM who will be the sole suppliers and by working on also OEM, any update on that sir?

Chandramowli Srinivasan: There is no change of status there still work in progress for the wheel end on commercial vehicles, but in an important development along with this we have also now become the sole source for new generation excels for the highest selling segment within LCV and HCV range so that's being the good development for us that we will going forward supplying all the bearing required for that…

Mukesh Saraf: For the particular OEM sir?

Chandramowli Srinivasan: For a new technological breakthrough for us.

Mukesh Saraf: And while you said this is on track do you expect this you know this CV wheel and bearing sales to kind of coincide with the BS- 4 or it is going to be later…

Chandramowli Srinivasan: It's not a BS-4 impacting thing but maybe we can do that.

Mukesh Saraf: But did you see that it coincides with it lot of OEM's might move to that.

Chandramowli Srinivasan: Yes.

Moderator: Thank you. Next question is from Karishma Kothari from Edelweiss.

Karishma Kothari: I just had two questions could we have the quantitative numbers regarding each segment growth as in four-wheeler, OEM, trucks, tractors, industrial OEM, replacement and Railways energy, highways segment wise growth and I also wanted to know about your CAPEX plans for FY 17 as well as for FY 18?

Chandramowli Srinivasan: The growth in the sales compared to same quarter last year, we grew in cars by 32% the industry grew by only 12% but grew by 32 so that's the answer to somebody who asked previously whether we have increased market share. On trucks, we grew by 27% industry grew by 5%, tractors we grew by 30%. As Shishir said only vehicle aftermarket we did not grow because after demonetization affect we actually had a drop by about 15% this quarter. And in two wheelers and small part of electrical we grew by 9% where the industry dropped by 4% so that's broad growth. When it comes to industrial side of the business, I think Shishir already said the energy we grew, of highways railways all of them we grew by big double digit numbers. Small industrial OE was only one which was flat comparatively; industrial distribution also this quarter grew for us by 8%.

Karishma Kothari: And sir the CAPEX?

Chandramowli Srinivasan: While we are still formulating the plan for CAPEX because we are still one quarter away from the financial ending. I would expect at the broad level we are expecting that our CAPEX will go up significantly compare to the levels that we have seen the recent years, because I do not have the exact numbers because we have not casted and approved them from the board yet which we will do soon, having said that on the other hand we are looking at something like at least doubling of our CAPEX going forward compared to current levels.

Karishma Kothari: So sir in the current year you have mentioned earlier about 700 million so doubling would be around 1400 million?

Chandramowli Srinivasan: So 50 crores is rough span this year for us about. So it will be of the order of between 50 and 100 crores range.

Moderator: Thank you. The next question is from Mahantesh Sabarad from SBI cap securities.

Mahantesh Sabarad: Just a follow up on the question that was previously asked you mention CAPEX being 150 crores I assume that this excludes the buyback related cost.

Chandramowli Srinivasan: Yes, we are not talking that as CAPEX.

Mahantesh Sabarad: I just wanted to understand what is it that you are looking in terms of industrial CAPEX revival thus far so you are as a company one of the on-ground observers of that cycle?

Chandramowli Srinivasan: See we don't see a big-ticket revival for capital goods as I would call it. They are not visible to us yet there are some segments which are still continuing to exhibit some decent potential we have talked about railways we have talked about of highway vehicles we have talked about so infrastructure related machinery you know, so those are the segments that we expect will do well in near future in midterm or long term we don't know yet or in terms of when will the big CAPEX cycle return, etc., but these guys are only doing well of highway construction , railways and lot of investments in modernization and safety related issues. On the automotive side of course the it is not so much CAPEX driven but capacity driven so we see a lot more whole commercial vehicle market will shift to new emission norm so that will be huge change in the commercial market going forward so that's the one big change that we can expect from them from all the vehicle makers.

Mahantesh Sabarad: Another question I had was related to increasing cost of raw material especially steel for you so how is that being behaving in terms of your own cost structure and what's your strategy in terms of mitigating that risk arising out of these rising costs?

