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Q2 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Sophie Arnius
Director-Investor Relations, SKF AB

A warm welcome to SKF's Q2 2024 Earnings Call. I'm Sophie Arnius, and I'm heading up Investor Relations. Our CEO, Rickard Gustafson; and CFO, Niclas Rosenlew, will take us through the highlights of the quarter where the performance marked another step towards a more resilient and competitive SKF. After their presentations, there will be opportunities to ask questions, and there are two ways to do that. So, if you are joining via the telephone line, you press a star and one to ask a question. If you're instead are watching via the webcast, you can already now type in your questions in the tab, and you find that just above the slides. So, without further ado, it's great to hand over to you, Rickard.

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

Thank you, Sophie, and a warm welcome to all of you joining on this earnings call. As Sophie mentioned, the story continues. We are creating a more competitive company capable of delivering consistent margins regardless of demand fluctuations. And to support this statement, I'd like to draw your attention to the right hand side of this chart. The solid line represents our adjusted operating margin, albeit on a rolling 12-month basis. And as you can see, it actually holds up pretty well despite a rather volatile organic growth quarter by quarter. And the reason for this is found on the left hand of this chart. Our continued, diligent execution of our strategy.

We have talked about it before. We have We have talked about it before. We have a decentralized organizational model, getting us close to our customers and providing more agility in our operations. We have driving effective cost measures across our businesses and we constantly drive an active portfolio management also across all parts of our business.

And at the same time, we are investing into our future. We are driving regionalization and building strong and competitive value chains in all of the geographies where we operate and we continue to drive innovation. And I would come back to innovation later in this presentation. But all in all, we believe that we're creating a company that is very well-positioned to take advantage of profitable growth, while once demand turns back into growth again.

But with that said then, let's take a look at the quarter in isolation. We report some SEK 25.6 billion in net sales. That equates to a rather stable operating margin, adjusted operating margin of 13%. This is a strong performance given that we have had a rather negative organic growth of almost 7% in the quarter to be compared with a positive growth of 8% the same quarter a year ago. And the reason for this are the same reasons as described on the previous page. Clearly, we have been able to drive price mix effectively in the quarter. We continue to drive our portfolio management activities and dare to walk away from unprofitable business. So some of this decline in organic growth is actually self-inflicted, but for the right reasons. And we've also been able to drive effective cost management.

Later on this presentation, you will hear Niclas, share some more insights to this.

you will hear Niclas share some insights to this. But we have been able to offset a rather significant wage inflation in the quarter through other cost measures. So, all in all, I think it's a decent and strong performance in the quarter.

If we then move on and take a look at our demand across our geographies. And as you can see on this chart, it's a fairly soft situation across all our geographies where we operate. But it is important to mention that, as you all know, we have exposure to so many different industrial verticals, and all of them are not at the same point in their cycle. There are some that have a rather strong development globally and others that struggle a bit.

If I start with being on the struggling side, one industrial vertical that is rather soft demand across all geographies still is wind. But otherwise, it varies a bit by region. So, if you take a look and start by EMEA, negative organic growth of some 6%, as you can see on this chart, a little bit worse than what we saw in the first quarter this year. So, clearly, the EMEA demand situation has not improved in the quarter. But there are pockets of growth to be found also here, aero and rail being two prime example of strong growth in the quarter, while most other industrial verticals are experiencing a softer situation when it comes to demand.

Americas, a somewhat different story, negative 5% organic growth in the quarter, a little bit less worse or a little bit better, regardless how you want to express yourself, versus the same quarter – or sorry, versus the first quarter this year. This is primarily driven by strong price/mix in the quarter. But also here, we find strong development in industrial vertical such as aero and marine, while agriculture continues to be in its low point in its cycle.

Turning to China and Northeast Asia, clearly a significant negative organic growth of just above 12%. Here, wind is the main driver behind this. And if we would exclude wind from these numbers, we would have reported a flattish organic growth. So, other industrial verticals are actually holding up pretty well in China, Northeast Asia. Rail and off highway are being two prime examples of that.

And finally, Asia. On a total level, fairly flattish. As you can see here, you have heavy industries and light vehicles being strong performers, while agriculture also has a rather low point in its cycle also in this region.

