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Q4 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello, everyone, and welcome to the SKF Year-End Report for 2023. My name is Seb, and I will be the operator for your call today. [Operator Instructions] I will now hand the floor to Patrik Stenberg to begin the call. Please go ahead when you're ready.

Patrik Stenberg

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

Thank you. Good morning to you all, and welcome to this SKF event. Today, we will focus on the Q4 results. We will start with presentations from our CEO, Rickard Gustafson; and followed by a presentation from our CFO, Niclas Rosenlew. These presentations will take some 25 minutes. And after that, we are ready to take on all your questions. And as usual, you can either post your questions live on this call, or you can use the chat function as you prefer.

With that brief intro, I will leave the word to Rickard. Please go ahead.

Rickard Gustafson

President, Chief Executive Officer & Director, SKF AB

Thank you, Patrik, and a warm welcome to all of you, and thank you for joining us for this webcast. It is no coincidence that I've chosen a train as the background image on this first slide. On the contrary, railway is a global, high-performing industry where we play an important role for our customers. I will come back to this later in this presentation, but, first, let me start by looking back at the full-year 2023. This was a year where we diligently executed on our strategy to further strengthen us as a company. The ongoing transformation has made us more resilient and competitive, both in the first half of the year with strong demand, as well as in the weaker demand environment that we faced in the second half of the year.

I am very happy to conclude that this is also reflected in our 2023 full-year results. Last year, for the first time ever, we delivered net sales north of SEK 100 billion, bringing our organic growth to around 4%. It is also very satisfying that adjusted operating profit came in at a record-high SEK 13 billion. The adjusted operating margin was 12.5%, which is a significant improvement compared to 2022. And cash flow from operations was just shy of SEK 14 billion, being one of our strongest performances ever. So, all in all, it was a very strong performance last year in a turbulent macro environment. But now, let's take a look at our performance in the fourth quarter.

Let me once again stress that I'm pleased that our strategy and operating model are creating a more resilient and competitive SKF. We delivered a strong performance also in the fourth quarter despite reduced demand across all regions. As you can see from this slide, we had net sales of SEK 24 billion. We delivered an adjusted operating profit almost SEK 3 billion with a cash flow just below SEK 4 billion. Our adjusted operating margin improved significantly and came in at 12% compared to 10% in the same quarter last year. This despite a significant volume drop.

Our 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 repricing, cost-and-portfolio management activities, and this has contributed positively to our profitability. It is also encouraging to note that our decentralized operating model has further enhanced our ability to drive productivity and efficiency. We have succeeded in reducing cost and inventories to effectively manage the business cycle. As an example, we have completed the previously announced SEK 2 billion annual run-rate saving program, including a reduction of more than 1,000 staff positions.

When it comes to our geographical regions, we see that demand in Europe continues to be resilient. This partly of – related to good growth in railway and aerospace as well as in the aftermarket business. In the Americas, we saw continued soft demand where the agriculture and food-and-beverage segments remained weak. In China and Northeast Asia, it is possible to see a more stabilized situation where demand was somewhat less negative than in the third quarter. However, demand in the wind segment continues to be very weak, but partly offset by strong development in distribution and aftermarket businesses. Finally, growth in India and Southeast Asia was, as you can see on this slide, relatively flat in the quarter.

Now, let's take a deeper look at the results for our Industrial and Automotive business areas. I am happy to report that our robust Industrial business, representing more than 70% of net sales, continued to perform well in the quarter. We delivered a strong adjusted operating margin north of 15%. As a result, the adjusted operating profit came in at SEK 2.6 billion, which is a significant uplift compared to the same quarter last year. The growth rate for the Industrial business was negative 3% due to the overall economic slowdown. However, our industrial distribution, railway, and aerospace businesses all demonstrated good growth fueled by our ability to develop innovative solutions together with our customers. I will present some more examples of this in a little while.

Turning to Automotive business, representing a little bit more than one-quarter of our sales, the adjusted operating margin for the fourth quarter came in at 4%, with Q4 typically being a lower-margin quarter. More long term, we feel confident that the underlying performance in our Automotive business is on a positive trajectory as we progress our ongoing portfolio repositioning. This is actually also visible in our 2023 full-year margin improvement in Automotive surpassing 5%.

With this, let's move on and look at our strategic execution. Our strategy makes us more resilient and competitive. And last year, it helped us to navigate in both a strong demand economy as well as in an economic slowdown. This year, we will continue implementing our ongoing strategic initiatives. This includes, for example, maintained efforts to optimize our supply chain and footprint, managing and restructuring our portfolio, as well as strengthening our leadership position within sustainability and low-friction products and services. I would like to share more details on these key priorities, what we have done in 2023 and maybe, more importantly, what we will do going forward.

Starting with our competitive and intelligent value chains. Localizing [ph] our (00:08:19) manufacturing footprint is an important part of our strategy. Being closer to our customers shortens delivery times and reduces the need for transportation. In 2023, we took some major steps in all our regions. And this year, we will build on this strong momentum. In Americas, we inaugurated our new greenfield plant in Monterrey in Mexico. As we now build up the capacity in this factory, we increase our competitiveness. We get close to our North American customers, and we reinforce our value chain in the region.

