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SKF AB (SKF.B.SE)

Q1 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Sophie Arnius
Director-Investor Relations, SKF AB

And a warm welcome to SKF's Q1 2024 Earnings Call. For those of you who I haven't had the opportunity to meet with yet, my name is Sophie Arnius and I joined SKF end of February as Head of Investor Relations. For today's event, our CEO, Rickard Gustafson; and CFO, Niclas Rosenlew, will take us through the highlights of the quarter where the ongoing transformation of SKF is showing in a more resilient and competitive company. And, of course, there will be opportunities to ask questions after their presentations. And there are two ways to do that. [Operator Instructions]

So without further ado, it's a great pleasure to hand over to you, Rickard.

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

Well, thank you very much, Sophie, and a warm welcome to the team. And good morning, everyone, and thank you for joining us for this report out. This quarter marked another step towards a more resilient and competitive SKF. Key to our competitiveness and long-term success are our innovation spirit and application engineering capabilities. This is something that we'll come back to later in this presentation. But first, let's focus on our first quarter numbers. And I am very pleased to report yet another resilient performance. Net sales came in at SEK 25 billion and we delivered a strong adjusted operating margin of 13.4%, which was somewhat ahead of Q1 last year. The margin improvement clearly demonstrates our improved resilience given that organic growth shifted from plus 10% in Q1 last year to negative 7% this year. This is a result of both our ongoing strategic transformation initiatives as well as from more tactical activities to manage the business cycle. Key tactical activities include decentralized accountability for pricing, portfolio pruning and cost management.

In parallel, we continue to execute on our strategy, including investments in regionalization and in building competitive value chains. This to ensure that we're ready to quickly ramp up production once demand bounces back. And when that happens, we are well-positioned to capture profitable growth opportunities. All-in-all, I am pleased with our strong quarter performance in a more challenging economic environment.

When it comes to our geographical regions, organic growth in India and Southeast Asia was slightly positive, driven by strong performance in heavy industries and light vehicles. In Europe, Middle East and Africa, most industries saw negative growth while two key segments, aerospace and railway, contributed positively. Americas was impacted by a combination of OEM destocking and us, actively exiting low performing businesses. Here, we see a potential to broaden our customer base and industry exposure, and this is a top priority for our new leadership in the region and it's actually great to now have Manish Bhatnagar in place to develop our American business further. China and Northeast Asia had a mixed development, with wind sharply down, a continuation of what we've seen in prior quarters, while other industries developed more favorably actually being at last year's level or even above. So, let's take a deeper look into China, which is a good example of our ability to create competitive and intelligent value chains.

As you can see on this slide, our localization rate in China has increased by 10 percentage points since 2021. And this has allowed us to swiftly adjust the volume outputs and improve our flexibility to better respond to changes in customer demand. Our local value chain also enables swifter assortment optimization. As an example, we are now refocusing on heavy industries to offset the weaker wind sales development in China. We are also targeting growth opportunities in supporting green industries such as battery equipment producers and vacuum pumps for semiconductor industries.

Moving on to our Industrial and Automotive business segments. Again, I am happy to report that our robust Industrial business, representing more than 70% of net sales, continued to perform well in the quarter. As you can see, we managed to maintain a strong adjusted operating margin above 16% despite the sales decline of some 7%. Again, this is explained by our active and ongoing focus on business cycle management, in combination with strong price mix development. The adjusted operating margin for Automotive Business improved to 6%, and this demonstrates our progress towards the 8% annual target in 2025 from the ongoing portfolio repositioning.

Now turning to our strategic execution. We continue to diligently work on implementing and execute on our strategy, increasing our efficiency and reducing fixed costs. Key focus areas in 2024 are, firstly, further optimization of our supply chain footprint, driving regionalization, manufacturing excellence and footprint consolidation. Secondly, managing and restructuring our portfolio, active pruning and pricing, assortment simplification and new product introductions for profitable growth. And thirdly, gearing up for intelligent and clean growth, driving decarbonization and circularity. A common theme across these priorities is innovation. And let me share a couple of exciting examples on this.

We are a global leader within railway. This is an industry that represents 5% of our sales and we have been outgrowing the market in recent years. Here, we constantly drive innovation in close cooperation with our customers for enhanced fleet efficiency and reliability. High speed is an important and demanding segment within railway where wheel set bearings are critical. As an example for this segment, we recently developed new ceramic bearings for railway drives, delivering increased reliable and lower maintenance costs. Customers also value our condition monitoring offers as they enable additional efficiency and reliability.

Here, we recently launched new monitoring capabilities for gearboxes. Turning to another example, capitalizing on the growing demand for sustainable solutions. To gear up for intelligent and clean growth, investments in decarbonization, high speed rotation and low friction products and services are key. We have developed a bearing tailored for the robotics industry with reduced CO2 manufacturing footprint of 70%. This is equivalent to 130 tonnes of emission savings per year.