Turning to our segments, and I like to start with sharing some insights on our industrial segment. Here, we report some SEK 18 billion in net sales that corresponds to more than 7% or around 7% negative organic growth. But despite this, we are actually able to slightly improve our operating margin to just about – about 16%, a clearly strong performance and again driven by strong price mix, effective cost management and also active pruning in our portfolio.

Turning to automotive. Minus 5% organic growth and just adjusted operating margin of just above 5%. This is somewhat lower than the same quarter last year, but we also have a very different demand situation this quarter than was – than what was the case a year ago. I'm still confident that our Automotive team, they have line of sight of the 8% operating margin target by 2025 and they continue at a high pace with the strategic transformation on this portfolio. And we continue to have a very strong progress in the important EV segment and especially in China.

Looking into the second half, as you will hear Niclas will share shortly when we come into the outlook. We don't really see a significant change in the demand situation going forward. And we will – we will continue to drive and leverage the momentum we have in our regionalization to create a stronger and more competitive company. These two together may potentially put some additional pressure on our cost competitiveness, but it's the right thing to do. By continuing to drive in this, we will create a stronger company that is geared for profitable growth once demand turns again.

Taking a look into our strategic priorities. They have not changed and we continue to deliver on these and execute on these priorities with diligence and rigor. I have talked quite a bit on the competitive and intelligent value change. We have built up a strong momentum and when it comes to driving that in our business and it's also visible in this quarter in terms of items affecting comparability, which is rather – is rather high in this quarter. And Niclas will share more details on that shortly.

But we also continue to manage and drive our portfolio and continue to innovate to build for intelligent and clean leadership. And it's important to reinforce that portfolio management is more than just pruning unprofitable accounts. It's really how do we transform our portfolio to be geared for profitable growth long term, and here innovation and product development plays a vital role.

So, let me share some more insights on what's happening on innovation. Firstly, all our innovation clearly and naturally starts with our customers. How do we create customer value and how do we eliminate pain points for our customers? That's kind of always in the forefront of what we do.

We have paid a lot of attention and worked very hard to transform our innovation portfolio, so that it's fully fits with our strategic intent. And as you can see from the numbers on this chart, the vast majority of all ongoing innovation projects and product development projects, they are now supporting our high-growth segments.

But maybe even more importantly, they all need to contribute to our long-term profitability target of 14% operating margin. And all products that not now it's in the pipeline and being worked on, all of them have operating margin targets significantly above the 14%.

But we have also felt that we wanted to share more insights on what we do with innovation and create more kind of engagement and excitement around our portfolio. And therefore, we have decided to host something that we call tech and innovation summits. And we plan to host them twice a year, and we actually had the first one in the beginning of June. And also to enjoy to participate in that summit and listen to some of these customer testimonials on the value that our innovative capabilities provide to their businesses.

And at the summit, we also introduced some new products to the market or showcased a few products that we're, you know, introducing into the market. And I'd like to give you some – a short flavor on a few of them.

As you can see here, we have introduced a new seals for heavy industries. This seal will really improve uptime in very tough conditions. We showcased a new split bearing also designed for heavy industries that significantly reduces downtime, but even more importantly, enhances safety in hard to reach locations. We introduced a new super precision bearing platform, and this platform has a unique solution to meet the performance requirements in the machine tool industry.

And finally, we also introduced a new monitoring and lubrication solution that will improve reliability and reduce noise within the railway industry. And this is just a few examples. We do have a very strong pipeline of new innovation that we're working on. All of them will continue to help to build a stronger, more competitive and resilient SKF as we move forward on our strategic journey.

So with this short introduction, I like to hand over to Niclas to take through – take you through the numbers in more detail. Thank you. Niclas, over to you.

Niclas Rosenlew

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

Thank you, Rickard, and hello, everyone. So as we just heard from Rickard, the quarter can be characterized as relatively low volumes but excellent in holding up margins and profitability. So if we start off with the volumes or the sales, SEK 25.6 billion was the sales in Q2. This is down from SEK 27 billion a year ago. But on the other hand, it's roughly at the level that we've had the last few quarters since the downturn for SKF started in Q3 last year. What comes to the bridge, sales bridge. We had a positive effect – slight positive effect from currency. When it comes to the organic component, we had an organic decline of 6.6%. And here within the organic, we have a negative volume, but we have a clearly positive price mix. So good job, continued job by the team managing both price and mix.