The optimization of our European footprint continues. And as an example, last year, we announced the closing of our plant in Luton, UK, with the capacity now being moved east to Poznań in Poland. In Schweinfurt, Germany, the restructuring continues by gradually moving some assortment volumes to China and to India to further enhance our regional competitiveness. In Asia, we announced the closure of our plant in Busan, Korea, with production volumes being moved to Mexico, China, and India. Speaking about India, we're also ramping up capacity and broadening the assortment to further fuel profitable growth in this important region. In China, we have finalized some of our larger investments in Dalian, Jinan, and Xinchang. We have now established an even more competitive China-for-China value chain geared for profitable growth.

So, let's turn to portfolio management. We have been successful in our efforts related to divesting and exiting lower-margin businesses or businesses that are not core to us today. Today, I would like to highlight another area that we focus on related to new innovations in our targeted growth segments that would provide significant customer value. For our distributors, and together with them, we have developed a new tool – we call it SKF Housing Select – to make it even easier to do business with us. This enables distributors to quickly offer their customers additional accessories like housings, seals, and lubricants in addition to bearing sales.

For our railway segment, we have developed a new robust bearings for gearboxes. This gives several benefits to our customers such as longer product life and fewer unplanned stops under harsh conditions. We have also introduced a new precision bearing for lithium batteries [ph] thin copper film (00:11:22) production systems. This precision bearing provides good anticorrosion characteristics and longer service life.

And finally, let's turn our efforts to strengthen our intelligent and clean leadership. Decreasing greenhouse gas emissions and decarbonization have become paramount objectives for industries worldwide. Hydrogen plays a crucial role in achieving these goals with hydrogen production and transportation being critical areas of research. Green hydrogen is an industry, which is growing rapidly for us, and we are active in the full supply chain. We are investing in R&D. We are increasing sales and we have multiple active customer projects ongoing.

Furthermore, we are working with some of the leading machine builders in the world. In the recent collaboration with Atlas Copco and Plug Power, our magnetic bearings are used in hydrogen liquification. This technology enhances reliability, eliminates the risk of contamination, and enables greater production capacity.

We are the market leader for bearings in the fluid segment with solutions for industrial compressors, expanders, blowers, pumps, and fans. There is an increasing utilization of magnetic bearings within the fluid industry, especially within the high-speed segment. This rapid growth and development of new magnetic bearing applications are very exciting for us being an important or a leading player in this field.

Now, I would like to hand over to Niclas to take you through the numbers in more detail. So, please, Niclas, the stage is yours.

Niclas Rosenlew

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

Thank you, Rickard, and hello, everyone.

I'll start with commenting on sales. After a strong period of strong growth, we started to see the effects of a macroeconomic slowdown in the last two quarters. In Q4, our sales amounted to SEK 24 billion, which is down from SEK 25 billion a year ago. Year-on-year volumes were down quite substantially. But, on the other hand, this was, to a large degree, offset by continued good pricing momentum.

Compared to last year, our net sales declined organically by 1.9%, currency impacted negatively by 1.8%, and the total sales therefore declined by 3.6%. In terms of currency, the largest effects came from the dollar, the Chinese yen, and the Argentinian peso.

In the fourth quarter, we delivered an adjusted operating profit of SEK 2.9 billion. The adjusted operating margin was 12%, very much as Rickard commented, which is a significant step-up compared to last year. The improvement is explained by our efforts to adjust our cost base to lower volumes, a continued positive effect from increased prices, and our work to improve or exit low-margin businesses.

If we take a look at the bridge step by step, we can see that the net effect of currency was a negative SEK 260 million mainly related to our relatively high cost base in euro countries. The organic growth contributed with a positive SEK 440 million. This was driven by a strong price mix offset, on the other hand, by lower sales and manufacturing volumes. Total costs declined by SEK 210 million where energy, logistics, and material contributed positively while, on the other hand, personnel cost inflation impacted negatively. During the quarter, we also continued with our efficiency measures. As an example, we've delivered a SEK 2 billion cost reduction program very much according to plan. So, all in all, we are pleased with our profitability performance, not least considering the more challenging macro environment.

Worth mentioning also is that we had a relatively high level of items affecting comparability in the quarter. This was very much a reflection of our strategy execution, as Rickard just commented on. It's related to firstly the consolidation of manufacturing in Korea as well as in China; secondly, the rightsizing of our operations in Germany and the final quarter of our SEK 2 billion efficiency program; and thirdly, the impact of the devaluation of the Argentinian peso. And in terms of Argentina, we are very much taking active steps to reduce our exposure.

Moving on to cash flow, we generated a strong operating cash flow of SEK 3.9 billion in the quarter. This is a record for a single quarter in SKF's history. The driver of the improved cash flow was, of course besides the operating profit or the solid operating profit, a strong reduction in working capital.

During Q4, we continued our work on reducing inventories with inventories coming down approximately SEK 400 million during the quarter. SEK 600 million actually is the number. For the full year, we've reduced inventories by some SEK 2.5 billion while at the same time having an organic sales growth of 4%.

