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SKF AB (SKF.B.SE)

Q1 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, welcome to the SKF Quarterly Report Q1 2023. My name is Grant and I'll be the moderator for today's call. [Operator Instructions]

I will now hand you over to your host, Patrik Stenberg, Director of SKF Group Investor Relations and Mergers and Acquisitions. Patrik, please go ahead.

Patrik Stenberg
Director-SKF Group Investor Relations and Mergers & Acquisitions, SKF AB

Thank you and good morning and welcome to all of you participating on this conference call for SKF's first quarter results. As usual, we will start with a presentation. It will last about 25 minutes or so. It will start by Rickard Gustafson giving his summary of the quarter and then followed up by Niclas Rosenlew's presentation of the financial performance. After that, we will be ready to interact with you over the phone or over the chat if you want to post your questions there.

So, with that very brief intro, I will leave the word, the floor and more importantly, the clicker to Rickard.

Rickard Gustafson
President, Chief Executive Officer & Director, SKF AB

Thank you very much, Patrik, and a warm welcome, everyone, and thank you for joining us for this interim report presentation. In the quarter, we have further accelerated our intelligent and clean transition to drive profitable growth and I'm pleased to report a strong set of numbers with sales, adjusted operating profit, and cash flow at record levels for the first quarter in absolute terms.

Net sales were strong in the quarter just north of SEK 26.5 billion, representing an organic growth of just above 10%. The adjusted operating profit came in at SEK 3.5 billion, corresponding to an adjusted operating margin of 13.1%. The positive margin development compared to previous quarter was mainly due to continued strong price realization but also our efficiency and portfolio management efforts that we have driven throughout the quarter. However, cost inflation remained at a high level throughout the quarter. Net cash flow was significantly up versus Q1 last year and came in at SEK 2.7 billion. This is largely related to the improved net operating profit as well as our efforts to improve net working capital and you will hear more about this from Niclas shortly. So, all-in-all, we saw strong organic sales growth as well as continued sequential price realization in the quarter. This supporting an improved adjusted operating profit versus previous quarter and the same quarter last year.

Turning to our strategic growth framework. Once again, I'm happy to report tangible progress across all four growth levers. In Q1, we saw strong double-digit organic growth in most targeted segments. Growth was particularly strong for electrical vehicles, as you can see on this chart, up 25% in the quarter. But also in segments that we highlighted in our Capital Markets Day, such as railway and renewable energy came in with strong double-digit growth.

Turning to new technologies. In the beginning of the year, we integrated the SKF Bearing App into the Ansys platform. This enabling for customers to quickly simulate and create SKF Bearing models in real-time while using the Ansys system for their application design and specifications. We continued to expand our service in aftermarket business. In the quarter, we saw an increasing interest in our performance-based railway contracts and I will share more details about this also shortly. And, finally, on portfolio management. Tactical and strategic activities are ongoing as we described in detail at our Capital Markets Day in December. All business areas are actively driving price and pruning sub-performing contract, segments or products.

So with this overview, let's now take a deeper look into our Industrial business. In Industrial, we saw strong organic growth of 10% with approximately two-thirds coming from price/mix. As you can see in the chart, by region, we saw solid growth in Americas of 5%, driven by heavy industries and industrial distribution. Strong organic growth in EMEA and it's actually surprisingly positive to see the resilience in EMEA and the growth of up 11%, especially strong in aerospace and material handling. Organic growth in China & North-East Asia coming in at 12%, a clear rebound after the COVID reopening, especially in industries relying on domestic demand such as wind, metals, and heavy industries. Finally, we also saw strong momentum and growth momentum in India & South-East Asia growing some 14% in the quarter, driven by wind, rail, agriculture, food and beverage, and heavy industries. The adjusted operating margin came in at a satisfying 17%. And due to solid pricing momentum cost take-out and active portfolio management, we can report an improved adjusted operating profit compared to last year at SEK 3.2 billion. As I mentioned, our tactical portfolio management activities, they do continue and we have accelerated our efforts across industries and geographies, starting with broad-based pricing initiatives. Now, we're also seeing tactical portfolio shifts, primarily within Americas and EMEA.

And our organic growth is a result of further enhanced competitiveness. And I would like to highlight, to bring to your attention three key differentiators in this presentation: Firstly, we're going to talk about sustainability and how that is enabling us to further drive growth in cleantech, how we drive regionalization to enhance our competitiveness and how we commercialize our technical and innovation leadership. But starting with sustainability. This is a clear value driver for SKF. Our total revenues from cleantech now significantly exceeds SEK 10 billion. And for your reference, we define cleantech as renewable energy, electrical vehicles, electric railway, recycling industries, bearing remanufacturing, RecondOil and magnetic bearings. In the quarter, we noticed especially strong growth in electrical railway with customer wins of three major metro operators in Asia. So why these wins? Well, SKF, we have a strong rail value proposition. We help our customers to lower their total cost of ownership from reduced maintenance and increased train utilization. Our contracts often includes bearings, condition monitoring and bearing refurbishment, and bearing refurbishment is a critical part of the circular economy, an area of growing importance among many of our customers.

