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Q3 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, welcome to the SKF Q3 Results Conference Call. I am Sandra, the Chorus Call operator. I would like to remind you that all participants will be in listen-only mode and the conference is being recorded. The presentation will be followed by a Q&A session. [Operator Instructions] The conference must not be recorded for publication or broadcast.

At this time, it's my pleasure to hand over to Patrik Stenberg, Director, SKF Group Investor Relations and Mergers & Acquisitions. Please go ahead, sir.

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

Thank you. Good morning and welcome to this Q3 conference call. We will start with a presentation by our CEO, Rickard Gustafson; and our CFO, Niclas Rosenlew, as usual. We will try to keep that shorter – slightly shorter than 30 minutes. After that, we will be open to receive your questions, and we look forward to the dialogue with you there. As usual, you could either use the chat function if you want that, which is available at this call, or you could post your questions over the phone, as usual.

With that brief intro, I leave the word to Rickard, please.

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

Thank you, Patrik, and warm welcome, everyone, and good morning to this quarterly report presentation. And I guess we get started all directly. So, when we started this year, we forecasted that demand would be stronger in the first half of the year and then soften in the second half of the year, and we were right. We now see reduced demand across all regions. However, I am pleased to note that our strategy and operating model are creating more resilient SKF.

Despite headwinds from negative volumes and a somewhat unfavorable business mix impact, we deliver a strong set of numbers in the quarter. All in all, we report a flat organic growth, with net sales of just shy of SEK 26 billion, an adjusted operating profit of SEK 3 billion, and a very strong cash flow from operations, north of SEK 3.4 billion.

Adjusted operating margin came in at 11.5% compared to 8.5% the same quarter last year, and our operating margin performance should also be viewed in the light of a somewhat negative mix effect, where automotive growing ahead of our higher-margin industrial business. Across our business areas, we have continued our price and portfolio management activities. We have reduced costs and inventories to effectively manage the turned business cycle.

But now, let's try and take a deeper look into the sales development by geography. Despite a general slowdown in the market, we saw that EMEA and India and Southeast Asia are holding up well, with a mid-single digit organic sales growth. In both regions, the underlying volumes are somewhat down, but compensated by a positive price and mix development. However, China clearly did not rebound as expected, with the downward pressure on demand. This was particularly visible in the Wind segment that turned from a solid growth in Q2 to a sharp decline in Q3. This in isolation had a 3 percentage points negative impact on our organic growth rate for the entire group in the quarter.

Another area [ph] we are (00:04:10) noticing softer markets is North America. This is a continuation of a slowing trend that we have seen for some quarters now. It's mainly related to destocking among some key OEM customers, primarily within food and beverage and agriculture. The ongoing strike affecting our customers in North American automotive industry has so far had a very limited impact on our growth rate in the region. But furthermore, we have also, across all our regions, exited some unprofitable business, this, of course, having a negative impact on volumes, but contributing positively to our profitability.

In the quarter, we were also affected by the increased geopolitical tension in the world. In August, our factory in Lutsk, Ukraine, was hit by a Russian missile attack. Three of our colleagues were killed and assets were damaged. But I'm impressed by the rapid response from the entire SKF organization to this outrageous event. Very quickly we were able to support and aid our Ukrainian colleagues, as well as rerouting our supply chain to eliminate any negative impact on our customers.

But let's turn into our business segments Industrial and Automotive. I'm starting with Industrial business. Here, I am pleased to report that many of our high-growth segments continue at double digit organic growth rates, with Aerospace and Rail growing north of 20%. Also, our industrial distribution business remained strong with an organic growth of 5% on a global basis. But however, as I mentioned, the slowdown in China and primarily the wind industry and the OEM destocking in North America, the overall growth rates for the Industrial business landed at a negative 2%.

It is, though, satisfying to see that all Industrial business areas continue to leverage price, drive cost-out initiatives and ensure rigorous portfolio management. As a result, we report an adjusted operating profit of SEK 2.5 billion, a significant uplift versus the same quarter last year. Corresponding adjusted operating margin came in at 13.7% despite declining volumes and a negative organic sales growth.

Turning to Automotive, a somewhat different story. The ongoing strategic repositioning within our Automotive portfolio continues at high pace and is progressing well. In the quarter, we saw an organic growth rate of 3%, with an adjusted operating profit of almost SEK 0.5 billion. The adjusted operating margin came in at 6.2%, which is a doubling from the same quarter last year, and an additional step towards our 8% annual margin target by 2025.