When we take a look at the overall net working capital as a percentage of sales, it decreased to 28%, down from peaks of 35% just a few quarters ago. As you can see in the bridge, net working capital had a positive impact of SEK 1.5 billion due to reduced inventories and also accounts payables.

We're very pleased with the work done by our teams to reduce net working capital. Saying that, we do see further potential and the work continues across our businesses also going forward. So, all in all, a very strong cash flow in the quarter and also for the full year 2023.

When it comes to our balance sheet, it continues to be very strong and our liquidity to be solid. Net financial debt amounted to SEK 7.6 billion, which is a continued decrease versus Q3 as well as versus last year driven by our strong cash flow. What comes to return on capital employed? We also saw another quarter of positive development. The 12-month rolling return on capital employed improved further to 15.4% driven by solid profits and a strengthened capital efficiency.

So, finally, let me turn to our outlook. Looking into the first quarter of 2024, we expect a mid-single-digit organic sales decline. For the full-year 2024, we expect a low-single-digit organic sales decline compared to 2023. Furthermore, based on the solid performance in 2023 and our financial strength, the board has decided to propose a dividend of SEK 7.5 per share, subject, of course, to AGM approval, up from SEK 7 per share a year ago.

And with that, I hand back to you Rickard.

Rickard Gustafson

President, Chief Executive Officer & Director, SKF AB

Excellent. Thank you, Niclas.

As we now have closed 2023, we conclude that it was a year of two tails. I am pleased that we performed well both when demand was strong in the first half of the year and when demand was weaker in the second half. We have effectively dealt with the turmoil in the world and the volatile economic environment. So, all in all, we delivered a strong performance both in the fourth quarter and for the full year 2023.

Looking into 2024, we expect to see continued market volatility and geopolitical uncertainty, and the business is prepared to tackle different scenarios. Our focus in 2024 is on implementing our ongoing strategic initiatives. This includes, firstly, continued activities related to optimizing our supply chain, including speeding up the regionalization of our manufacturing footprint. We will, for example, as previously mentioned, scale up regional production volumes, especially in Mexico and India. Secondly, managing and restructuring our portfolio. Here we are, for example, actively pursuing our aerospace strategy, but we are also refocusing product development to capture growth in targeted industries. And thirdly, strengthen our leadership position within sustainability and low-friction solutions, and thereby contributing to the needed sustainability transformation.

For our own operations, we plan to invest about SEK 0.5 billion this year to further reduce energy consumption and drive decarbonization. We will also continue our focus to grow within clean tech industries, already today representing some 10% of our annual sales. These areas and plenty of other exciting things will further strengthen us as a company.

Finally, I would like to sincerely thank our employees for their excellent work and commitment, and also thank our partners for their support in 2023. Thank you. Together, we have delivered a very strong performance with net sales over SEK 100 billion, a good profitability, and a very strong cash flow. This is not a coincidence but the results of everything that we have achieved together last year.

With this, I'd like to thank you for your attention this morning, and we are now ready to enter into the Q&A session. And I will invite both Niclas and Patrik and also Seb, the facilitator, to help us manage this session. So thank you.

QUESTION AND ANSWER SECTION

Operator: Thank you. [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. Thank you. If I could just sort of ask two things, please. I just wanted to confirm on the gross margin. Obviously, when we look at the income statement, it looks like it fell down, but you have all of these one-off items. So, I guess, that's not a picture of underlying.

Can you clarify what the underlying has done in this quarter? And also, in the sequence of that, given your commentary on the high-single-digit volume decline, that means that pricing was probably quite strong. What's your outlook for pricing next year? Thank you.

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

A

Hey. Good morning, Daniela, and thank you for joining us early morning. Yes, as Niclas described the details, yes, we do have a rather significant amount of items affecting comparability in this quarter. But I truly believe that all of them are really a proof point or evidence that we are doing what we said that we're going to do. We are delivering on our strategic transformation. We are making the efforts to reduce our assortment in Schweinfurt to move that closer to our customers in China or in India.

We are making the hard steps in also closing our effort or our production capacity in Korea and replacing that and moving that to Mexico and other areas getting close to our customers. And we are proud that we have been able to also fulfill our target of reducing the staff, number of staff by some 1,000 employees. So, all of these, of course, will strengthen us going forward and help, what we call, the adjusted operating profit and also the margin.

When it comes to your question regarding pricing. It is true that we have had a rather significant negative volume decline in the quarter to some extent offset by strong price mix that we have continued to drive as we said that we're going to do. We don't really guide for how we see that going forward, but I will reinforce what we said also in Q3 and what's also relevant as we move forward.

We intend to fight for our margins. We intend to continue doing active dialogue with our customers and make sure that we clearly can articulate the value that we bring and charge for that. And if the world becomes even more volatile ,and we do see now signs of this disruption in the supply chain due to the development in Red Sea, of course that is something that we also need to think through how we're going to manage to ensure that we don't have to sit with the entire cost for that problem. So, it will be a continuation of what you'd already seen in 2023 is what you should expect in 2024.

Daniela Costa
Analyst, Goldman Sachs International

Q

Thank you. Sorry, just to make sure I understand on the first one. So, underlying gross margin has sequentially gone up in your view once you take the one-off?

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

Yes. Yes, Daniela, that's the short answer.