Our recent achievements in our sustainability transition are also Science Based Targets Initiatives, validation of our emission reduction targets for 2030 and 2050. We are now among the world's top 5% of companies receiving SBTi approval for both mid- and long-term net zero targets. We have an A- or leadership climate rating from CDP. And in 2022, more than half of all electricity used by SKF was derived from renewable resources, a major milestone in our net zero journey.

When it comes to localization and regionalization, it's a cornerstone in our strategic framework and India and South-East Asia is being no exception. India is poised to double its current annual GDP from almost $3.5 trillion to a mind-blowing $7 trillion by 2030. Of course, this is a huge potential for us and we are well-positioned to benefit from this but also to help India in its growth aspirations. We have a rich and long history in the country. Actually, in Q1 we celebrated our 100 years of operations in India. We have a robust presence in the country with six manufacturing sites, eight distribution centers, four solution factories. We have a nationwide supplier and distribution network and a global technical center for end-to-end engineering. But in order to take part of the fast-growing Indian economy, the ability to develop and manufacture products locally is and will be key. Therefore, we have recently invested some SEK 250 million to further improve our local manufacturing capabilities, bolster our supply chain network and secure additional engineering capabilities.

And, finally, an example on how we commercialize our technical innovation and leadership. SKF, we are a key manufacturer in the Machine Tool segment with annual sales of about SEK 2 billion. Within this segment, we offer a wide range of super precision bearings, often with ceramic rolling elements. Super precision bearings come with a strong value proposition. They enable high-speed and high-load with maximum reliability and temperature stability. A recent success case is a new contract with the Swiss-based high-end spindle producer. We won this business due to that our engineers were able to deliver a bearing solution with leading technical design, advanced ring material and innovative heat treatment, surpassing the performance of standard super precision bearings.

So with this, let's shift focus and now turn our spotlight to our Automotive business. In Automotive, organic growth was also very strong, up 12% in the quarter. In this case, more of a balance between price/mix and volume. Again, as you can see in this chart, we saw a continued good growth of 12% in Americas, especially driven by light vehicles and a solid vehicle aftermarket. In EMEA, organic growth was 17% with strong growth both from trucks and passenger cars. In comparison to Q1 last year, we noted an exceptionally strong growth in EV sales in Europe to both traditional OEMs and pure EV producers. In China and North-East Asia, demand relying on local consumption and exports such as light vehicles and vehicle aftermarket were low and resulting in a negative growth of 2% as evident on this chart. India and South-East Asia maintained a strong organic growth of 15%, primarily due to high demand for light vehicles. Our operating profit here came in at SEK 300 million, corresponding to a 3.6% operating margin. We saw a positive price contribution, both from the OEM and the aftermarket. And in comparison to last year, the operating margin is impacted to some negative mix effects. So with that said, I would like to reinforce that we continue to see an improvement in the underlying Automotive profitability as we progress this strategic shift in the portfolio. And we are making good progress in this strategic shift and well-aligned to deliver on the SEK 1.2 billion of revenues that we're about to exit of non-strategic sales by the end of 2023. And as you all recall, these exits are primarily related to ICE powertrain applications.

Strategically, we are pleased to note the continued strong growth in EVs, the vehicle aftermarket and commercial vehicles, all according to our strategic shift. And talking about EVs. We also want to give you an example on how we participate in the electrification of the two-wheelers. We have partnered up with a company named CAKE, which is a Swedish maker of premium lightweight electrical motorcycles aiming at launching the first fossil-free two-wheeler. SKF will provide bearings produced with a minimal carbon footprint as part of CAKE's ambition to create the cleanest dirt bike ever. SKF Bearings will be used in key areas of the bike such as steering, wheels, frame and of course the e-motor.

With this, it's time for me to hand over to Niclas to give you some more details on our numbers in the quarters. So, Niclas?

Niclas Rosenlew

Chief Financial Officer & Senior Vice President-Group Finance, SKF AB

Thank you, Rickard, and hello, everyone. So, let's get on with the numbers and the – starting with sales. So, as Rickard mentioned, we had a strong sales growth in Q1. Our sales was SEK 26.5, up from SEK 23 billion a year ago. This is a sequential growth as well as a growth compared to last year and it's driven by broad-based demand from multiple different industries and multiple different product segments.

If we break up the growth into parts here, compared to last year our net sales increased in total by 15.7%. The impact of the Russian exit was a negative 2%. And as a reminder, we exited the Russian business completely in Q2 last year. The organic sales increased by 10.1%, with approximately 3% being volume and 7% being price/mix. The currency effect on sales was a positive 7.6% with the largest effects coming from the dollar, from the Brazilian real, and from the euro. So all-in-all, a strong and good sales momentum.

Let's then take a closer look at our adjusted operating profit in Q1. So, adjusted operating profit was SEK 3.5 billion versus SEK 3.1 billion last year. As Rickard mentioned, this is actually a record-high Q1 adjusted operating profit for SKF. A contributing factor to the good progress in profitability was that price/mix compensated the higher cost in the quarter.