Looking at the end customer application, this bearing also enable an additional CO2 reduction of some 20%. So sustainability is a really core element of our strategy. Therefore, I am very happy that I received top sustainability ratings both from EcoVadis and from CDP. This demonstrates that we are making progress in our sustainability efforts and that we are strengthening our position as the sustainability leader. But before I hand over to Niclas, let me put our journey in a broader perspective.

We are transforming SKF into a more resilient and competitive company. And as you can see, we are now delivering a consistent margin performance regardless of demand fluctuations. Our decentralized accountability has been key to increase agility and accelerate execution of our strategy. Based on this, I am convinced that we are well-positioned to capture profitable growth when market conditions improve.

So on this positive note, I will now hand over to Niclas to explain our Q1 performance in more detail. So Niclas, over to you.

Niclas Rosenlew

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

Thank you, Rickard, and good morning, everyone. As Rickard mentioned, we are pleased with the progress we are making and the financial performance in Q1 where we improved margins despite declining sales. On the Auto sales, the soft market conditions that we experienced in the second half of 2023 continued as you can see also in Q1. Sales amounted to SEK 24.7 billion and this is down from SEK 26.5 billion a year ago. Year-on-year volumes continue to decline and this was partially offset by continued good price mix execution.

Compared to last year, very much as Rickard mentioned, sales declined organically by 7% and we had almost no impact on sales from FX or from M&A. While of course, 7% is a significant decline, it's worth noting that we had a significant variation in sales performance between different industries. So, for instance, wind declining sharply, while on the other hand, aerospace and rail growing.

Moving on to profitability, we delivered an adjusted operating profit of SEK 3.3 billion in the first quarter. The adjusted operating margin was 13.4%, compared to 13.1% last year. And this is a strong performance, not least considering the sales decline, must say that the teams have done a great job managing the business in this softer demand environment. The improvement, very much as Rickard commented on, is explained by our efforts to adjust our cost base to lower volumes, continued positive effect from price mix and then, 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 from currency was a negative SEK 300 million. And this is mainly related to our relatively high cost base in euro countries. The sales decline had a negative impact of SEK 430 million, and this was driven by lower sales and manufacturing volumes, partly offset by continued solid price mix.

Total costs declined by SEK 550 million, where materials and energy contributed positively. Logistics was slightly positive, while then personnel costs impacted slightly negatively. On the note of personnel costs, we had salary inflation, which continued at the relatively high level. On the other hand, we had a positive impact from the efficiency program that was concluded end last year. So all-in-all, the teams did a good job managing the profitability by taking down costs, continue to work with pricing and managed the portfolio.

Moving on to cash flow. Cash flow from operations came in at SEK 1.8 billion, which we see as a pretty normal level for our first quarter. As you can see on the graph to the left, cash flow was down versus Q1 last year. But we need to keep in mind that last year, we had a unusually high or strong cash flow for the first quarter.

This year, we saw a typical seasonal pattern as receivables and inventory in general increase in the first half of the year while it's then the opposite in the second half. So I am very pleased with all that we have made good progress over the last year, taking down inventories, even if inventories are still too high and the work continues to take them down.

Looking at overall networking capital as a percentage of sales, it went down from 32% to actually over 32% last year to just below 31% this year. And 30% to 31% is a pretty normal level looking back in time, but we do see potential to reduce it even further. And on that note, our longer term net working capital to sales target is 25%.

And to be able to reach this level, we need to continue with our regionalization efforts and also additional working capital activities. So all-in-all, it was a solid cash flow in the quarter and we will continue to work across all businesses to further improve it or improve the networking capital with a special focus on inventories.

Moving on to our balance sheet, continues to be strong and our liquidity to be solid. Net financial debt amounted to SEK 7.8 billion. And this is, as you can see, a significant reduction compared to last year and roughly on par with Q4 last year. However, note that last year we paid a dividend of some SEK 3 billion or so in Q1, while this year, we paid a dividend in early April. So in Q2.

When it comes to return on capital employed, we have seen a positive trend with an improved return on capital over the last year. The 12-month rolling return on capital employed was 15.1%, driven by solid profits compared to 13% last year.

Finally, before handing back to Rickard, turning to our outlook. Outlook in the second quarter of 2024, we expect a mid-single-digit digit sales decline year-over-year. And for the full year 2024, we maintain a low-single-digit organic sales decline outlook. And this again compared to 2023.

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

Rickard Gustafson

President, Chief Executive Officer & Director, SKF AB

Great. Thank you, Niclas. I am pleased to conclude that our first quarter performance marked another step towards a more resilient and competitive of SKF. All-in-all, we delivered a strong performance with an improved adjusted operating margin year-over-year.

We continue to execute on our ongoing strategic initiatives with a focus on optimizing our supply chain, including regionalization of our manufacturing footprint, managing and restructuring our portfolio. For example, product development to capture growth in targeted industries and gearing up for intelligent and clean leadership, capitalizing on the ongoing sustainability transformation.