Daniela Costa
Analyst, Goldman Sachs International Q

Okay. Thank you very much.

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

Thank you.

Operator: Our next question is from Klas Bergelind from Citi. Please go ahead.

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

Thank you. Hi, Rickard and Niclas. Klas at Citi. So, first on the inventory impacts [indiscernible] (00:27:14). Niclas, just to confirm, the inventory reduction this quarter was that largely volume led and not linked to finished goods? So, there was no sort of impact from the inventory reduction in the bridge. I just want to start here.

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

Yeah. Yeah. You are right. I mean, this quarter or in Q4, it was relatively small. I mean, there was some impact, but relatively small.

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

All right. And my second one, maybe for you, Rickard, on the Red Sea. You're obviously working towards improving the manufacturing balance, the localization, as you say, but you're still quite heavy on production in Europe. And that is why we saw obviously this currency effect. So, how will this impact you now when you look at sort of the Red Sea and the flows of both the finished goods, but also supply, whether you can comment if you see anything and what you see ahead? Thank you.

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

Right. Thank you. Klas. It's an important question that you raised. If I start with the more longer term strategic dimension to your question. Yes, you're right, we are actively driving towards what we call more a regionalized setup or a region for region setup on our value chain. We have come a fairly long way on that journey, but we do admit that we still have a lot of work ahead of us to get to a point where we want to be and make sure that we have resilient supply chains and value chains in all of our regions that are more self-sufficient. So, that journey is ongoing and will continue.

Clearly, we will also need to do some tactical maneuvers to ensure that we manage through the situation that has been developed in the Red Sea. We all know that the Red Sea is one of the largest passages for the world trade, and we are not immune to that. So, what we are doing is of course we work together with our customers, we look into alternative transportation routes, and we also have to look into do we need some safety buffers in terms of inventories to ensure that we keep our customers unharmed from this development. So, strategically, we continue to drive our agenda forward. Tactically, it will be a lot of maneuvering as things develop in that region.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

Okay. My third and final very quick one is on China ex wind. Looks like growth can be better than at least what I thought when I back out the China drag. Where did we see that sort of improvement if it is improving? Is it largely sort of end of destocking you see? Any sort of final demand improvement in China sequentially as you went through the quarter and in the beginning of the first? Thank you.

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

A

No, thank you and I do echo what you said there. I think that we were also pleased to see that we saw a bounce back in China. Wind is still dragging us down, but was, to better, larger extent, compensated by positive development in some other industries. And there are two that I'd like to primarily bring to your attention here was our industrial distribution and the aftermarket businesses in China. They came in particularly rather strong in the fourth quarter and was able to offset, to some extent, not fully, the negative development in wind.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

Thank you.

Operator: Our next question is from Sebastian Kuenne from Royal Bank of Canada. Please go ahead.

Sebastian Kuenne
Analyst, RBC Capital

Q

Yeah. Good morning, gentlemen. I have a question regarding the one-offs, especially regarding restructuring. You mentioned that in 2024 you wanted to drive more regionalization, scale-up regional production and management portfolio. Historically, SKF always close three to four plants a year. So, should we really see these closure costs, these restructuring costs as one-offs or is this now becoming part of SKF where you have these higher restructuring charges annually, especially now in 2024, which you just mentioned? I just want to get a feeling of how much one-off this was in Schweinfurt, and Busan, and Luton. Thank you. That's my first question.

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

A

Niclas, would you like to take...

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

A

Yeah. Yeah. Hey, Seb, super good question. In 2023, if we just start with that before we move on to the future, we had a SEK 2 billion program. And when we launched that a bit more than a year ago, we did say 1,000 persons and we did say approximately SEK 1 billion in restructuring cost or one-off cost or [ph] IAC (00:32:12). So, you can see that roughly half of the [ph] IAC (00:32:18) in 2023 was related to this one specific program. And then the other half is, broadly speaking, related then to what you talk about the restructuring plans and so on. So, I would say that, in that sense, 2023 was exceptionally high when it comes to [ph] IAC (00:32:40).

Very much as Rickard commented earlier, yes, we do have an ambition and a plan and we will continue with our footprint activities, regionalization. I wouldn't say that one should assume or we don't see that one should assume that we continue from here to eternity. We had very good level of activity, exceptionally good level of activity in 2023. Let's see what it turns out to be in 2024. But therefore we very much view this as, in that sense, restructuring activities, not something that goes on for the rest of the future.

Sebastian Kuenne
Analyst, RBC Capital

Q

Understood. Then my second question is on the Argentinian peso. I assume the products that you did have in or do have in Argentina, you sell them in Argentinian peso. So, you booked that loss in the normal course of business, [ph] so (00:33:46) revenue, operating loss and the charges you put underneath the adjusted operating profit line, this is probably then for expected losses or it for asset write-downs? How do I understand it and what should be planned for the first quarter and second quarter of 2024? Is this now all done? Is Argentina put aside? Are all the potential losses booked or is there more to come?

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

A

No. So, 2023. Argentina being a high inflation country, not to bore you with all the details, but you do high inflation accounting, IFRS, and we had a devaluation of more than 50% in Argentina in December. That's what we booked. So, that's up until then.