So, to leave the numbers for a second and turn towards strategic framework and our execution of it, throughout the quarter, we have continued to embed and execute on all dimensions of our intelligent and clean framework. In today's presentation, I will share more details on some of them, namely innovation and technology, regionalized and competitive supply chain, service and aftermarket and portfolio management.

But starting with the innovation and technology, naturally, innovation and technology development are key to our long-term success. And we have built a healthy innovation pipeline with new products being introduced to the market at a regular basis.

In today's presentation, I would like to share a few examples of new innovations that provide significant customer value. For our Machine Tool customers, SKF designed a new generation of super precision bearings. Our new digitally connected bearings enables real time fine-tuning of the machine cycle and thereby significantly improving productivity, efficiency and quality.

Within our Rail segment, we have recently launched 3D printed axlebox covers. This enable us to produce and offer spare parts on demand and thereby creating additional customer value through reduced lead times, lower inventories, and solving many obsolescence issues.

We have also introduced a new Agri Hub with improved robustness in the housing, enabling customers to seed at double speed with more precise placement. Furthermore, the new hub for agriculture is also more environmentally-friendly by eliminating the risk of grease contamination into the soil.

So, many exciting examples there but let's move on to the supply chain. Competitive and resilient supply chains by regions are critical to be close to our customers, improve our cost competitiveness, reduce our environmental footprint, and to mitigate geopolitical risks. In some regions like EMEA, we are focusing on consolidating our manufacturing footprint. The announced shift of production capacity from Luton in the UK to Poznan in Poland is one prime example of this.

In other regions like the Americas, it's more about capacity – building capacity from scratch. As you may recall, in Q4 last year, SKF communicated its investments in Monterrey, Mexico. And already in October this year, we celebrated the official inauguration of our new factory. With this new factory, we are increasing our competitiveness, positioning ourselves close to our North American customers and reinforcing the value chain in the region. This investment also supports the ongoing automotive portfolio repositioning by strengthening our offering to EV and commercial vehicle customers in the region.

Now, let's take another look at service and aftermarket. In many industries, effective monitoring of assets and predictive maintenance are key to reduce downtime, and thereby unlocking financial and environmental benefits. We see strong demand for our asset monitoring services. And we recently signed a five-year agreement with international mining and mineral group, LKAB, to develop monitoring solutions for all their assets. This is a great example of how we expand our service business with our customers. The contract now includes online and onsite vibration analysis, remote diagnostics, application engineering and lubrication management. By introducing data-driven maintenance, SKF can effectively support LKAB in reducing unplanned stops and lowering the risk of accidents.

And finally, I'd like to take you through an update on portfolio management with a particular emphasis on aerospace. As you will recall, at our Capital Markets Day in December last year, we announced a strategic review of our Aerospace business. And today, I am pleased to report back the conclusions and the outcome from this review. The Aerospace Industry is a high growth, high-tech industry, where we have a strong and unique position. However, our current aerospace portfolio is to some extent the result of historical acquisitions, creating a wide assortment range.

To leverage our full potential within this industry, we intend to put even more emphasis on our core segments, Aeroengine bearings and Aerostructures. We have already initiated numerous pricing and contract management actions that will step up the profitability in near term. In addition, these areas will be further strengthened through accelerated investments, including digitalization, automation, and additional modernization of our manufacturing footprint.

In our strategic review, we have also identified some high quality business lines with strong market positions in their respective niches, but they fall outside our of core Aerospace offering. For these non-core assets, we intend to explore options to exit these attractive business lines. I'm convinced that by focusing on our core business and seeking strategic options for areas outside of our core, we will unlock the full potential of the Aerospace business. But let's take a deeper look into the aerospace portfolio.

In total, our Aerospace business has a turnover approximately SEK 6 billion, but the majority, some SEK 5 billion, come from our core areas, aerospace engines and aerostructures. For these business lines, we intend to leverage our leading position and tangible synergies with our industrial bearing business to become an even stronger partner to our customers.

Our non-core business lines with a turnover of approximately SEK 1 billion cover product lines such as mechanical seals, rings, precision elastomeric devices. These are primarily manufactured in our facilities in Hanover and Elgin in the United States. We're convinced that these high quality assets with attractive business prospects will have an even greater potential with the right owner or partner.