So with this, I thank you sincerely for your attention. And now I will hand you back to the safe hands of Sophie.

QUESTION AND ANSWER SECTION

Sophie Arnius
Director-Investor Relations, SKF AB

A

Thank you. Thank you, Rickard. We will now open up for questions. And let me remind you on how to ask a question. [Operator Instructions] So let's start with the first question. And it's from the telephone line and it is from Andy Wilson at JPMorgan. Andy, please go ahead.

Andrew Wilson
Analyst, JPMorgan Securities Plc

Q

Hi. Good morning, everyone. Thanks for taking my questions. I've got two, if that's okay. One short term, one longer term. I'll start with the short-term one. I just wanted to try and understand or better understand the impact that you're seeing in terms of the China win business. Because I think we've seen this for a number of quarters, and apologies, if I should know this, but when will that sort of pretty brutal by the looks of it, year-on-year headwind kind of drop out of the base, i.e. when does China comp start to be a little bit more comparable because you obviously point to some of the China business is actually growing year-on-year. So just to try and understand that, please.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Rickard, do you want to take this one?

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

A

Yeah, happy to. You're right. We have for now, a number of quarters in a row experienced a rather negative sales development in wind in China. I mean, we're talking significant numbers. We're talking negative 50% of their thereabout. And we don't really see when this is going to change or when this will end, but now into the third quarter and with this development.

But if we allow ourselves to exclude wind for a while, the other industries in China have a more – a very different development where we basically have – would have a small positive organic growth if we exclude wind from our numbers in China. Clearly, as I've tried to say in the conference call, we are taking actions and we're redirecting our efforts to other growth opportunities in heavy industries to compensate for this.

And then, of course, we are, continue to work within wind. We still have a wind business and we're ready to ramp it up once demand comes back. But right now, short term, we don't see any change to this.

Sophie Arnius
Director-Investor Relations, SKF AB

A

And Niclas. Yes.

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

A

Yeah, just to add, Andy, to your question. The technical part of it, the sharp drop started in Q3. So from Q3 onwards, assuming everything else equal, we out of this year-on-year effect. Yeah.

Sophie Arnius
Director-Investor Relations, SKF AB

A

And Andy, you had another question also for us.

Andrew Wilson
Analyst, JPMorgan Securities Plc

Q

Yes, please. Yeah. I wanted to ask on the strategic objectives, I think it was the priorities for 2024. On the second one, the manage and restructure of portfolio. I was just hoping you could kind of give us, I guess, a little bit more color in terms of how wide range in that is kind of what's on the agenda there? Is it something similar to what we saw with the aerospace businesses in terms of strategic review? I appreciate it might be difficult to give specifics, but just a little bit more color around kind of the scope and the thinking around that would be interesting because I think that's a really interesting development.

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

A

Yeah.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Rickard, do you want to start with this one?

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

A

Sure. Sure. No, you're right, Andy. We are looking into this when it comes to portfolio, both from a strategic and a technical point of view. What we did within aerospace was more in the bucket of strategic actions. And the answer is yes. We are also looking into other opportunities and maybe reshaping the balance of our portfolio moving forward. I have nothing to report today, but you can rest assure that that is work that is ongoing. And I hope that in not too distant future, we can share some details on what our thinking and how we see how we're going to evolve our portfolio in certain segments.

On the tactical side, there's more an ongoing active activity, and this is one of the key reasons why we have been able also to uphold our margins in this, in a low volume environment. The teams are actively working on pricing and pruning, as we have discussed in a number of times, but also driving commercial excellence, more pricing rigor. We are looking into assortment simplification, which is rather massive in our portfolio and that also holds a lot of simplification opportunities in that regard, but is also forward leaning and forward-looking where we tie our innovation into new innovative products and solutions that would enable us to grow in our targeted segments. So, we have a broad kind of view on the portfolio management, both strategic and tactical.

Sophie Arnius
Director-Investor Relations, SKF AB

A

And...

Andrew Wilson
Analyst, JPMorgan Securities Plc

Q

Thank you very much. That's really helpful.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Thank you, Andy. And we will continue with a question from the webcast here. And it's from Daniela Costa at Goldman Sachs. And it's about India here. Why is India not growing more much for SKF given the climate here in our industrials locally for most industrial companies? And Rickard, do you want to take this one?

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

A

Yeah, we are growing – hi, Daniela, by the way. Yes, we are growing, as you saw, even though rather modest, as for the India and Southeast Asia region. And we don't break out the countries in isolation, but we do see maintain strong demand. We have big expectations and hope for India longer term, given that there is a strong economic development in that region.