What I did say earlier is of course the focus area goes for Argentina is that we reduce our exposure. We already have taken action. We started some while ago already and we have some actions left still to reduce our exposure.

Sebastian Kuenne
Analyst, RBC Capital

Q

But the products that's now selling in Argentina, are they now quoted in US dollar, in Swedish krona, or local currency, but then double the price? What's the situation?

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

A

So, we do...

Sebastian Kuenne
Analyst, RBC Capital

Q

[indiscernible] (00:35:16) contracts where you still have -long-running contracts and you still have to book losses against that.

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

A

No, no, no. So, we have a normal ongoing business in Argentina like we have in many other Latin American countries. There's no pending losses or anything like that. It's just business as usual. And I said on the operational side, given the volatility in Argentina, we're of course taking action to minimize the exposure there.

Sebastian Kuenne
Analyst, RBC Capital

Q

Okay. Thank you very much.

Operator: Thank you. The next question is from Max Yates at Morgan Stanley. Please go ahead.

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

Thank you. Good morning, everyone. Just my first question was on the cost savings, the SEK 2 billion program. And just to understand how much of that has actually been recognized in the P&L so far, well, in 2023, and how much is still to come in 2024? That's my first question. Thank you.

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

A

Maybe I can start, Niclas, and you can correct me or add on to my answer. But just to remind you, Max, and good morning, by the way. The SEK 2 billion we said was as run rate savings coming out of 2023. So, some of it has been reflected already. But there are run rate savings as we move in now into 2024. That's how you should read it. As always, it's very hard to find the number in the profit and loss statement because things are moving. That's why we also reinforced the 1,000 staff head count reduction because that you can also see in our numbers and that is actually visible in our report. So, as a proof point that we have delivered on what we actually said we're going to do.

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

A

Yeah, exactly as you said, Rickard. So, it's a kind of an entry into 2024 run rate.

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

A

Yeah.

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

Okay. Understood. And then just my second question is just around your component costs. Because I guess if I think back to kind of cost lines that sort of took us by surprise maybe towards the end of 2022 and early 2023, it was really your component costs that still seem to be rising kind of quite significantly. And I can kind of see in the Industrial division you call out sort of lower cost of material.

And I guess my question is, when you say that, are you talking about kind of raw material purchasing or are you actually now sort of having seen steel cost start to come down versus the peaks, so we're now starting to see that actually come through in your component costs as well?

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

A

I guess the short answer, Max, is it's the latter. So, when we talk about materials, we lump components as well as raw mats into one, and raw mats is actually a very small portion of the overall materials. So, it's both components and materials with components being by far the largest cost item there. And that kind of bubble that we've seen started to come down in cost versus the previous year. And as we've had many of these discussions during the last six months or so, what do we see? What do we see? We've always expected this cost to start to come down, and that's what we see now.

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

Okay. And maybe just very quick final one. I mean, I think versus some other companies, I think your kind of regional growth is sort of slightly unusual in that kind of Europe is holding up better than the US. Most of it – or Americas. Most other companies we kind of see the reverse.

And so, I guess my question is you've talked about seeing sort of destocking at some of the OEMs in the US. I guess I just wanted to understand, A, are we sort of nearing the end of that process or do you have any visibility on when we start to sort of see that come to an end? And I guess additionally, any comments around your industrial distribution in the US where some of your competitors, I guess, have been more vocal about destocking? What are you seeing there? Thank you.

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

A

Right. You're right, we are happy to see a resilient EMEA in that regard. I think it's a reflection also of our ability to effectively drive price mix in this region. And we have also seen a strong development in some of our focus industries. Distribution as being one. Clearly, there is some destocking going on in Europe as well, but maybe not as paramount as has been in North America.

Moving over to North America, I think we still see some destocking, especially in certain industries like agriculture, like food and beverage still ongoing. But we should reach the tail of that that fairly shortly. It's hard to predict exactly when and how, but it should. We should enter into territory where we should reach the tail and have a different comparison. And finally then on industrial distribution in North America, so far, we are pleased to see that is holding up pretty well.

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

A

Maybe to add, Rickard,...

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

[indiscernible] (00:40:44)

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

A

...to what you said, I mean, we've also been quite active when it comes to portfolio management in North America, so it's both...

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

[indiscernible] (00:40:53)

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

...I guess or not I guess, but it's both the destocking as well as then taking active measures on pruning, exiting low-performing businesses. And exactly as you say, Rickard, distribution in North America has been holding up quite well and also price mix in North America has been good.

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

Right. But the pruning is important. So, thank you for that important clarification.

Max Yates
Analyst, Morgan Stanley & Co. International Plc
Q

Understood. Thank you very much, both.

Operator: The next question comes from Erik Golrang from SEB. Please go ahead.

Erik Golrang
Analyst, Skandinaviska Enskilda Banken AB
Q

Thank you. I have three questions. The first one on your export/ import flows from the US or North America. You had a slide on transformation activities and the 66% on Americas. Is that where sort of the level of localized supply is in North America at the moment? [ph] Then if you could say (00:41:52) something about what's imported to North America and from where?

And then the second question, going into Q1 and your guidance, realized you don't give regional guidance. But is it fair to assume that in EMEA that you see sort of a deterioration in year-on-year demand from an organic perspective?