So, with this overview, I will now hand back to Niclas to take you through the numbers in more detail. Niclas.

Niclas Rosenlew

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

Thank you, Rickard. And hello, everyone. Starting off with sales, as Rickard mentioned, after a long period of strong growth, we started to see the effects of a macroeconomic slowdown in the quarter. Q3 sales amounted to SEK 25.8 billion, up from SEK 25 billion a year ago. And while we continue to see sales growing in many industries and geographies, overall growth was impacted by a decline in China, as Rickard mentioned, to a large degree driven by wind and continued destocking at large OEMs in the US. Year-on-year volumes turned negative in the quarter, but this was offset by a good pricing momentum across multiple industries and product segments.

Compared to last year, our net sales increased by 3.2%. We had a small positive structural impact from two seals business related acquisitions made in Q2. Organic sales declined by 0.6%, and the currency effect on sales was a positive 3.7%, with the largest effects coming from the euro and the dollar. So all in all, a solid sales performance in Q3.

What comes to the operating margin? We delivered an adjusted operating profit of SEK 3 billion and a margin of 11.5%, which is a significant step up compared to last year. We adjusted our cost base to lower volumes, continue to have a positive effect from increased prices and continue to improve all exit low margin businesses.

So looking at the bridge step-by-step, the weak Swedish krona and our relatively high cost base in Europe affected profitability. The net effect was approximately SEK 70 million negative in the quarter. The organic growth contributed with SEK 400 million positively. This was largely driven by a strong price mix, offset by approximately SEK 100 million from lower production levels as we reduced inventories.

Total costs declined by SEK 500 million. And within costs, energy and logistics contributed positively. Materials was relatively flat, while personnel cost inflation impacted positively.

During the quarter, we also continued our efficiency measures as planned. The earlier announced SEK 2 billion cost reduction program is on track. And furthermore, we also took action specifically in Germany related to our footprint shift, resulting in provisions of about SEK 300 million. Profitability was solid, especially considering the more challenging market environment. And it should also be noted that margins in Q3 and second half typically are lower than in first half.

Moving on to cash flow. We generated a strong operating cash flow of SEK 3.4 billion in the quarter, a clear step up compared to last year. The driver of the improved cash flow was besides, of course, the stronger operating profit, a reduction in working capital. During Q3, we continued our work on reducing specifically inventories with inventories coming down approximately SEK 1 billion compared to last year.

Looking at overall net working capital as a percentage of sales, it decreased to 31%, down from close to 36% a year ago. And this is – we are now approaching a more normalized level of around 30%. As you can see in the bridge, net working capital had a positive impact of about SEK 800 million, mainly due to reduced inventories.

So, we continue to work on reducing net working capital with focus on inventories across our businesses. As said before, there's no quick fixes, but we are actually very pleased with the progress made in Q3. So, all in all, a very strong cash flow in the quarter.

What comes to a balance sheet, it continues to be strong and our liquidity to be solid. Net financial debt amounted to SEK 9.8 billion, which is a decrease versus Q2 and also decrease versus last year, driven obviously by the strong operating cash flow. What comes to return on capital employed, we also saw a positive development in the quarter with the 12-month rolling return on capital employed improving further to 14.9%, driven by both solid profits and a strengthened capital efficiency.

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 sum up. In Q3, we delivered resilient margins and strong cash flow despite the volume decline. Our actions to manage cost, prune the portfolio, and reduce inventories have enabled us to effectively manage the shift in the cycle. In addition, we have maintained our high pace in deploying our strategic framework, enhancing our product innovation capabilities, and concluded the strategic review of our Aerospace business.

Going forward into the final quarter of the year, we expect a continued lower demand scenario. The fourth quarter of 2023, we expect a low-single-digit organic sales decline. For the full year, we expect a mid to low-single-digit organic sales growth compared to 2022. Beyond 2023, we expect continued volatility and geopolitical uncertainty, and we are preparing the business for different scenarios and we're ready to act accordingly as the situation develops.

But regardless of the economic cycle, we will execute our strategy with speed and create an even stronger SKF. We are encouraged by the results to date and we continue to build for the future by investing in regionalization, automation and product innovation. Finally, I would also like to take this opportunity to sincerely thank all SKF colleagues for their hard work and contribution in our ongoing transformation journey.