But also our portfolio in India today is somewhat more tilted towards automotive and industrial. So that's maybe why, they really doesn't connect with your numbers that you sit with. But clearly, one agenda of the team and also that's with the new leader of Mukund is also to broaden our exposure to industrial and industrial verticals in India. And we see significant opportunities there for profitable growth.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Thank you, Rickard. Let's move on to our telephone line here. And Max Yates at Morgan Stanley, please go ahead.

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

Thank you very much. Could I just start on the selectivity that you've talked about and particularly in the Americas – I have to change that, I'm going to ask something else. Could I just...

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

A

Okay.

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

...ask about the organic growth kind of cadence in the US? You've obviously talked about minus 7%, kind of we've just down minus 5% in or down mid-single-digit. What is it that you look at that gives you the confidence that to get to that kind of low-single-digit, we can be kind of flat or even slightly positive by the end year? Is it sort of conversations with your customers? Is it China Wind dropping out? So, if you could give some framing because obviously that's going to be quite a significant improvement in the second half and more than what we're seeing kind of quarter-on-quarter in Q2.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Rickard?

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

A

Right. I think there are two things. Firstly, if we look into the intelligence that we gather and also even though we don't guide in our order book, but we – I can't say that things have changed or the tide has turned, but we do see signs of that things are flattening out. So that's kind of one answer to it, why we believe that the second half will be better from a demand point of view than the first half. But then it's also mathematics.

We are reaching the tail as we go into Q3 and Q4 when – last year, when we start to see the negative volume drops or the softer demand. And, of course, the comparison will be somewhat easier as we come into Q2 – sorry, Q3 and Q4 this year. So I kind of some signs of flattening out. I don't dare to predict when it will turn. But clearly some signs that's encouraging. And then mathematics, I guess, is the answer to your question.

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

Okay. And then maybe just the sort of longer term follow-up. I mean, if we look at your sort of sales, they're around kind of maybe SEK 100 million this year. You've got a 14% margin target. So it's kind of SEK 14 billion of EBIT. I guess what I'm curious is we've got a lot of moving parts around kind of cash flow in the last couple of years, kind of supply chains now moving kind of down inventories. Do you have in mind a kind of sustainable free cash flow number kind of on those below SEK 100 billion of sales that you think is achievable for the business in a more normalized environment when we're doing 14% margins? Thank you.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Niclas. This is a question for you.

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

A

Thanks. Well, I won't give you an exact number. Of course, this is something where we have a clear view on where we want it to be and need to be. And again, it's a bit back to what we have said before, 14% margin. That's a hardcoded target. And there, we have line of sight, how to get them in not too distant of a future without saying an exact date or year. It's a long-term target.

And then on the net working capital side, we do have a long-term target of this 25% of sales. And now, being at this 30% 31%, that's quite a way to go still to 25%. But – and it will take time. That's pretty clear. But hopefully, that gives you an idea of what the cash flow potential could be of the company long term.

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

Okay. Yeah. Thank you.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Thank you. We will continue with a question here from the webcast and it is from Mattias Holmberg, DNB Markets. And also a financial touch to this one. What drove the inventory increase quarter-on-quarter? And have you had a fixed cost over absorption effect boosting the margin in the quarter? Niclas, please.

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

So inventory, as you saw in the large or bigger scale of things, inventory was quite flat in the quarter. Slightly up, that's correct, Mattias. And this was mainly a valuation topic. So what drove that small uptick was valuation driven while the real kind of volume of stuff was pretty much flat. And then on this, on the over absorption, I mean, we had a negative effect from absorption roughly SEK 400 million.

Sophie Arnius A
Director-Investor Relations, SKF AB

And continuing on that theme when it comes to inventories, but more across the value chain. And this is a question from Daniela Costa at Goldman Sachs. So Niclas, inventories across the value chain. Any comments to that?

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

No, I think pretty much the same as we've seen before and discussed before. So if we think about our customer go-to-market, we don't see – we see distribution inventory levels being pretty normal. And then on the OEM side, there are pockets of destocking. As we mentioned, in the US, it continues and most likely elsewhere [indiscernible] (00:30:29). I mean, we see it on ourselves as well. As we said, I mean, we still think we have to somewhat too high inventory levels, even if we've taken down inventories a lot in the last 12 months, we still have some way to go during this year. And it's for sure similar for some of our customers as well.

Sophie Arnius A
Director-Investor Relations, SKF AB

Thank you. Thank you, Niclas. And let's move on to the telephone line here. And we have a question from Rory Smith at UBS. Rory, please go ahead.

Rory Smith Q
Analyst, UBS AG (London Branch)

Good morning. It's Rory, UBS. Thanks for taking my questions. I've got two, if I may. Just on the near-term price mix, obviously in the quarter, you've called out high speed rail, aerospace, very strong win, very weak. Is that the main – is that mix the main driver or obviously that is the main driver of price mix in the quarter, but what – or how would you expect price mix to develop through the year? Just thinking about comps in for wind in China coming back in in the second half, should we expect a sort of reasonably steady improvement? Or do you think there are some moving pieces to think about? I suppose it's more of a qualitative question than a quantitative one, but just thinking about price mix through the balance of the year. That's the first question. Thank you.