On that note, if we move on to profit and adjusted operating profit, it was SEK 3.3 billion in the quarter, slightly down from SEK 3.6 billion last year. If you look at this difference, this delta between SEK 3.3 billion and SEK 3.6 billion, as you can see in the bridge, half of that actually comes from currency. When it comes to organic, of course, the lower volume, slightly lower volumes or lower volumes affected negatively, but there was a very good offset in terms of price mix. So, the organic component in the bridge being SEK 244 million negative.

What comes to cost, I would say that was well managed by the team. We had materials slightly better than last year, so slightly lower than last year. No big change.

better than last year. So, slightly lower than last year. No big change, but still same actually goes for energy. Logistics, on the other hand, where slightly higher than last year. So more cost.

But then a large component, of course, is our wages and salaries. And here, despite a 5% to 6% wage inflation, the wages and salaries total cost was reasonably flat in the quarter. One thing to note in the quarter was our relatively high IAC. So one-off costs and the main part of the one-off costs of roughly SEK 800 million came from all the good activities that we are doing in Germany. And this is very much part of regionalization.

So, a long-term thing that we want to do need to do in order to further improve competitiveness of SKF. We are taking down some of the activities and focusing Germany. We are moving some of the volumes to other geographies closer to customers and thereby improving our competitiveness, lower costs, and also shorter lead times being closer to the customers.

Moving on to cash flow. It was solid in the quarter, SEK 2.2 billion. Yes, it's a bit down how it is down compared to last year. But on the other hand, it's up compared to 2022 and for being a Q2 this is actually quite normal.

In Q2, ee typically build inventories ahead of holiday seasons, which we then deplete in Q3 and in Q4. And that's exactly what you can see here in the bridge with net working capital being SEK 700 million negative. This is when we were building in Q2 inventories. And again, expect to deplete that in the second half.

What comes to our balance sheet, it remains strong. We had a net debt of SEK 10.7 billion. And this is excluding pensions. If you would include the pensions, it's roughly SEK 19 billion. We have a return of capital employed, which is moving in the right direction, somewhat up from last year, very much towards our target of 16%.

On net debt, a couple of specifics to note in the quarter. We paid out dividend roughly SEK 3 billion, which, of course, then increases net debt somewhat. So, that's the reason for the increase, essentially. And we also repaid a SEK 3 billion bond in the quarter. Of course, that doesn't have an impact on net debt, but it does on cash. So, all in all, strong and solid balance sheet.

Then, if we move on to the future and the outlook. We do expect markets to be volatile and the geopolitical tensions to continue also in the near term. For Q3, we expect organic sales to be relatively unchanged year-on-year. And for the full year, we reconfirm our guidance, our previous guidance of low-single digit organic sales decline year-over-year. One thing to note here on the guidance part is that we have decreased the CapEx of additions to property, plant and equipment from the previous SEK 5.5 billion to SEK 5 billion now. This is actually very much in line with the strategy where we have said that we are going to peak around 2023 and then gradually start to come down in CapEx.

So with that, hand back to you, Rickard.

Rickard Gustafson

President, Chief Executive Officer & Director, SKF AB

Excellent. Thank you very much, Niclas. And before I sum up the quarter, I'd like to share a few comments to the background on this slide. As of as we speak now, they're the world's largest youth tournament in football or soccer, if you prefer, called the Gothia Cup is ongoing. This tournament attracts some 2,000 teams from across 75 countries, all gathering here in Gothenburg during a very intense football week. SKF has for many years been the main sponsor of this event, and we're a proud sponsor of it. But it's not just this week that makes this unique for us. We use this as a platform to connect with the different markets and communities where we operate.

In many other countries where we operate, SKF hosted locally tournaments, qualifying tournaments to travel to the Gothia Cup. This enables a number of unfortunate teams that may never have the financial means to make such a trip, to provide for their youngs an opportunity and a memory of a lifetime to come and visit the

Gothenburg and be part of the Gothia Cup experience. So, it's clearly one way for us to give something back to communities where we operate.