Let's go through this step-by-step. So firstly, the currency impact was a positive SEK 135 million compared to last year. While the strong dollar contributed to higher sales, we do have a relatively high portion of our costs in euro, resulting in a more limited benefit on our profits from FX. The FX impact was somewhat smaller than our guidance. As you might recall, we guided SEK 300 million and this was driven by high inflation countries, Argentina and Turkey. The small impact on structure relates to our Russian exit. And then on – related to our organic growth which as a reminder is volume, price/mix, it contributed with a positive SEK 2.3 billion. Out of the SEK 2.3 billion, the vast majority or approximately SEK 2.2 billion actually is price/mix and then the rest is volume. And as noted, price/mix has continued to develop favorably throughout the last few quarters. And this was a very good thing now in Q1 and we foresee this continuing also going forward.

The total impact from costs, on the other hand, was SEK 2 billion, i.e., less than price/mix. Cost continued to be high but we do see a moderation in inflation. And just to give you a bit of a flavor, logistics and energy costs were in Q1 at the lower level than last year. But on the other hand, materials and shop supplies clearly higher than last year although we did see some moderation in inflation compared to prior quarters. Salary inflation, on the other hand, accelerated. So, to sum up, we had a continued good momentum with sales, price and mix offsetting inflation. Costs are still high but we do see a moderation in inflation going forward.

Also, we wanted to give you a status update on the efficiency program that we launched in connection with Q3 results last year. This program, as a reminder, is about working more efficiently and reducing fixed costs with focus on staff positions. It's actually a result, as explained back in connection with Q3, of us introducing the decentralized operating model last year with six business areas being responsible for the business and having a more lean group function.

We continue to make progress according to plan. During Q1, we went down in number of total positions by approximately 560. And since the launch of the initiative, we have reduced approximately 250 positions in staff. The annual savings achieved by the end of Q1 amount to approximately SEK 500 million, this being a run-rate number. And just to give you some additional details, some additional flavor of what we are doing here. A larger part of the savings done are actually done in Europe where we do see opportunities to work more efficiently and also have a relatively high number of staff positions. We have retirement programs and voluntary leave programs of agreements. We've also scrutinized our IT spend. We brought parts of our technology development closer to customers and we have scrutinized the usage of consultants.

Moving on to cash flow, we generated a net operating cash flow of SEK 2.7 billion in the quarter. This is a clear step-up compared to Q1 in the prior two years. The driver for the improved cash flow was besides, of course, a strong operating profit, a less negative working capital. Typically, we do build inventories during Q1 and actually during the first-half. But in Q1 this year, we actually worked and also before Q1, we worked quite diligently on inventories to ensure that they do not increase like they did in prior years. So looking at overall net working capital as a percentage of sales, it decreased to 32.4% from 34.3%. The net working capital had a negative impact of about SEK 1 billion but this was due to higher sales which drove higher receivables while inventories, on the other hand, were relatively flat in the quarter. Also, worth mentioning that we have seen a normalization of supply chain bottlenecks and we continue to work on reducing net working capital with a particular focus on the inventories across all of our businesses. And as mentioned before, there are no quick fixes but we are confident we'll start to see net working capital come down over time. So all-in-all, a strong cash flow in the quarter.

What comes to our balance sheet? It continues to be strong and our liquidity also continues to be solid. We had net financial debt amounting to approximately to SEK 12.8 billion, which was a slight increase compared to Q4 and this was driven by the SEK 3.2 billion dividend payout which took place in March. The 12-month rolling return on capital also improved, the 13% driven by our improved profits.

So with that, I hand back to you, Rickard.

Rickard Gustafson

President, Chief Executive Officer & Director, SKF AB

Thank you, Niclas. And let me then try to sum this up. In the first quarter, we delivered a strong organic sales growth of just north of 10% and continued a positive margin trajectory with an adjusted operating margin of 13.1%. Based on the strong growth in Q1, we now update our guidance somewhat. For Q2 2023 and for the full-year 2023, we now expect high single-digit organic sales growth. We will continue to execute on our strategy with good progress in portfolio transformation and strong growth in our targeted segments. The strong financial development and business achievements during the quarter are naturally, to a large extent, the result of the hard work and commitment by our employees. And I would like to take this opportunity to express my sincere appreciation to all colleagues and partners across the entire SKF footprint.

I'm also pleased to announce that SKF is about to embark on a journey to become a purpose-driven company. Collectively, through co-creation by thousands of colleagues, we have defined our purpose that will guide our efforts as we move on from here. Our purpose is together we re-imagine rotation for a better tomorrow by creating intelligent and clean solutions for people and the planet.

So, with that, I thank you for your attention. And I hand back to Patrik and the operator to help us facilitate the Q&A session.