Sophie Arnius A
Director-Investor Relations, SKF AB

Well, Niclas, do you want to support Rory here?

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

A

Sure, Rory. So, yeah, I mean, we've had a good run with price mix over the last few quarters. And so, it was in Q1. On the pricing side, which I guess isn't exactly your question. But anyway, on the pricing side of price mix, we continue – especially continue selectively to increase prices, continue to work with value-based pricing. And as Rickard just mentioned, this is a – it's a big theme of the improvement work as well to do better pricing, more value-based pricing, capture the value we have or provide to our customers. And that work will continue.

Then when it comes to mix, it's more – if price is a bit easier to predict what we are going to do, mix is, of course, a bit harder to predict exactly as you said. So which industry moves up, which moves down over the next year or so, but another theme that we continue to working us work on as part of portfolio management.

Rory Smith
Analyst, UBS AG (London Branch)

Q

That's very helpful. Thank you. And apologies to a badly worded question. That was exactly what I was looking for there. Second question for me, please.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Yes.

Rory Smith
Analyst, UBS AG (London Branch)

Q

Second question from me, just a sort of a longer term or bigger picture question on China. You drew out the localization rate increasing over the last few years. Is there an upper bound to that number? I mean, let's not assume 100%, but can it go much higher?

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

A

Yeah.

Rory Smith
Analyst, UBS AG (London Branch)

Q

And if it can't go very much higher, what are the sort of imported sales in China that you would have to keep doing there? Is there a market or product that would drive that? Thank you.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Rickard, please.

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

A

Yeah. Let me first try to put this in a broader perspective. Yes, we are on a journey trying to drive regionalization to the extent possible in order to create more resilience and actually safeguard our business for disturbances in global supply chains. And in China, here, as we mentioned, we have come a rather long way. I think there is still a bit more to do. We will never get to your point. You're absolutely right. It will never be 100%. But maybe creep up a little bit further, kind of a 75-ish, 80-ish percentage, something like that. It's not a fixed number as such, but maybe something at least gives you a reference point.

And in terms of how to get there, I think that over the last few years, we have done some rather significant investments in China. I think we have the capacity now in place to start to ramp that up in phase with how demand develops to get to such a level. So I don't see that we need continue massive investments to get to where we want to be in China. I think the foundation is in place. It's all about how quickly will be done, ramp it up and to support the market demand as it evolves.

In terms of product assortment, I won't go into those details. But clearly, there are some kind of – some part of our assortment where you have rather low volumes on an annual basis and then make no economical sense to spread that across the world. You probably need to have a centralized operations for economies of scales and so forth. But for the majority of our assortment and the high volume products, our aim is to regionalize them to the extent possible.

Sophie Arnius
Director-Investor Relations, SKF AB

A

And the next question...

Rory Smith
Analyst, UBS AG (London Branch)

Q

Got you.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Thank you, Rory. We have the next question here from Anders Roslund at Pareto. Anders, please go ahead.

Anders Roslund
Analyst, Pareto Securities AB

Q

Yeah, it's a very short one. What did you say about the mix, the negative effect of under-absorption? I didn't really understand. Did you say that it was minus SEK 400 million or did I misunderstood it?

Sophie Arnius
Director-Investor Relations, SKF AB

A

So, Niclas, do you want to clarify here?

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

A

Yeah. Yeah. Yeah. So on the EBIT, the effect of lower volumes in terms of under-absorption, SEK 400 million negative.

Anders Roslund
Analyst, Pareto Securities AB

Q

Yeah. That's a far bigger level than previously. So. Yeah. Okay.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Yeah. But I mean as you...

Anders Roslund
Analyst, Pareto Securities AB

Q

That's also mean...

Sophie Arnius
Director-Investor Relations, SKF AB

A

...know, 7% sales down and fixed costs and we haven't had negative 7% in the prior quarters.

Anders Roslund
Analyst, Pareto Securities AB

Q

Yeah, but that means that you have taken down production. I mean the under-absorption should come from that you have lower production than sales.

Sophie Arnius
Director-Investor Relations, SKF AB

A

We can maybe better to take that offline as it's a relatively technical...

Anders Roslund
Analyst, Pareto Securities AB

Q

Yeah.

Sophie Arnius
Director-Investor Relations, SKF AB

A

...discussion.

Anders Roslund
Analyst, Pareto Securities AB

Q

Okay, thanks. That's all for me.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Thank you.

Sophie Arnius
Director-Investor Relations, SKF AB

A

And it's so to say, not the effect of inventory change is more about the lower manufacturing levels here.

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

A

Correct.

Sophie Arnius
Director-Investor Relations, SKF AB

A

But, Anders, if you have further questions, please give us a call here. And we will continue with questions here from the phone line. And it's Max Yates at Morgan Stanley that is the next stop here. So, Max, please go ahead.