But back to kind of reality operate. But back to kind of reality and back to Q2, as I said in my opening remarks, I think we again, prove that the journey continues. We are creating a more competitive and resilient company. In this quarter, despite a rather significant negative organic growth of around 7%, we are holding the margin at 13%. And for our important industrial business, we're even able to actually improve it somewhat to over 16%. This comes from rigorous delivery on our strategic intent.

We continue to be effective when it comes to price mix. We drive effective cost management activities across our operations, and we dare to prune and walk away from unprofitable business, even though that may actually further enhance the negative organic growth development, but it's the right thing to do. And we're not walking away from continuing our long-term strategy execution, investing in strong local supply chains, and regionalization of our manufacturing footprint and driving innovation forward. All of this will provide for a stronger company that is geared for growth once demand turns again.

So with this, I'd like to thank you for your attention and hand back to Sophie and the Q&A session.

QUESTION AND ANSWER SECTION

Sophie Arnius
Director-Investor Relations, SKF AB

A

Thank you. Thank you, Rickard, and thank you, Niclas. So we are now ready to take your questions. Before we open up for questions, let me just remind you on the practicalities here. [Operator Instructions] [Operator Instructions] For our webcast audience, you can type in your questions in the tab just above the slides. So, let's start with a question from the telephone line, and it's from Daniela Costa at Goldman Sachs. Daniel, please go ahead.

Daniela Costa
Analyst, Goldman Sachs International

Q

Hi. Good morning. Thank you for taking my questions. I have two. I'll ask them one at a time if possible. So first one, just on the actions that will impact the margin in the second half. I guess margins normally are seasonally like lower in Q3, Q4. Compared to normal seasonality, can you talk us a little bit through the magnitude of those actions that will impact and what those action exactly are?

A

Yes. We have Rickard here to answer. Yeah.

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

A

Right. Good morning, Daniela. Thank you for bringing to the attention the seasonality. That is absolutely correct. We do have seasonality and I think you're all aware of that. And as far as I know, you have baked into your spreadsheets and you should maintain it like that.

To answer your question, as I've said, there is no drama in this. We have all seen Q2, experienced this a low demand environment and we have driven our regionalization and we've been manage – been able to manage and maintain the margins.

As we look into the future, we foresee that this situation will continue but we will not walk away and reduce the momentum that we have built up for regionalization. We will maintain it even if it may have a small or somewhat impact on our cost efficiency. So, it's no drama. It's not a number that I'd like to give you. Yes, I want to share with you that that's how we see things, because we believe it's the right thing to do even if it may have a short-term negative impact on us potentially.

A

Daniela, you have another question? Yes.

A

And Daniela, you had...

Daniela Costa
Analyst, Goldman Sachs International

Q

Thank you.

Sophie Arnius
Director-Investor Relations, SKF AB

A

...another question? Yes.

Q

Yeah. Thank you. Thank you. It was just regarding sort of how and it relates to this topic of regionalization. And if you could remind us the current imbalances. Particularly in the US, given the debate around tariffs that we are hearing and tariffs to the world, how much do you bring into the US from outside and specifically from China versus from the rest of your operations? And what could be the tariffs impact for you?

A

Right. It's an important question. I can't give you an exact number. But if you may recall, a year or a year and a half ago, we announced a significant investment in Mexico, where we're building up a new capacity to serve the North American market. And this is exactly for the reason that you mentioned. Today, we saw quite a few of those components from China. All of that is in transition now to Mexico from China.

So, that's just one example of the reorganization efforts that is ongoing. Niclas mentioned on the items affect comparability in the quarter. We are working hard on downsizing our capacity in in Germany, in Schweinfurt. Some of that capacity is actually moving to Asia because it's actually geared for customers there. And we get close to the customers. And some of that capacity is moving eastbound to Eastern Europe to drive long-term cost effectiveness and competitiveness in our organization.

So, it varies by country and there are different means that we are undertaken in order to deliver on this regionalization effort. But North America is not forgotten in this. Mexico will be the key platform as we move forward there.