So with this, I'd like to hand over to Patrick and the operator to help facilitate our Q&A session.

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

Thank you, Rickard, and welcome back, Niclas. With that, I suggest that we move over to the Q&A. And let's start with any questions we received so far over the phone. Operator, please.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] Our first question comes from Daniela Costa from Goldman Sachs. Please go ahead.

Daniela Costa
Analyst, Goldman Sachs International
Q

Hi. Good morning, everyone. Thanks for taking my question. I have three questions. The first one is kind of a few clarifications around Q4. If you could maybe comment more clearly on like how much pricing do you have and any carryover that – sorry, in Q3, how much pricing did you have and any carryover left? And also, whether there was any underproduction impact on the margin, if you could clarify that?

And then, just following on on margin, as a second question, more over the medium-term, you have your 14% target, which this quarter you were still quite far from that. The environment is deteriorating. Does that push your expectation of when you can reach that further away or do you have actions the next year in particular that you can pull forward perhaps on the cost side?

And the final point, now that you've sort of commented on the last thing that you had mentioned on the portfolio, which was aero, what are the next things, the next priorities? Is there anything left on the portfolio that you would like to do? And can you maybe give us a hint on sort of how to think about it going forward? Thank you.

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

Thank you, Daniela, and good to hear your voice again. I answer you – the second and third question and then go on to ask Niclas to refer to your first question, if that's okay. I'll start with the 14% target. And yes, you're right, we still have a way to go to deliver on that target. I personally and this is my message to the SKF organization as well, that of course a setting in the global demand will make it a tougher to reach the target. But that should not stop us. We should be able – through actually driving efficiencies and further cost improvements and through automation and digitalization, we should be able to aim and reach that target regardless of the economic situation.

So, that's kind of the mindset and the drive that we have in the organization. As normal, I don't dare to stick out my neck and give you a date for when I think we're going to get there. But we clearly have not lost line of sight of that's where we want to take this business as the first step.

On the aerospace question, or rather your question about portfolio management in general, are there more like aerospace. I think this was one important step that we did. There are other similar parts of our portfolio like aerospace where I think we could benefit from some further clarification. And a number of those activities are ongoing. And once we conclude them, I'm sure that we will have a chance to come back to you to share more. But this is not just a one-off. I think there is more work to be done in the portfolio but probably the generic answer to your question. Now, Niclas.

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

A

Yeah, pricing. Hi, Daniela. So in the quarter, we had – the price/mix impact was roughly 5% positive. And what comes to pricing, increasing prices, we continued with very select price increases, more select than before. But anyway, price increases and that's what we intend to do also going forward.

Daniela Costa
Analyst, Goldman Sachs International

Q

Clear. Thank you.

Operator: The next question comes from Andrew Wilson from JPMorgan. Please go ahead.

Andrew Wilson
Analyst, JPMorgan Securities Plc

Q

Hi. Good morning. Thanks for taking my question. I've got three. But they're quick so I'll do them all together. And can you just – just on – to follow Daniela's question on price, are there any conversations taking place with customers on prices maybe coming down given what we've seen in terms of, for example, the steel price after obviously a period where prices were able to be pushed up as a result?

And secondly, can you help us a little bit – you sort of mentioned on the [indiscernible] (00:27:17) the volume contribution from the exits in terms of the work you're doing with regards to sort of pruning that portfolio. Just to try and give us an idea of the quantum and maybe what you think of in 2024 on that.

And then I guess finally, and it's probably a broader question, but you sort of identified quite sustained destocking in a couple of the US market, and obviously, a big decline in wind in China. Are there any other markets that you would flag to be aware that look like they are particularly above trend and therefore, how we should think about the trajectory in those markets as we go through kind of Q4 and into 2024? I appreciate that's quite a broad question and just asking you to kind of make a call on the outlook to some degree. But it'd just be really helpful for us to understand if there are pockets which you would particularly flag so we can better understand that. Thank you.

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

A

Okay. Thank you. I'm going to ask Niclas to answer your price improvement question and I'll try to come back to the more industry development question at the end there.