Patrik Stenberg
Director-SKF Group Investor Relations and Mergers & Acquisitions, SKF AB

Thank you, Rickard and Niclas for the presentations. And operator, we are now ready to take the questions from the audience. And as usual, I suggest that we start with questions coming over the phone and we'll continue with the questions posted in the chat. Thank you.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] We have our first question. It comes from Klas Bergelind from Citi. Klas, your line is now open.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

Thank you. Hi, Rickard and – hi, Rickard and Niclas. It's Klas at Citi. So, my first question is on price costs. You say Niclas that price/mix compensated for the cost inflation, but you also say that you had I think posted a volume in the organic growth in the 10%, with Europe and China accelerating. If you fully compensate for the cost inflation, i.e. the SEK 1.9 billion-plus, then I don't get that much volume in the organic growth. Could you help us with how much the volume growth was versus price/mix, please? And I can't see that slide where you back out price/mix versus cost inflation that we've had in the most recent quarters. I'll start there. Thanks.

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB

A

Yeah. Again, hey, Klas. And so, we made – I'll take a step back but we made good progress on price/mix for several quarters. And out of the 10% organic growth, we had – the vast majority was actually price/mix. So, hopefully that gives you a bit of a flavor and this clearly offset the cost now in Q1.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

Okay. Yeah. No. I get the 1% volume growth and I was a little bit surprised considering that China is coming back in March and Europe is bottoming but maybe we can take that later.

And my second one is on the manufacturing side. It looks like SEK 1 billion of inventory reduction clean and typically 20% fixed cost absorption should give you a SEK 200 million negative impact in the bridge, if you could confirm that? And if you could talk about your inventory ambition also into the second quarter if you intend to under-produce again? Thank you.

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB

A

Yeah. No. You are right. Roughly SEK 200 million in the bridge is the effect of that. And on inventories, in general as I said, I mean this has been a focus area for us quite for some time and we clearly start to see a stabilization and of course we want to push it much further and actually take down inventories also. So it's a journey but we are pretty confident that we'll get there.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

And a very quick final one for you, Richard – for you, Rickard. It seems like you increased prices again in January. And I was curious, obviously demand is still relatively strong but will it be at certain levels out there among your customers have changed at all given the changes, looking at the cost inflation side? Thank you.

Rickard Gustafson
President, Chief Executive Officer & Director, SKF AB

A

Yeah. Hey, Klas. Yes. You're right. We have continued to increase prices and our ambition is to continue to compensate for the cost inflation. And now we see also that some new movements, especially related to salaries and wage is on the rise. So it will be a constant focus.

Of course, as the economical climate or engines start to maybe slow down a bit, those activities will be tougher. I can't shy away from that. But for as long as we see cost inflation, we will continue to do our utmost to compensate for those. And so far I think we maintain successful. And I think we're able to articulate clearly the value that we provide to our customers and therefore they also can accept that we need to compensate for the cost inflation. But of course it's getting tougher and tougher out there.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

Thank you.

Operator: Thank you, Klaus. Our next question comes from Daniela Costa from Goldman Sachs. Daniela, your line is now open.

Daniela Costa
Analyst, Goldman Sachs International

Q

Thank you. Good morning, all. Thanks for taking the question. I have two. One, I wanted to follow-up, I think Rickard mentioned during the Industrials presentation some tactical portfolio shifts and I just wanted to follow-up exactly sort of what you're referring to there? Is that – you're referring to the aerospace? Can you give an update there or the localization actions that you've mentioned you wanted to do in US and China, just some further color on how those things are going?

And then a question for Niclas on free cash flow conversion, sort of when you were talking through what you expect to see this year. Is it fair to say that you expect better cash conversion this year or too early to say the inventory will come down only more gradually and too early to call that? Thank you.

Rickard Gustafson
President, Chief Executive Officer & Director, SKF AB

A

Well, thank you, Daniela, for your question, and good morning to you. My comment during my walk through of our Industrial business and the tactical shifts did not point towards the aerospace. I can come back to aerospace. But this is, as I tried to say, pure tactical. We're constantly looking at managing our portfolio, looking into different customer contracts, different product lines or different parts of our business areas. They scrutinize this and they identify some non-strategic volumes that may be dragging the overall results down. And then if we can't fix it within the reasonable timeframe, we are prepared to exit, just as we do within Automotive. So, it's more of this tactical maneuvering. And I don't want to give you any particular examples but you should rest assure that this is an ongoing activity in the way we operate in order to constantly improve our profitability in our business areas.

When it comes to aerospace, that's a different discussion there. There, we have, internally, an initiative ongoing to do a very thorough strategic overview of that business. And I say again we have not yet concluded if we're talking about a divestment or a partial divestment or actually retain it and grow it. We're looking at all these options and we have not yet had a conversation with our board of directors about our conclusions. So that work will continue and I will stick out my neck and say to you that I believe that we should have some sort of idea of the way forward some time during the second-half of this year.

You also had a question on the regionalization efforts and nothing really new to report there. It's still an important part of how we see our business structure evolve over time and the importance of region-for-region or local-for-local. It's just becoming stronger and stronger by every month, primarily also driven by the geopolitical developments that we see. And our efforts remain firm and we drive those activities at high speed as we can. Niclas?