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

Thank you. Could you just give us the year-over-year price impact in the quarter? You did minus 7% organic. What was the contribution of price in the quarter?

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

A

So price mix in total was positive. As I said, we won't give an exact number. We're well aware we gave it previously, but it was a different that volume and so now we stick to price mix being positive. And price, within that price mix, as I mentioned, also being positive.

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

Okay. I mean, maybe just sort of qualitatively, did you still put up prices in Q1 versus sort of Q4?

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

A

Yeah.

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

Are you still putting through price rises?

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

A

Yes. Yes. Yes. Yes. So, the very much as discussed before, we continue to work with pricing, meaning we continue to increase prices. Of course, there might be an exception in some way but the general direction is increasing prices. And as I mentioned earlier here, this is a key theme also going forward to work with pricing and also increased prices.

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

Okay. And maybe just sort of another quick follow-up. Just when we think about – I mean, I've seen in other companies that we look at, there was obviously quite a substantial kind of working day impact this quarter, particularly in March. Could you maybe just talk through just in terms of sort of sequential development, when you think about kind of Europe and the Americas. Did you really see kind of when you look in the business, talk to your people, any real fundamental change sequentially? Because obviously, when we look at these year-over-year growth rates, I know it can be skewed by working days and things like that. How would you sort of characterize the sequential developments in Europe and the Americas?

Sophie Arnius
Director-Investor Relations, SKF AB

A

Niclas...

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

A

Yeah.

Sophie Arnius
Director-Investor Relations, SKF AB

A

...do you want to take this one?

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

A

Well, on a very high level, of course, and exactly as you said, there was some impact of Easter in the quarter. Year-over-year, the number of days wasn't that different. You could see it clearly in the March performance, but we don't publish the March in itself. So some impact and small part of the reason for negative 7% being explained by this year-over-year. But nothing, nothing too big.

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

Okay. Could I just squeeze in one more, Rickard, sorry, on your portfolio comments, when you talked about sort of nothing to report. I just want to understand kind of what is in the scope of your consideration. And I guess kind of very bluntly, what I'd like to ask is the Automotive division as an entirety, you talked about getting this to sort of 8% margins. You've got a very healthy kind of 6% margin. Would you say that within the scope of your kind of thinking, your review, you're looking at not just pruning, but also the kind of wider, I guess, sense of having those two divisions together?

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

A

Right. I may disappoint you on my answer and the level of depth in my answer. But if I come back to Automotive but in general, as I said, I'm not going to pinpoint any particular area. And my message was that, yes, we are looking into different parts of our portfolio to see, are there potential strategic moves that we should do to maybe shift something out and replace that with something else. So that is a work that is constantly ongoing. And once we have something exciting to report, you will be the first to know or the market would be the first to know, of course.

Regarding on automotive, as I said before, we are working hard to create an autonomous Automotive business with within SKF. Automotive is a very entangled that integrated in the way we operate. We share factories, we share R&D, we share IP. We share to some extent, commercial sources. So that work is ongoing. We have no decision to split those entities. So Automotive is an integrated and vital part of our business. But we are working on, how do we create a more autonomous Automotive division. To create, what I said a few years ago, what I call strategic flexibility. You never know what the future will entail, and it's always good to have options to maneuver. And maybe we have a different answer tomorrow. But today, that's the answer you're going to get.

Max Yates
Analyst, Morgan Stanley & Co. International Plc

Q

Okay, that's very helpful. Thank you, Rickard.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Thank you, Max. And we move on to the next question and it comes from the line of Klas Bergelind at Citi. Please go ahead.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

Thank you, Sophie, Niclas and Rickard. So I was late on the call. Too much going on. You might have answered some of these. But I just want to come back the manufacturing impact, and sorry to [ph] belabor (00:42:58) the point Niclas. I checked in with IR this morning about the pure impact from manufacturing inventory, about the negative SEK 400 million. That, however, seems to be linked to the lower utilization, the volume effect, not the absorption from production, the cost absorption accounting. If I look at the inventories, it looked like you were building inventory and more than last year, that in itself should boost EBIT. Did the inventory boost the EBIT? That was my question, really. And sorry for if I wasn't clear before with IR. Apologies, but thank you.

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

A

No, no, no. Sorry.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Niclas, please clarify that.