A

Maybe just to add, Daniela. To be specific, we are getting to a point where what we sell and how we serve our customers in America is actually but specifically the US, very little is from China.

very little is from China. So, this has been, as you know, a journey for the past couple of years, and we are at the point where – where we are not that dependent actually. So, let's see, but not particularly concerned about what comes.

Daniela Costa
Analyst, Goldman Sachs International

Q

And sorry, if I may follow up on this, because also the debate on the tariffs is that the 10% tariff would apply to – coming from anywhere, not just from China, but those you can pass through, for example, to pricing or other things. I guess Mexico would still be subjected to tariffs?

A

Yes. The plan is that when we looked into this, that we feel confident that we're going to be able to manage this. And, you know, the reorganization will help. And if we need to take other measure including, you know, pricing activities, we're going to go after that as well.

Daniela Costa
Analyst, Goldman Sachs International

Q

Got it. Thank you very much.

A

Thank you, Daniela. We have the next question from Max Yates at Morgan Stanley. Max, please go ahead.

Max Yates
Analyst, Credit Suisse

Q

Thank you. Could I just ask my first question on pricing? I think you've talked about kind of positive trends around price/mix in the quarter. Could you just give us a feel of what pricing did in the quarter? Thank you.

Sophie Arnius
Director-Investor Relations, SKF AB

A

That's a question for Niclas.

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

A

Sure. Sure. We are actually quite pleased with how, you know, price/mix has continued to hold up quite well. There's no drama to it. It's exactly as we talked about before. Of course, you know, year, year and a half ago, it was a different pricing environment. We increased prices a lot. And now, that has faded. And we are shifting more towards, as Rickard mentioned, new product launches, innovation, value-based pricing. But it's still on a positive – in a positive territory. And then actually, the mix component has remained relatively strong where we manage the portfolio again partially through pruning. Other actions more towards higher margin high up products affecting mix positively. So, won't give you an exact number but continues to hold up quite well.

Q

Okay. And just my – my follow up would be on – on the growth guidance. So you're obviously kind of implying that growth goes from sort of minus 7% in Q2 to flattish in Q3. I kind of understand there's a lot of moving parts with easier comps kind of China when dropping out. But could you just give us a feel for kind of conceptually, what are you kind of assuming.

Is it the end markets are broadly unchanged? Do you worry at all that kind of US customers? And are you getting any indications from your US customers in ag equipment, construction equipment that they're ramping that production down? Just give us a feel for kind of what you're assuming on a sort of sequential basis for your business. Thank you.

A

Rickard, do you run a share here?

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

A

I'd be happy to. And in general, I would say that we foresee not that the overall demand, it's going to improve in the second half of the year. It's actually going to stay at this level. So it's kind of flattening it out, I guess is the best way to describe it when it comes to kind of the general total view.

Clearly, as I said in the presentation, there are exceptions. There are some industrial verticals that, you know, maintain and will maintain strong growth in the second half where, you know, aerospace being one prime example. You're right that when it comes to the kind of flattish forecast for organic growth in third quarter relates also to the fact that it's easier comparison versus last year. The net number won't change that much. So, we basically believe that we're going to stay at this demand situation that we have at the moment.

I can't really really comment specifically in every geography and every industry, but you mentioned agriculture. And we don't really see a significant change there. I think they – they are in a low point in their cycle and I think that's going to be retained at least throughout this year.

Max Yates
Analyst, Credit Suisse

Q

That's helpful. Thank you very much.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Thank you, Max. The next question comes from ben Heelan at Bank of America. Ben, please go ahead.

Benjamin Heelan
Analyst, Bank of America

Q

Morning. Thank you for taking the question. The first question I wanted to ask was around aerospace. Obviously, we've seen a couple of production challenges at the OEMs. So, obviously – it's obviously been a tailwind for you in the first half of the year. Just wondering if there have been any changes that you've seen in terms of scheduling around production and potential destocking, etcetera? That was the first question.

And then secondly, on inventory levels, I mean, you've talked in the past about a willingness to get inventories down. Could you talk a little bit about where you are on that journey, how we should think about the pace of that inventory unwind from here? Thank you.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Niclas, I think – let's start with both aerospace and so on.