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB

A

Yeah. And then on cash flow, to give you an idea of what we are working on. I mean, as you know, our net working capital is really the key. And of course we are working on profits and continuing to improve and enhance profits. But net working capital is the thing we are focusing on. And in net working capital, it's really about the inventories. That's the kind of big bulk of it where we should see some change and positive change going forward. And we work on inventories, inventory reduction for some time. I think we start to see the first inklings of improvements and we do expect this to improve gradually over the year. Let's see how it pans out quarter-by-quarter. But the direction is at least pretty clear that the inventories will continue to come down in relative terms.

Daniela Costa
Analyst, Goldman Sachs International

Q

Thank you very much.

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB

A

So, I can't – yeah. So, Daniela, I won't give you an exact answer on the kind of conversion but that's anyway the direction. So of course we work towards even further improved cash flows going forward.

Daniela Costa
Analyst, Goldman Sachs International

Q

Understand. Appreciate that. Thank you.

Rickard Gustafson
President, Chief Executive Officer & Director, SKF AB

A

Thank you.

Operator: Thank you. We have our next question. It comes from Max Yates from Morgan Stanley. Max, your line is now open.

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

Thank you. I've just got two questions. The first one, please. Could you talk a little bit about the material costs and what is driving the year-on-year increase? I would have thought – I appreciate kind of a lot of the inflation that we've been seeing is components. I know those move with a lag versus raw materials, but even accounting for that I'm kind of surprised those are still going up to the extent they are. So, maybe if you give us some color within the cost inflation, kind of is it mostly materials and when would we start expecting those to moderate given what we're seeing in steel prices?

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB

A

Sure. And super good question. So, one thing, of course, to remember that when we look at the bridge it's a comparison to Q1 last year and Q1 last year we did not yet see a major effect from inflation in our cost base. So, it's a comparison to quite a low cost base in simple terms. While then during the year, the inflation pushed up the costs and we still see therefore, from a bridge perspective, a relatively – or high cost.

On the kind of components and materials and so on, I mean, you're absolutely right. A big chunk of our costs is components and then materials components actually being the big bulk. We don't buy that much raw materials as a company but we do buy components.

And then as I mentioned, we have logistics and energy which are already now at a lower level than last year. So, it's really materials and particularly components which is driving the cost. And we do see – I mean this comes with a delay. And all else being equal, we do see that the effect in the bridge to look more positive going forward. That's pretty clear.

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

Okay. So, it's fair to assume that kind of the negative bridge impact will start rolling off when we get to sort of...

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB

A

Yes.

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

...Q2 and Q3? Is that fair? Okay.

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB

A

That's correct. Yeah.

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

Okay. That's helpful. My second question was just if you could talk a little bit about your competitive advantage in electric vehicles. You're obviously generating sort of stronger growth rates here or strong growth rates here.

Could you talk about how your competitive advantage may differ in electric vehicles as opposed to traditional vehicles? Thank you.

Rickard Gustafson
President, Chief Executive Officer & Director, SKF AB

A

I think the main difference why we're successful in the electrical vehicles is that we have a strong footprint in the e-powertrain, which is not the case on traditional ICE powertrains. And here we have applications that are truly enabling higher speed, more resilience and robustness and also we have solutions that enables the higher voltages without electrical damages to other critical components through the isolation that's comes with ceramic rolling elements in some of our bearings.

So, we have a broad set of capabilities and applications that many of the major EV manufacturers favor and see that they truly add value and we have something that competitors not yet can copy or can compete fully. And therefore I think we have established a very strong position and we are today a clear number one in the EV segment.

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

That's helpful. Thank you very much.

Rickard Gustafson
President, Chief Executive Officer & Director, SKF AB

A

Thanks.

Operator: Thank you. [Operator Instructions] We have our next question. It comes from Sebastian Kuenne from RBC Capital Markets. Sebastian, your line is now open.

Sebastian Kuenne
Analyst, RBC Capital Markets

Q

Hi, gentlemen. I have a couple of questions. First of all, you made several comments on the EV and also ceramic bearings for industrial applications today. I'm wondering how much more equipment like machinery do you need to ramp-up your ceramic bearings business? You have CapEx of SEK 3 billion in 2020 and over SEK 5 billion in 2022. Do you now expect another step-up going forward and how would that impact capital returns? Thank you.

Rickard Gustafson
President, Chief Executive Officer & Director, SKF AB

A

All right. I can start and Niclas you can fill in. I actually going to turn your question around. I think the main issue to really continue to further scale our ceramic solutions is actually the – there is the supply of the raw ceramic balls that we've been then can further refine. So it's actually the excess of ceramic rolling elements.

There are very few producers out there. They are at their maximum capacity. They are, at the moment, investing and building it out. And we are looking into different ways to secure our access to these critical components. So, one key thing to really scale this up is to build out the supply of ceramic rolling elements is going to be key.

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB

A

And I think Sebastian, on the...

Sebastian Kuenne
Analyst, RBC Capital Markets
Q

[ph] Go ahead (00:40:40).