Chandramowli Srinivasan: So steel prices have started to firm up globally in the last especially in the last two months we have seen reasonable level of firming up of the prices for commodities steel especially and so that is obviously a cause for concern, because the cost have started to move up. We are watching it very closely. We have long term contracts in place with many of our suppliers, so which gives us some breathing space but obviously we have started to discuss what is it we need to do in terms of the overall impact assessment and see as to how we approach our customers about change in price point that is almost inevitable thing. Steel prices continue to be this firm, we have no choice but to approach our customer for price correction.

Mahantesh Sabarad: And as a ballpark number how much steel be a proportion of your revenues in terms of cost?

Chandramowli Srinivasan: 25% is raw steel. I am talking about the raw steel now.

Mahantesh Sabarad: That's the direct steel you incur so I assume there is an indirect component via your traded goods also?

Chandramowli Srinivasan: You know that is one plus all the steel what I am talking about is the raw steel so beyond that I think that will be converted into zing and ball and cage in change shape and size and then come into production.

Mahantesh Sabarad: And my final question is just wanted to understand you are the sole supplier for some of the hub bearings for the Ignis of Maruti Suzuki am I right sir?

Chandramowli Srinivasan: For what?

Mahantesh Sabarad: Ignis Suzuki Ignis the new?

Chandramowli Srinivasan: The new Maruti Suzuki Ignis car, no.

Mahantesh Sabarad: So which was the car that you were the sole supplier for the Maruti?

Chandramowli Srinivasan: I think Breeza is one car where we are the only guys supplying to them. and they do have a very sound sourcing policies so they wouldn't want to be in the position for long, but Breeza is something that we are in the sole supplier position for them.

Moderator: Next question is the follow up question from the line of Puneet Gulati from HSBC Securities.

Puneet Gulati: Just if you can give more color on where the additional 50 crore spend is going to be in what segment what are the plans and how it will be spread out over the years?

Chandramowli Srinivasan: So first of all there will be no Greenfield projects, so these are all going to be capacity expansions from our current locations. So that's one clarification I can provide you already. It will be mostly for new products that we are putting these capacities not for existing products. So in the beginning as I was mentioning earlier was that a lot of wins in recent times based on what kind of technological changes we are proposing in the market and winning with customers so that's the broad category, no green field It only expands the current locations plus or new build in the current locations expansions may not be the right word. And the second one is a new product line driven investments.

Puneet Gulati: Can you share which are this new products and new product lines?

Chandramowli Srinivasan: No, they are all bearings most for automotive more from listed company perspective mostly for automotive but not all. There is significant investment coming for the industrial as well in the listed entity.

Puneet Gulati: So is the policy more like developing industry in the parent and then selling it through.

Chandramowli Srinivasan: No, it's not like that. It just a there if you know little bit then the bearings that Ahmadabad makes are very different in shapes and size so where diameters would run into meters, whereas what we make in India here in SKF India is millimeter. So I mean there is no comparison between the two. So a very different set of, yes as I have said in the past also the company is very clear for those items where we believe that the in it capability of managing supply chain production line, etc., line in the listed will happen in listed entity. Or those which lie in other entity will happen in other entity. At that moment of time we created it just so happened industrial was those and automotive was these. So that's not the only policy that we are following so don't be surprised if tomorrow some industrial capacity comes into listed entity and there could be an automotive part which they are better off to make because of their configuration whatever that is, I am not saying that's the truth but I am saying that it could happen. So the policies more around capabilities and the supply chain efficiencies rather than deciding on formalizing industry **(Inaudible) 39.28** automotive there.

Puneet Gulati: And to which industry it will cater to largely?

Chandramowli Srinivasan: A lot automotive, drives, railways, off-highway vehicles, steel, cement.

Moderator: Thank you. As there are no further questions I will hand over the conference to Mr. Choudhary for closing comments. Over to you sir.

Vijay Chaudhury: Thank you very much. Thank you all for participating in this call and we will on behalf of SKF India I would like to thank you all for joining us today. And should you have any further questions for the management kindly drop me an email at vijay.chaudhury@skf.com have a great day.

Moderators: Thank you members of management. Ladies and gentlemen on the behalf of SKF management that concludes this conference call. Thank you all for joining us and you may now disconnect your lines.