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

A

Yeah. So, thanks, Andy, for the quick and short questions. But on pricing, obviously, with the tougher economic climate, there are pricing discussions with customers. We do not see a particular need for price down. That's the short answer. As I said earlier, we are continuing actually to work on select price increases. And then on the auto volume effect of exits, again I refer back to what we've said before that we have SEK 1.2 billion in sales roughly that we plan to exit. Half of that is something that we've realized while the other half of it we've agreed with customers essentially on price increases, and that's of course affecting the volumes as well. But by and large, it's not the major part of our overall business, but it is affecting volumes.

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

A

Right. And Andrew, on your destocking question. It's not one size fits all here. And as I mentioned in my comments during the presentation, we also see a number of industries where we have still very strong double-digit organic growth. Rail and Aerospace being two prime examples. While in some others, we have seen the destocking and it's been primarily visible in some industrial segments in North America. I mentioned food and beverage now and agriculture, but of course, it's not isolated in just North America. We see the same trends in India and Southeast Asia and to some extent also in Europe, but not to the same extent.

Clearly, in a way, we now have a world where we come out of the very problematic logistic situation that we had a couple of years back that forced many of our customers to stock up. At that time, interest rates were rather low. Now, we have the opposite world where, gladly, the logistics have stabilized globally. On the other hand, interest rates have gone up and that also pushes the incentive to destock further.

The good news is also that our global distribution business is holding up well, and it's hard to guess how long this will continue. But at some point, many of these customers start to stock up again. And then hopefully, we're going to have a more positive trend. So I started to give specific examples besides the one that I shared, because those are the ones that really stand out.

Andrew Wilson
Analyst, JPMorgan Securities Plc

Q

No, that's all very helpful commentary, guys. Thank you. Appreciate it.

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

A

Thank you.

Operator: The next question comes from Max Yates from Morgan Stanley. Please go ahead.

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

Thank you. Good morning, everyone. Could you just talk a little bit about Europe and what you're seeing, because I guess when I look at sort of Europe, China, and Northeast Asia and North America, Europe is your strongest region? And I think quite a lot of kind of your industrial peers have seen quite sort of meaningful slowdowns there. So, what would you say is sort of the difference that you were seeing here? I mean, are you seeing kind of weakness in your general industrial business but it's just rail and aerospace is sufficiently strong, or do you think there's any kind of delayed effect that we may see that take a leg down given where kind of PMIs are and general European industrial sentiment? That's my first question.

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

A

All right. I agree with you. Europe has turned out to be more resilient maybe than anticipated. But I also think it's important that we clarify that also in Europe, we do see negative volumes at this stage. So, yes, there are also downturn in the economic sentiment also across Europe. So far, our price and mix actions have been able to overcompensate for this slowdown, and that's why we still report a solid organic growth in this particular region.

Clearly, when we get into this end of this year, we're going to meet the tail. Some of these price initiatives that we were able to push start in the second half last year. And, of course, the comparison was going to be tougher as we move into 2024. But in many aspects, though, I do believe that – I'm very pleased to see that Europe is holding up better. And for – right now, we see a stronger pattern in Western Europe than Eastern Europe at the moment.

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

Okay. And maybe just a quick follow-up on your China wind comment. Could you just clarify? Did you say that China wind had impacted growth by 300 basis points or what exactly did you say there? And are we at the – I mean, where are we in this process? Is this – I mean, it's something that you've particularly started talking about this quarter. So does that mean that this is something that probably continues for a couple of quarters or what sense do you get when you speak to your customers and look at the market there?

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

A

Right. What I did say was that we have seen a very, very strong growth in Chinese wind industry throughout Q1 and Q2 that turned to a sharp decline in Q3. And yes, that thing in isolation, the change in wind industry in isolation had a 3 percentage points impact on our organic growth rate in the quarter.

What has – this is driven, what I call it, for political reasons. I'm not pointing out to China. I think – wind has a lot of political dimensions in many geographies. But focusing on China, what we've seen there, we've seen that in the quarter, some of the planned wind parks, offshore wind parks that were in the making has been stopped, I guess, for defense reasons. And then many other companies that are applying to build new wind farms, offshore wind park and onshore wind farms in China, the approval process for new farms is stalling and takes longer time.

Is this something that's going to be remained for a long period of time or a shorter period of time? It's hard to guess. But for us, it means that number of our OEM customers in China that are willing to build out wind capacity is waiting for permission to get started. And while they wait, they have stopped their orders. So, that's kind of where we are, and I hope that gives you some color to the situation on wind.