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB
A

...on CapEx. I mean ceramics as such will not drive CapEx. Of course, we continue to invest in ceramics. We do a lot of research, super-interesting developments. And of course production is also evolving and we are developing production but it's not the major, major driver for CapEx as such. As Rickard said, the interesting thing where we – which we are looking into and making good headway on is the overall supply chain.

Sebastian Kuenne
Analyst, RBC Capital Markets
Q

Understood. And then my second question is again on electric vehicles because you flagged it today so much. What is the current proportion of electric vehicle revenue in the powertrain compared to your overall OEM business? Can you give us an indication? Is it exceeding 10% now or are we still far away from that?

Patrik Stenberg
Director-SKF Group Investor Relations and Mergers & Acquisitions, SKF AB
A

Do you have that secret, Patrik?

Patrik Stenberg
Director-SKF Group Investor Relations and Mergers & Acquisitions, SKF AB
A

It's slightly above SEK 1 billion on an annual basis. So that's the EV part.

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB
A

Pure EV? Yes.

Patrik Stenberg
Director-SKF Group Investor Relations and Mergers & Acquisitions, SKF AB
A

Pure EV. Pure EV.

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB
A

Yes.

Sebastian Kuenne
Analyst, RBC Capital Markets
Q

Pure EV.

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB
A

Yes.

Sebastian Kuenne
Analyst, RBC Capital Markets

Q

And would that mean market share of more or less than 50%? Because I think you are in all the main platforms now, apart from [indiscernible] (00:42:14) I think. But...

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB

A

We don't – we don't comment on...

Rickard Gustafson
President, Chief Executive Officer & Director, SKF AB

A

We will not give you a number but what we say is that we are a clear number one and I think we'll leave it at that.

Patrik Stenberg
Director-SKF Group Investor Relations and Mergers & Acquisitions, SKF AB

A

Yes.

Sebastian Kuenne
Analyst, RBC Capital Markets

Q

Okay. Final question. The exit from internal combustion powertrain business, the partial exit I think it's SEK 1.4 billion that your plan for the year and how much have you already exited? So did you already see this in the Q1 revenues? Is this already partially reflected in Q1 revenues? Thank you much.

Rickard Gustafson
President, Chief Executive Officer & Director, SKF AB

A

It's part – yes, it's partially affected. But of course, we have contracts and commitments that we need to live up to. So it's a phase-out there. So, I don't have the exact number. But clearly a significant part of the SEK 1.2 billion has already happened and still a significant part is still to happen during 2023.

Sebastian Kuenne
Analyst, RBC Capital Markets

Q

Thank you very much.

Operator: Thank you, Sebastian. We have our next question. It comes from James Moore from Redburn. James, your line is now open.

James Moore
Analyst, Redburn (Europe) Ltd.

Q

Yeah. Good morning, everyone. Hi, Niclas, Rickard. I wondered if I could start with the organic piece of the bridge, the SEK 2,274 million. Just wanted to clarify something. Is inventory absorption still in-line? I ask because it's not in the asterisk on page 16 of the presentation but manufacturing is still in the title in the press release. It's always been in that line. I just wanted to firstly...

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB

A

Yeah. Yeah. Yeah.

James Moore
Analyst, Redbum (Europe) Ltd.

Q

...check if that's still the case?

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB

A

James, yes. Yes is the short answer.

James Moore
Analyst, Redbum (Europe) Ltd.

Q

That's great. Thanks. And can I assume that basically the volume, a small positive, broadly offsets or is even less than the absorption item. So, we could draw the conclusion that price/mix as a number on its own is bigger than the SEK 2,274 million. Is that the right way to think about it?

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB

A

Well...

James Moore
Analyst, Redbum (Europe) Ltd.

Q

So, I was thinking about under the volume, minus SEK 170 million is absorption and that would give you...

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB

A

Yeah.

James Moore
Analyst, Redbum (Europe) Ltd.

Q

... sort of SEK 2.3 billion. I'm just trying to get a rough scale.

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB

A

Yeah. Maybe, James, I see your question. Yeah. I can't immediately figure it out in my head. So maybe we can take it offline. Not to take too much time on the call just to mention...

James Moore
Analyst, Redbum (Europe) Ltd.

Q

Not a problem. And in terms of active portfolio management and the sales that are leading. Is it just the Automotive side or away from the SEK 1.2 billion, are there any other portfolio elements that you're exiting?

Rickard Gustafson
President, Chief Executive Officer & Director, SKF AB

A

The answer is yes. We haven't give you a number beyond what we have said for Automotive. But as I try to explain also for Daniela in her questions that, yes, also in our Industrial business and all our business areas, we are driving tactical improvements to our portfolio, addressing low-performing contracts or product lines or other things that is of non-strategic nature to what we want to achieve. And then the teams are putting a clock ticking, saying either we have an idea of how we're going to fix this in a reasonable timeframe. If not, we're going to find a way to leave it and put our emphasis elsewhere. And that is ongoing.

But I don't have a specific number there. It's more kind of an ongoing activity that would drive – which is important to further strengthen our underlying profitability also on the Industrial side.