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

A

Yes, thank you. Sorry. I know I probably haven't been being clear enough. And if there are further discussions on this topic, please let's take it offline. But I'll make an attempt. So we had less sales. We had lower volumes year-over-year in Q1. And of course, that led to an under-absorption as we had fixed cost and less activity. And that's the SEK 400 million I referred to in EBIT impact. Then when it comes to inventories this year, on Q1, we actually, as you can see in our accounts, it increased slightly, but again very slightly considering the base number. And that slight increase was mostly related to valuation of inventory rather than increasing the kind of hard stuff on the shelves. So without that valuation impact, pretty much the same level.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

Thank you. No, that's much clearer.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Was that clear enough Klas? Yes.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

Thank you for that. Yeah. So I have one more. My second one is on the cost element of the SEK 550 million in the bridge. Niclas, can you please confirm that this was largely the components [indiscernible] (00:45:02) improving rather that you are ahead on world-class manufacturing. Or that, I mean, we know that OpEx is already run rate in SEK 1 billion, right? So that shouldn't come in higher. But on the world-class manufacturing, was that greater than you thought or is it tracking broadly in line? Thank you.

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

A

No, I would say exactly as you say, tracking world-class manufacturing, tracking broadly in line with plans. And exactly as you said. I mean, we had a tailwind from components, materials. So that was on a lower level than last year, the cost. Same goes for energy, although it's a much smaller category. So it doesn't matter that much. And then also on logistics, slightly positive, i.e. lower cost compared to last year.

Then on the other hand, personnel cost, which is the second biggest kind of cost bucket, we had a slight negative, so slightly higher cost than last year. And within that personnel cost, we had salary inflation pushing cost up. But then, the efficiency program that we concluded in December last year helped big things, so taking cost down when it comes to personnel cost.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

Thank you. My third and very quick final one is around price mix. And I totally get it. You're not going to give the exact number now. I appreciate that. I'm just going to ask about from a seasonality point of view, when we look at [indiscernible] (00:46:41) data, et cetera, it seems to be improving at the beginning of the year. Yes, basically, very high level. Do we have some sort of seasonality impact or that you typically get a little bit better pricing start of the year than end of the year? That's my only question on that. And apologies if that's kind of annoying.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Niclas, do you want to continue here?

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

A

And the short answer Klas is no. So, no particular seasonality in pricing. That's more of a constant job we do over the year and over years.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

Thank you.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Thank you. [Operator Instructions] We will continue with a question here from the phone line, and it comes from Andreas Koski at the BNP Paribas. Andreas, please go ahead.

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)

Q

Thank you and good morning. I hope you can hear me. I want to ask about the organic growth in the quarter. It was minus 7%, a quite significant step down from the minus 2% in the fourth quarter. And I also understand that you won't give us an exact price mix component, but would you say that the delta from the minus 2% to the minus 7% is mainly explained by a lower price mix component and the volumes in the quarter was still down only single digit numbers? Thank you.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Let's – Niclas, do you want to try to sort this out?

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

A

Yeah. I mean, there's different ways to try to get to price mix. But no, I mean, we had – and again, now we've – I refer to year-over-year. So minus 7%, now in Q1, as you said, a smaller minus number in Q4. And we had a – from a volume perspective, more negative impact in Q1. So, meaning that it wasn't suddenly price mix that skewed the numbers in itself.

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)

Q

Okay. So volumes were down, say around high single digit or even low teens in the quarter. It sounds like.

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

A

We won't. No, we won't give the exact number.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Yeah.

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

A

But you get rough idea. So positive price mix minus 7% in organic.

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)

Q

Understood. And then the second question is on your [indiscernible] (00:49:46) manufacturing footprint programs, all the restructurings you are doing. We had another restructuring cost of around SEK 200 million in this quarter. I think over the past four years, restructuring costs have reached to around to more than SEK 200 million a quarter corresponding to around 10% of your adjusted EBIT. And maybe if you can just – what are you spending all those money on in the laying of people or closing down factories or what are all those restructuring costs going to? And how long will the restructuring cost continue? Thank you.

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

A

Right. I'm going to give it a try.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Yeah.

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

A

If we start by looking into this quarter, it's primarily related to the ongoing transformation that we have embarked upon. Please recall that we have announced that we are about to close down our factories in Luton in the UK. We have announced that we are closing down the factory in South Korea. We have announced that we are restructuring some of our activities in Germany in Schweinfurt. Clearly, that's the majority of the one-offs that you see in this quarter. And that relates to costs for, unfortunately reduce head count and other costs in terms of transforming moving equipment and so forth. So that's the majority. And that has been the case also in the last few years. And we have set that we are on a journey for the kind of world-class manufacturing program that was [indiscernible] (00:51:23) before that we say believe it's fairly on track, and that is due to be completed sometime during 2025. So through that period, I think you should expect us to continue at this level.

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)

Q

Understood. And then lastly, maybe on the Americas' organic decline of around 10%. Do you see that distributors are still doing a lot of destocking or is that coming to an end, do you think? Thank you.

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

A

I'm actually rather pleased to report, when it comes to destocking, that has primarily been visible in our OEM part of the business and not so much on distribution. And that is also the case in this quarter. So – and that's a positive for us.

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)

Q

Perfect. Thank you very much.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Thank you, Andreas. And we continue with a question from Daniel Cunliffe at Bernstein. Daniel, please go ahead.