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

Yeah. That was helpful. And just maybe one final very quick follow-up. Just on your margin comments, you mentioned kind of seasonally margins are typically sort of weaker in the second half. Could you just talk a little bit about how you think internally about fourth quarter seasonality? I mean, should we assume kind of with the low-single-digit decline in organic growth that we do see as sort of normal, I think it's something around 100-basis-point step down in margins for the fourth quarter, perhaps without giving specific guidance, but how should we think about margins in the fourth quarter versus the third?

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

A

Well, thank you for giving me a chance to clarify myself. My remark on the Q3 margin was more that Q3 is – has the seasonality pattern in our business due to the holidays in July and August. Q4 is not, as I say, has not the same seasonality pattern, even though at the end of the fourth quarter, of course, we get into the holiday season as well. So, there's a little bit of that there. But it's primarily Q3 that I refer to.

And I'm sorry, we don't really guide for the margin development. We guide for organic growth. And we have seen that, and I know that our business areas are working diligently to hold the margins and continue to strengthen our operation. But we also know that volatile world around us and with FX moving quite a bit that is also impacting us. So, I'm going to defer to give you any kind of idea or any more clarity or guidance on what to expect in Q4, but you should not see it as a highly – some seasonality in the Q4 is not really what we're talking about.

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

Okay. Very clear. Appreciate the comments. Thank you.

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

A

Thanks.

Operator: The next question comes from Sebastian Kuenne from RBC. Please go ahead.

Sebastian Kuenne
Analyst, RBC Capital Markets

Q

Yeah. Good morning. Two remaining questions here. You haven't mentioned anything on the electric vehicle business. And I was wondering if the momentum there has dropped a bit. Maybe you can give a bit more detail there and also what you expect for the full year on that business.

And secondly, the SEK 300 million charge for Germany is – can you tell us if that relates to [indiscernible] (00:38:01) to the main plant or what the reasoning is for that charge? I had assumed it relates to Luton and Poland, but it seems to be another thing. Maybe you can elaborate a bit. Thank you very much.

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

A

Yeah. Hey, Seb. So, on EV, we have a good momentum as we've commented on before and that very much continued in Q3 as well. And we expect it to continue going forward as well. On the German kind of provision, we made SEK 300 million. You are correct, it's not related to Luton, for instance. It is related to German footprint shifts. So, it's part of our long, bigger kind of program to shift footprint as Rickard was commenting, right, ensuring we have the right set up in Europe and then increasing our presence in, for instance, Mexico. So, it's specific actions that we are taking in Germany.

Sebastian Kuenne
Analyst, RBC Capital Markets
Q

Understood. Just a follow-up for the electric vehicle business. In the past, you had given [ph] all the good (00:39:22) guidance. I remember 2021, you said SEK 800 million. In 2022, you mentioned that 60% growth. What's the current view on 2023 for the [indiscernible] (00:39:33) business? Is it still the 25% you mentioned in Q1, 25% growth, which would give you the, like, SEK 1.6 billion revenues there?

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

Right. We continue to see good growth in the EV segment. It's still solid double-digit growth rate, somewhat down from what we've seen in Q1 and Q2. Also, again, very much related to China, but still solid double-digit growth in the EV segment.

Sebastian Kuenne
Analyst, RBC Capital Markets
Q

Excellent. Thank you very much.

Operator: The next question comes from Kim, John from Deutsche Bank. Please go ahead.

John Kim
Analyst, Deutsche Bank AG
Q

Hi, it's John from Deutsche. Good morning. Can we talk a bit about the cost controls in the 2024/2025, should the market stay soft? I think you alluded to this a bit earlier. If you could kind of flesh out what sort of measures you're thinking about, what sort of magnitude that could have would be helpful. Secondly and unrelated, can you give us some sense of timing for the aerospace process? I believe you indicated there's about SEK 1 billion in sales that are non-strategic. Any view on the timeline there? Thank you.

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

All right, John. Niclas will answer your cost question. I will try to give you the answer to your aerospace question.

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

Yeah. Okay. Hey, John. So, on cost control, as you know, I mean, we have a couple of broader initiatives. We have the so-called SEK 2 billion program that we launched late last year. And there, as commented, we are very much on track. So, the target there is to end that program or get to a SEK 2 billion run rate by end of this year. And that's where we are heading towards. And that should then have an impact all over the cost 2024, also 2025.