James Moore
Analyst, Redbum (Europe) Ltd.

Q

No. I fully understand that and important drive to any business forward with portfolio management. I just wondered...

Rickard Gustafson
President, Chief Executive Officer & Director, SKF AB

A

Yeah.

James Moore
Analyst, Redbum (Europe) Ltd.

Q

...whether you have any idea as to what it's doing to the impact on group volumes. Obviously, it's an accretive thing to be getting out of loss-making business lines.

Rickard Gustafson
President, Chief Executive Officer & Director, SKF AB

A

Yes.

James Moore
Analyst, Redbum (Europe) Ltd.

Q

I just wondered if you thought it was taking [ph] points (00:46:25) of volumes or 4 points of volumes?

James Moore
Analyst, Redbum (Europe) Ltd.

Q

Well, I don't – we don't – I don't disclose that. But I hope that you also see that we – our outlook is still strong organic growth and we actually even taking up the outlook a little bit this year. So, it should not have a significant impact on our growth ambitions.

James Moore
Analyst, Redbum (Europe) Ltd.

Q

Thank you very much.

Operator: Thank you, James. We have our next question. It comes from Andre Kukhnin from Credit Suisse. Andrew, your line is now open.

Andre Kukhnin
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Hi. Good morning. Thanks for taking my questions. Can I just started with a quick follow-up on the EV versus internal combustion engine within Automotive, the exposure. So is there a margin difference between these two revenue streams for you and which way?

Rickard Gustafson
President, Chief Executive Officer & Director, SKF AB

A

The answer is yes. And the EV market is – given that those applications and our value-add in those applications are higher. We also see a higher margin but I won't go into further details on that.

Andre Kukhnin
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

I appreciate that. Thank you. And could you just confirm where your labor inflation is settling for the year? I presume now you had the negotiations complete...

Rickard Gustafson
President, Chief Executive Officer & Director, SKF AB

A

Yeah.

Andre Kukhnin
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

...and you've got...

Rickard Gustafson
President, Chief Executive Officer & Director, SKF AB

A

Yeah.

Andre Kukhnin
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

...visibility for the whole year?

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB

A

Well, it's – given we have more than 40,000 people all around the world, it's not like there's one date where it moves up. It's correct that in Northern Europe, from 1st of April onwards, or in Sweden there was an agreement. Recently, in Germany, there was an agreement late last year and so on. So, it comes throughout the year and we said we did see a – not surprisingly at all, exactly according to expectations. We did see a further increase acceleration in inflation in Q1. And let's see where it ends up. But I mean, 5%-plus, it's 6% maybe what we see now.

Andre Kukhnin
Analyst, Credit Suisse Securities (Europe) Ltd.
Q

Got it. Thank you. And then that's what you saw in Q1 as well, 5%-plus for the year and that's where you think you are?

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB
A

Yeah. Again – yeah. I don't – I'm not sure we want to go into the exact numbers per quarter of salary inflation as such, but it's more the trend that we are highlighting, which again is no surprise as such that there was nothing surprising in Q1. But we do see a continuing trend with salary inflation pushing up overall employee costs. And we expect that also now to continue in the coming quarters.

Andre Kukhnin
Analyst, Credit Suisse Securities (Europe) Ltd.
Q

Thank you. And just last one for me, a broader question on M&A. We see some of your peers kind of exploring adjacencies, maybe even going farther for immediate adjacencies. Do you think we can see SKF participating in the kind of M&A trend in this industry or in the near-term, or is the current priority very much on streamlining the portfolio and high grading and once that's done then we maybe think about it?

Rickard Gustafson
President, Chief Executive Officer & Director, SKF AB
A

Well, Andrew (sic) [Andre] (00:50:01), thank you for an important question. My answer is actually to your later part of your comment. As of now, our main emphasis of focus is to really, you know, embed this new operating model of ours, really get the momentum and traction going in this whole portfolio shift and strategic transformation that we have embarked upon. I'm pleased to note that that transformation is really starting to yield some positive returns. And I think the numbers in this quarter is a proof point of that.

Once we have this, we will definitely also start to think about a broader agenda that could also include M&A activities. So – but I think you have to wait for a few more quarters before we are ready to really embark on that journey. Now, it's all about making sure that we maximize the efficiency in the business that we set on.

Andre Kukhnin
Analyst, Credit Suisse Securities (Europe) Ltd.
Q

Great. Thank you very much to both of you.

Rickard Gustafson
President, Chief Executive Officer & Director, SKF AB
A

Thanks.

Operator: Thank you, Andre. We have our next question. It comes from Andreas Koski from BNP Paribas. Andreas, your line is now open.

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)
Q

Thank you and good morning. I have a couple of questions. First one is on your organic growth guidance for the second quarter. You guide for high single-digit organic growth versus 10%-plus in the first quarter. So, you are sort of guiding for a year-over-year slowdown in your organic growth. And I would assume that we will see much stronger growth contribution from China and North-East Asia because of the lockdowns that we saw in Q2 last year, implying that the growth rates in Europe and North America are expected to slow quite a lot. So I just want to understand is that slowdown expected to come from price/mix or from volumes?