Daniel Cunliffe
Analyst, Bernstein Autonomous LLP

Q

Hello. Thanks. Thanks for the question. Just really a follow-up on these one-off charges, which we understand the restructuring. Just want to look at the impairment charges, I think it's just under SEK 100 million or so. Could you just give us a color where we should think about that going forward? Because if I look at the impairment one-off costs for the last 10 years, I think those one-off costs average about SEK 250 million a year. So obviously, SEK 100 million for this quarter would seem at the higher end of that. So just give us a flavor of those? And just –

you've given the one-off costs at the higher end of the clearly 10-year average, what should we think about that? And any color would be really helpful for the remainder of the year on the impairment costs.

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

A

Yeah.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Niclas, I think this is a CFO question.

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

A

Not sure about that. But anyway, when it comes to – if we talk about one-off for IAC in total for us, as Rickard mentioned, it mostly relates to the manufacturing transformation. And with some exceptions, and for instance, last year, as you know, we had this call it white-collar reduction program, efficiency program. So then it was more broad than just manufacturing. But looking over time, it's mostly related to manufacturing. I think I mentioned some of these initiatives in South Korea, Busan, in Luton, UK, where we close down production and then ramp it up elsewhere. And within IAC, what you see most often, for instance, in the quarterly number is head count related. So redundancy costs.

Daniel Cunliffe
Analyst, Bernstein Autonomous LLP

Q

So should we assume that sort of the run rate for the rest of the year...

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

A

Yeah.

Daniel Cunliffe
Analyst, Bernstein Autonomous LLP

Q

...will be at the upper end of the sort of five or 10-year average sort of restructuring...

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

A

No.

Daniel Cunliffe
Analyst, Bernstein Autonomous LLP

Q

...charges just to sort of view on.

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

A

Yeah. So just to give you some sense and idea. I mean, last year, we had unusually high because of the program. So this year, most likely or it will be less than that. But then again, it very much depends on the timing of, for instance, a bigger restructuring. Doesn't it fall into Q4, Q1? But anyway, just to give you an idea, less than last year.

Daniel Cunliffe
Analyst, Bernstein Autonomous LLP

Q

Less than last year. Okay. Perfect. Thank you very much.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Thank you, Daniel. And we have time for one final question and it is a follow up then from Andy Wilson at JPMorgan. Please, Andy.

Andrew Wilson
Analyst, JPMorgan Securities Plc

Q

Hi. Thanks for squeezing me in. I've got two hopefully they're both very quick. Just on the cost development that you've outlined for Q1, would you expect a similar picture in terms of the Q2? I appreciate obviously that can change. But in terms of the visibility you have on savings coming through and I guess the visibility on where your cost lines are kind of running, should we expect a similar picture in Q2? And I guess secondly, and apologies if this is either too technical or if misunderstood, but is there any EBIT impact from the revaluation of the inventory in the Q1?

Sophie Arnius
Director-Investor Relations, SKF AB

A

I think, Niclas, its your name on these two questions.

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

A

Okay. Thanks. Thanks, Andy. So on the second one, no, and we can look into that offline if needed. On the first one, so no, we don't give margin guidance on Q2 in particular. But more broadly speaking, when we think about our cost categories, cost components materials has been, gradually coming down. Energy is a bit more choppy. And then logistics also because of everything happening in the world, a bit more unpredictable. But maybe directionally, everything else equal, kind of see some continuation of the past patterns.

But then personnel costs is there we have some seasonality where 1st of April, new salaries kick in in some European countries for instance, where we have relatively large number of people. So in that sense, that's a step up from an inflation perspective. On the other hand, then the efficiency program that we referred to should, of course, continue to show effect. So it's a bit of a mixed picture.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Thank you.

Andrew Wilson
Analyst, JPMorgan Securities Plc

Q

Thanks, Niclas. That's very helpful, as always. Appreciate it.

Sophie Arnius

Director-Investor Relations, SKF AB

Thank you, Andy. And thanks for all of you that have asked question here to us today. We – let's wrap up this call. And Rickard, do you want to say some concluding remarks here?

Rickard Gustafson

President, Chief Executive Officer & Director, SKF AB

Yes, please. And again, thank you for your attention and for your insightful questions. I am pleased that we are building a more competitive and resilient SKF. And I'm encouraged about our ability to maintain and actually even improve the margins in a rather soft demand environment. But even more importantly, we are staying firm on our strategic transformation. We are investing in our future. We are creating a more innovation spirit in the company, bringing new exciting products and services into the market, and we are gearing up for profitable growth once demand bounces back again. So, I really like to take this opportunity also to thank all of my colleagues across our global footprint for all their contributions and hard work. It's truly appreciated. And we will continue on this journey that we embarked upon.

So with this, I thank you so much for your attention and I wish you all a wonderful day and a great weekend once you get to it. Thank you.