The other kind of longer-term initiative that we have is, of course, related to our, what we call, the world-class manufacturing, including footprint shifts, automation and so on. And there, we also are on track. That's a 2025 SEK 5 billion benefit program.

In addition, obviously, I mean, these are larger initiatives. But in addition, obviously, we're very much focused on managing the day-to-day costs and align with the environment around us. Essentially, when volumes go down, we work on or take costs out in addition to these programs.

So, I'm not sure that that gives you everything you need. But managing cost is very much topical and important thing that we work on day in, day out here.

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

A

Right. And coming back to your aerospace question and the timing for it, today, we have concluded and communicated our conclusion on our strategic review. And we have identified a set of highly attractive assets that in – but in our way of driving the business forward, it will be treated as non-core. I know for sure that these assets are attractive to many players out there, and I hope that we will get in constructive dialogs pretty quickly. But I can't give you any timing here. It's – this process will now start, and we are prepared to move as quickly as possible to find the right future homes for these very, very attractive niche segments that we sit on and these assets. So, we're going to do a professional process, of course, and we'll see how long it will take before we find a conclusion.

John Kim
Analyst, Deutsche Bank AG

Q

Okay. Thank you.

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

A

Thank you, operator.

Operator: Your next question...

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

A

I think we have time for one last question. After that, we will need to call it a day for this conference.

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

A

Yeah.

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

A

Thank you.

Operator: Okay. The last question for today comes from Klas Bergelind from Citi. Please go ahead.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

Thank you. Hi, Rickard and Niclas. I was late on the call, a lot going on. But maybe you have answered some of this, but when I do the bridge, you're around SEK 1.7 billion in price-cost, if I take into account the SEK 500 million net cost inflation, up from SEK 1.3 billion in the second quarter. And I think there is a SEK 100 million effect negative from destocking and you have negative SEK 70 million from FX. That leaves the pure volume drop-through higher than I thought. If this the sort of sudden drop in volumes in China that might be – might have been a surprise for you, is there anything on mix utilization beyond the destocking?

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

A

Yes.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

So, I sort of understand that sort of volume effect, because that was high than I thought. Thank you, Niclas.

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

A

Yeah, Klas. With less than 1 minute left, I suggest that we come back to you and elaborate on it.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

Okay.

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

A

Otherwise, it will just be confusing. But, [ph] I mean (00:44:57), of course...

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

All right.

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

A

...in general, mix, as I said earlier, both price, mix were positive and mix is something that we work on quite a lot. Rickard mentioned that distribution was reasonably relatively strong and so on. But, again, let's come back to this separately so you get a proper answer.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

[indiscernible] (00:45:22). On the OEM destocking, this is where the visibility is tricky for all of us. I mean, industrial distribution, we can sort of track much better. When you're thinking about your guidance, Rickard, into the fourth quarter, I mean, do you expect the sort of destocking effect to continue sequentially into the fourth quarter at the OEM level, is that how you think?

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

Yeah, I don't see any significant change to that ongoing pattern. And that's also a reason why we – in our outlook, we now say a low-single-digit decline. So, basically, the trend will continue, I guess, is the short and fast answer.

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

And one thing to comment or add there, Klas, is that, of course, we do destocking ourselves as well. I mean...

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

Yeah.

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

...that's one of the – what we see in our results. We took down inventories by some SEK 1 billion.

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

Yeah.

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

And not surprisingly, other companies around us also do it. And just to give you some flavor, we started earlier this year. And now, from an overall net working capital perspective, we are starting to approach kind of a normal historic SKF level of around...

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

Correct.

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

...30%. Of course, every company is – has its own schedule and ambitions there, but that's it for us, at least the timing.

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

Yes. It's good clarification. Thank you. I think we need to...

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.
Q

Yeah, that's good color...

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

A

...round this off.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

Yeah. Thank you. Thank you.

Rickard Gustafson

President, Chief Executive Officer & Director, SKF AB

Well, thank you all. Thank you for joining. I appreciate that you take the time to be with us this morning. As you heard, we are seeing a shift in the general economic sentiment, but we are pleased to see that, so far, we have been able to cope with it and we deliver a strong set of numbers, and we continue our strategic journey and are making good progress in that. That gives us hope for the future. So with that, I thank you so much for your attention and wish you all a very good day a nice weekend when you get to it.