Rickard Gustafson
President, Chief Executive Officer & Director, SKF AB

A

Well, your conclusions there, I agree with some. I am not sure I'm fully following your logic on some of those comments. But, in general terms, yes, from a comparison point of view, in Q2 I would expect China to be – have a strong growth number given that the Shanghai region was basically in lockdown in Q2 last year and we saw a strong rebound, as I mentioned, here in Q1. And we foresee that to continue.

Based on the momentum that we saw in Q1 and what we have seen in the beginning of Q2, we believe that the best guidance we can provide is a high single-digit for Q2. And the second-half of the year, while we do think that there might be a more challenging there – more challenges, more volatility potentially, and at some point I also believe that the slowdown in the economy will be visible. We don't foresee a massive drop but maybe not significant volume growth either. So, all-in-all for the full-year, if you do the math, you will end up in a high single-digit where you see some maintained growth throughout the entire year.

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB

A

Maybe if I just add. I mean you are right in the dynamics. I mean we'll see China, for comps reasons, already. But also for fundamental reasons, we expect a good China and north of China and maybe somewhat more muted Europe and US.

Saying that, I mean overall it is pretty positive. I mean we upgraded the guidance and we feel pretty confident about that. So, both Q2 and full-year and also our second-half of the year, of course the comps are a bit tougher.

Rickard Gustafson
President, Chief Executive Officer & Director, SKF AB

A

That's true.

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB

A

But also there we see a good momentum as far as we or where we are today at least. So, overall, quite positive outlook.

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)

Q

Thank you. And then on the cost bridge and the SEK 2 billion headwind that we saw in this quarter, could you help us understand how much of that was explained by salary, how much of that was explained by material and shop supply and what was the tailwind that you had from logistics and energy?

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB

A

Again, the big picture is that, first of all, as I said earlier, I'm sorry if I'm repetitive. But last year, we did not have a major impact on cost of inflation on the cost. Then gradually over the last 12 months, the costs have become higher and higher as a result of inflation. And we are still at a high level and we expect, from a bridge perspective, things to ease quite significantly going forward.

And as I mentioned, we have some categories such as logistics and energy already showing in the bridge as positive and we expect some other categories to follow. Material sales, by far, the biggest chunk of the cost, then followed by salary costs and then other.

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)

Q

Okay. The reason for asking is that I think you've been helpful quantifying the different categories in the past but you don't want to do that now.

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB

A

Well, no. Well, we have two minutes left of the call. So, let's – we can go through the details also. But I think the big picture is very important to understand that, yes, we do see high costs but we also do see a good momentum there that gradually costs will start to, from a bridge perspective, come down. Then as Rickard said earlier, we still have inflation, as we all know, out in the economy and that's why we are still very much focusing on price increases.

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)

Q

Sorry. What was the inventory build of finished goods and the impact on EBIT in the quarter?

Patrik Stenberg
Director-SKF Group Investor Relations and Mergers & Acquisitions, SKF AB

A

Andreas, it's Patrik here. We had a swing of about SEK 1 billion in terms of build of finished good inventories in between Q1 this year compared to Q1 last year, so the EBIT effect would be about SEK 200 million or so negative.

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)

Q

Okay. But compared to Q4, you built inventory or reduced inventory?

Patrik Stenberg
Director-SKF Group Investor Relations and Mergers & Acquisitions, SKF AB

A

We reduced inventory...

Niclas Rosenlew
Chief Financial Officer & Senior Vice President-Group Finance, SKF AB

A

Yeah.

Patrik Stenberg
Director-SKF Group Investor Relations and Mergers & Acquisitions, SKF AB

A

...compared to Q4 in terms of finished goods.

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)

Q

Okay. Thank you. Thank you very much.

Patrik Stenberg
Director-SKF Group Investor Relations and Mergers & Acquisitions, SKF AB

A

Thank you. We are coming to...

Operator: Thank you.

Patrik Stenberg
Director-SKF Group Investor Relations and Mergers & Acquisitions, SKF AB

A

...an end of our time slot here. So, I think...

Rickard Gustafson
President, Chief Executive Officer & Director, SKF AB

A

Yeah.

Patrik Stenberg
Director-SKF Group Investor Relations and Mergers & Acquisitions, SKF AB

A

...we have to cut the Q&A session here and in order to make room for a couple of last words or final remarks rather from Rickard. So with that, thank you so much.

Rickard Gustafson
President, Chief Executive Officer & Director, SKF AB

Well, thank you, Patrik, and thank you for joining. As I said, we are pleased with the numbers that we report in this quarter. The strategic transformation of this company continues. I believe that the strong sequential improvement in profitability compared to the last few quarters and the improved cash generation is a clear proof point that our activities are having the impact as we were hoping for. Those – that work will continue as we take on the further challenges in the rest of this year.

So with that, I think we'll stop. And I thank you so much for your attention and I wish you all a very, very good day. Thank you.