And then thirdly, on working capital, a big reduction now compared to quite elevated levels. Where do you see this in 2024? Is there room to improve a bit further here also near term, working capital to sales? Thank you.

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

Well, thank you, Erik. Three important questions, and I'll try to give you some color to the first one, and then I will be, in warm hand, hand over to Niclas to the second two.

When it comes to North America, a big emphasis for us is really to now build on the plant that we have established in Monterrey, Mexico. Clearly, it's a building that is now up and running. We do have equipment installed and production is ongoing, but we're far from 100% utilization and capacity there yet. So, it will come. So, that will really help to further enhance our localization in Americas to go up north of the 65% (sic) [66%] that you referred to.

And where does things come from? Well, it varies by assortment. But we, today, have some significant volumes for the automotive industry being imported from China that would then, as we ramp up in Monterrey, that will then stop. And we rather – we're going to serve our North American automotive customers more out of the Monterrey facility. But Monterrey is not just for automotive. It also has a number of industrial companies or customers. But, clearly, North American automotive is a key part of the strategic intent with Monterrey.

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

A

And then, Erik, on the two other, so 2024 demand, rather than commenting exactly on countries, regions, and so on, just to share our thinking, we do see from a year-on-year perspective a slightly weaker start of the year and then an improvement towards the second half of the year. So, you can see kind of a – say that it's bit of a mirror picture compared to 2023. And then, of course, we have the different regions moving in and not in sync all of them. But that's just to share our thinking.

When it comes to working capital to sales, very much, as said, we see a further upside potential there. Remember, we do have the seasonality where we, second half, take down inventories a bit more and then, during first half, usually build up inventories. But disregarding that effect, we do see potential to continue to improve net working capital to sales, and that will continue throughout 2024.

Erik Golrang
Analyst, Skandinaviska Enskilda Banken AB

Q

Thank you. And then a quick follow-up coming back to the currency discussion previously on Argentina. I didn't fully understand. The SEK 338 million from currency devaluation in Argentina, what specifically was that? Was that balance sheet items, hedges, or what was it?

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

A

No, no, that's the – what you do in IFRS high-inflation accounting, you take the full-year impact, so you adjust the profit from January onwards. And as the devaluation happened in December, you take the full-year impact, and you record that profit based on the lower currency rate.

Erik Golrang
Analyst, Skandinaviska Enskilda Banken AB

Q

Thank you.

Operator: Our next question is from Ben Heelan of Bank of America. Please go ahead.

Benjamin Heelan
Analyst, Bank of America Merrill Lynch

Q

Yeah. Morning, both. Thank you for the question. I just wanted to talk or ask about the China wind situation and how far through that cycle you are and how you're feeling about that into 2024 and whether that's going to continue to be a material drag, particularly in the first half. And then, secondly, in terms of the breakdown between Industrial and Auto into 2024 on the volume side, is there any color that you can give in terms of how you're feeling about those two different businesses? Thank you.

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

A

All right. Good morning, Ben. Yeah, when it comes to wind, it's hard to predict. There are also, of course, some political dimension to this, how that particular industry will evolve. It's not the only answer to the question, but it has some significant impact. We have seen, as we mentioned, a rather steep volume decline in Q3 that was also maintained in Q4, even though in Q4, as I mentioned, was somewhat offset by good development in some other Industrial segments. Moving into 2024, at least for the first half of 2024, I see no reason why I dare to change the outlook or believe that wind will dramatically turn positive in the shorter time period. For the full year, it's a bit hard to speculate, but in our plans, we maintain a bit conservative in our expectations for wind for the first half of 2024.

Maybe, Niclas, you want to touch on the...

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

Yeah, on the split.

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

...Automotive split.

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

...in Industrial/Automotive. I mean, we look back at 2023, of course, Auto had a stronger growth than Industrial, and then it kind of tapered off, commenting on Auto, towards the end of the year. What comes to our intention going forward, Auto is very much a focus on margins, essentially, so margins over growth. Saying that, we do have a very good momentum when it comes to driving electric vehicle solutions and a very good position with our customers in that segment. So, I won't – can't, won't give you an exact answer or forecast on how the split will evolve, but you can maybe look at it, taking a look at the rearview mirror of what – how the two segments developed throughout 2023.

Benjamin Heelan
Analyst, Bank of America Merrill Lynch
Q

Okay. Very clear. And just a quick follow-up. You mentioned, I think, to one of the questions earlier that underproduction wasn't a big hit to margin in Q4. Given the – where the balance sheet and net working capital is today, is underproduction something that we need to be thinking about for margins in the first half of 2024 being a material drag? How should we think about that?

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

I don't think maybe necessarily the underproduction as such. Yes, it will be. As we reduce – if we reduce, as we reduce, it will have an impact. Of course, the bigger impact comes from lower volumes and then us taking action to adjust the cost base. That's where you have the big margin impact.

Benjamin Heelan
Analyst, Bank of America Merrill Lynch
Q

Okay. Thank you very much.

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

Andrew Wilson
Analyst, JPMorgan Securities Plc
Q

Hi. Good morning, everyone. Thanks for taking my questions. I have, I guess, probably three short ones. And I'm sorry if I missed it, but did you quantify the price/mix versus volume split in the Q4?

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

No, we didn't miss it. We did not, particularly – [ph] being explicit with that (00:50:16). We do admit that we have had a significant volume decline, partly offset by price/mix, but we don't share in the details on how much contributes from what.

Andrew Wilson
Analyst, JPMorgan Securities Plc
Q

All right. Understood. Just on wage inflation, which obviously you flagged as a headwind, which I don't suppose is a surprise to anybody. But can you give us an indication of kind of how you see that developing in 2024? I'm assuming it's going to be a headwind again, but whether you sort of feel you've taken the worst of the inflation pressures and, therefore, going to be a lower number in the bridge, or would you expect that to be higher?

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

Niclas, do you want to...

[indiscernible] (00:50:58)

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

Yeah. So, when you look at our costs and put it in different buckets, we discussed materials here earlier, that's the biggest chunk. And then, of course, wage is very much – Andy, as you were saying, that's the kind of second biggest bucket. I think we are no exception there. We've had a significant pressure on wage inflation in the last year also. A lot of increases have been made during 2023. If anything, one should expect maybe less pressure in 2024 when it comes to wage inflation. But of course, there's the tail coming from 2023 going into 2024. So, therefore, yes, there's going to be that wage inflation pressure quite far into 2024.

Andrew Wilson
Analyst, JPMorgan Securities Plc
Q

That's very helpful. And finally, just I guess broader, more strategic, you've obviously – you've talked a lot about that very helpfully this morning. And in terms of the strategic review in aerospace, have you got plans for some more of that type of project as we go through 2024? It feels like you're very much on the front foot from a strategic perspective, so kind of interested as to whether that's going to be something that we can hear about, I guess, through forums like this, or is that going to be [ph] some background (00:52:31)? Just some thinking around that and maybe any projects that you could flag, even if I appreciate you're not going to give details at this stage.

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

Well, thank you, Andrew. It's important, and it's very close to our strategic intent and our effort here is what we do with our portfolio. And as I – as we tried to explain in a number of occasions, I see this in different dimensions. We have a tactical dimension to when we talk about portfolio, and that is really what we're doing in day-to-day activities in our business areas to work hard on improving the mix in our portfolio. Dare to walk away from unprofitable business and dare to focus on those accounts or those segments that are really contributing strongly. So, that's kind of the [ph] tactical (00:53:22) activities. I think we have proven that we have been successful in that space during 2023, and it's one – not the only, but one of the reasons why we also see an improved margin in 2023.

But we also work, to your question, strategically on our portfolio. The one that we have highlighted and have been very transparent about is the strategic review in aerospace and our conclusion of that strategic review and that we now are embarking actually delivering on finding a home for some of those assets that was not deemed as core to us. So, that work is ongoing. And then do we have others? The answer is, yes, we do work. We do constantly look into our portfolio. We do think about how can we further enhance or reposition it also strategically. As of today, I have no information to share in that regard. But you can rest assured that it is something that we work on. And potentially maybe at some point in the future, we have concluded something, and then we'd be delighted to share it broadly with you.

Andrew Wilson Q
Analyst, JPMorgan Securities Plc

That's very, very helpful. Thank you very much for the time.

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

Thank you.

Operator: The next question is from James Moore at Redburn Atlantic. Please go ahead.

James Moore Q
Analyst, Redburn Atlantic

Yeah. Good morning, everyone, Rickard, Niclas. I've got three as well if I could. Maybe we could start with the Automotive margin, a softer number. I just wondered if you could help us unpack that a bit. I mean, is it ICE versus EV weakness, or is it VSM or truck, or is it a function of underutilization in Monterrey? And what's the trajectory from here? If you could just help us think about that a bit.

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

Yeah, I think, Andy (sic) [James], first of all, the way we look at it is that 2023 was a good progress, progression when it comes to putting in place the new Automotive, implementing the strategy. So, we saw a significant margin uplift. Q4, you are right, wasn't as exciting when it comes to margins; a bit on the low side compared to our ambition. But as Rickard said earlier, we see it more as a seasonality impact rather than anything about how the future will look like. We're quite confident that Auto will start – or continue to progress well when it comes to improving margins. So, Q4, usually weak, turned out to be weak this year as well for Auto, but we are very confident about the margin progression going forward.

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

And if I may add just one thing, as I also tried to say in my earlier remarks, when it comes to Automotive, please also take a look at the full-year development because that clearly sends the signal that this positive trajectory that we're talking about is also visible in the full-year improvement of the margin. So, more work to be done there, but we're not walking away from our ambition to reach an 8% operating margin, adjusted operating margin, by 2025 as I said before.

James Moore
Analyst, Redbum Atlantic

Q

That was very helpful. Thanks. And maybe one technical question. On the cost development line, the SEK 213 million, I mean, it's made up of three buckets as far as I can see. You've got the savings where I would have thought you could have had quite a big number as you hit your peak quarter for the SEK 2 billion plan, and you still got some of the SEK 5 billion COGS, I could imagine a high triple-digit number for that. And if wages are still minus SEK 400 million, and we're getting positives from raw material and energy and logistics, I could have seen a scenario in which that number was materially higher. I wondered if you could just help us think a little bit about whether there's anything dragging that down and how it moves going forward.

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

A

I don't think, James, there's anything particular – nothing particular comes to mind – dragging it down. I think it's a progression. I mean, three buckets out of four came down, and the fourth one being salary inflation pushed it back up again. And we – of course, depending on what happens with logistics and so on, but we see it continuing, but nothing particular that comes to mind.

James Moore
Analyst, Redbum Atlantic

Q

Okay. Thanks. And just in terms of profitability, the 14% margin, when do you think we can reach that, given what you see today?

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

A

It's a target that we have set out there. And, yes, we are determined to deliver on that target. I know that we still have to prove ourselves to get there, but I'm confident that the ongoing transformation that is happening within SKF and our operating model with the clear accountability and drive in our organization will enable us to get there. Again, I'm not going to share or provide any idea on when we're going to get there, but definitely we truly believe that it is an achievable target and something that we definitely should aim to deliver as soon as possible.

James Moore
Analyst, Redbum Atlantic

Q

Okay. Great. Thank you very much.

Operator: Our next question is from Magnus Kruber from Nordea. Please go ahead.

Magnus Kruber
Analyst, Nordea Bank ABP

Q

Hi. Thank you so much for taking my question. I have two, and I wanted to push you a little bit more on the pricing question you had earlier. Is it fair to say that the year-over-year contribution you had on pricing was on par what you saw in the third quarter?

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

A

So, Magnus, you are essentially asking about the price/mix in Q4.

Magnus Kruber
Analyst, Nordea Bank ABP

Q

Yeah, yeah, in Q4.

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

A

Yeah. Is that right?

Magnus Kruber
Analyst, Nordea Bank ABP

Q

Yeah, exactly. How does it compare to the contribution we saw in Q3? I think the contribution in Q3 was around 5-ish or so. Is it similar in...

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

A

Yeah. So, similar, yes. Maybe a notch lower, but similar and a good development. Good momentum when it comes to pricing. And as we commented earlier, we also – as Rickard said, we'll continue to work on pricing. Also price up going into 2024.

[indiscernible] (01:00:30)

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

A

Yeah. So, just to be a bit more precise, 5-ish percent in Q3, 5-ish percent in Q4 when it comes to price/mix.

Magnus Kruber
Analyst, Nordea Bank ABP

Q

Perfect. Thank you so much for that. Super helpful. And then finally, could you quantify a little bit the volume impact you had on the portfolio pruning initiatives? And is that felt more in the Automotive or Industrial side of the business? That would be very helpful.

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

A

Right. I am afraid, Magnus, that I'm going to disappoint you. We will not disclose any significant numbers. We have disclosed what we said that we're going to do in Automotive, that we had a SEK 1.2 billion of unprofitable business [ph] we got away from (01:01:16). We have concluded that one. But that's not all – that's not the whole story. There has been more activities within Automotive and within our Industrial business areas. They have also constantly and continuously worked on this. But as I mentioned before, you see the result of that both in a little bit maybe more negative volumes, but an improved adjusted operating margin. So, we leave it as such and don't actually share any more light to this than what I have said.

[indiscernible] (01:01:52)

Magnus Kruber
Analyst, Nordea Bank ABP

Q

For sure. No, I understand. It would be helpful to see it, though, given [indiscernible] (01:01:56), following on James' question about the margin progression to 14%. I guess this would be a big stepping stone towards that. So, granularity on that would be very helpful for us.

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

A

Correct. I hear you. Thank you.

Magnus Kruber
Analyst, Nordea Bank ABP

Q

Yes, thank you. Thank you so much.

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

Thank you, Magnus. And thank you, all, for listening in. We are now two minutes over the hour. So, I think we've come to the end of all the questions as well. And please, one or two finishing words perhaps from Rickard.

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

Thank you, Patrik. And, again, thank you, all, for taking your time in joining us for this early morning call. Again, just to reinforce some of the key messages, I think and I hope that Q4 is another proof point that we are creating a more profitable and competitive SKF. Despite a volume drop in the quarter, we do see an improved adjusted operating profit of SEK 2.9 billion. We improved the operating margin to 12%, and we delivered a very, very strong cash flow of SEK 3.9 billion in the quarter. This comes from a rigorous execution on our strategic transformation. We have had a lot of emphasis on the portfolio mix. We have driven cost efficiency very rigorously. We are making real steps into the green transition. We are driving customer innovation at a higher pace. And we've been able also to reduce inventories.

All of this contributes positively to our numbers in the quarter. And for the full year, again, I think I like to reinforce that we have been able to demonstrate that our business model and way of working works both in an environment of significant growth and high volumes as was the case in the first half of the year, as well as it continues to enhance and improve our margins and profitability also when the tide turned in the second half. And we do have some historical milestones that we can report for the full year with the net sales reaching SEK 100 billion for the first time in our history. So, a number of good things that we take with us as we now tackle things that would evolve in 2024.

So, I stop there and, again, I thank you so much for joining us, and I wish you a wonderful day. Thank you very much.

Operator: This concludes today's conference call. Thank you, all, very much for joining. You may now disconnect your lines.