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

A

Yes. So, on aerospace, I would say continuous, very good momentum, very happy with how that business is evolving and the team is doing a great job. I mean, you are right, I mean, if there's one thing holding us back, it's on the supply side. So, it's not really about demand, it's really our supply side that. But again, that's nothing new for specific for Q2 as such. It's something that we've been working on for some time already. So, I would say no major change, good traction. Team is doing a fantastic job there. Demand is there.

Then on the inventories and specifically on our inventories. We are at the too high level. That's pretty clear. This better to be blunt about it. And we have significant potential to take it down further. We have said that we have a long-term target of net working capital to sales of 25%. Yes, that's far out. It's not this year or maybe not even next year or not next year either, but it is something that we are determined to go towards. And, of course, inventories is the main component there. And we are very aware of this and the teams are working diligently on this. So, we should expect inventories to come down. And what we look at is primarily inventories to sales ratio, which now in Q2 was somewhere around 24%, if I just south of 24%. And 20% -- roughly 20% should be the kind of norm for SKF. So, that 4% point delta is what we are shooting for and addressing.

Benjamin Heelan
Analyst, Bank of America

Q

Okay. Great. Very helpful. Thank you.

A

Thank you. And the next question comes from John Kim at Deutsche Bank. Please go ahead.

John Kim
Analyst, Deutsche Bank AG (Broker UK)

Q

Hi. Good morning, everybody. Wanted to ask two questions, if I may. Could you comment about the sequential development on price mix as we think about Q1 and Q2 this year?

I know that the pricing mix was so positive. I'm trying to get a sense of perhaps magnitude or tailwinds from that aspect of the business model.

Secondly, on the restructuring, was that done fairly early in the quarter or towards the end? How should we think about the employee base as we think about on a go forward cost base? Thank you.

Sophie Arnius
Director-Investor Relations, SKF AB

A

So, Niclas, should you start with the first question and then, Rickard, perhaps...

A

Sure.

Sophie Arnius
Director-Investor Relations, SKF AB

A

...take the next one?

A

Yeah. Happy to.

A

Yeah. The first.

Sophie Arnius
Director-Investor Relations, SKF AB

A

It was a price mix.

A

Okay.

A

Yes. Price mix up. Well, again, won't give a specific number, but you can see it has a, you know, a gradual shift down in price mix over time. It's not a straight line necessarily, but the gradual, you know, shrinking of the price mix component saying that, holding up quite well.

A

Right. And on the restructuring, no. It's not been a one-time event in the second quarter. This has been an ongoing journey for quite some time and it's been further accelerated by the softness in demand that we have experienced since Q3 last year. And if you have followed our head count numbers, you will see that they have actually come down primarily on blue collars.

But we also, a year ago, we had a kind of a cost efficiency program that targeted to reduce staff by thousand and net or a net number of 1,000 employees and we did execute on that one. And since then, that has been some further head count reductions given the softness of demand. So it's a continuous journey, and you should expect us to continue to take down costs to compensate for a lower demand environment just as we're down in the last few quarters.

A

And if I just may add, specifically this IAC that we took in Q2 related to Germany...

A

Yes.

A

...as said, and it was late in the quarter. In that sense, you are right.

Q

Great. Thanks so much.

Sophie Arnius
Director-Investor Relations, SKF AB
A

And let's continue with questions from our telephone line. It's from Andy Wilson at JPMorgan. Andy, please go ahead.

Andrew Wilson
Analyst, JPMorgan Securities Plc
Q

Hi. Good morning. Thanks for taking my questions. I've got two which I'll take separately because they're different. Just on the comment on near-term demand which is helpful in terms of trying to calibrate that. When you talk about demand staying on the current level, I'm assuming we should build in the typical seasonality, Q3 versus Q2, as we think about that. Is that the right way to think about that?

A

Yes. Thank you. Yes. That's the right way to think about it.

Andrew Wilson
Analyst, JPMorgan Securities Plc

Q

And maybe just on that, just conscious of sort of where [indiscernible] 00:38:38 some of the top down data has been as we've kind of gone through – on through the Q2, has it sort of – has that view on a sequentially flat development changed? You know, I think we were sort of maybe more hopeful of a stronger second half earlier in the year. Is that a fair reflection of sort of how you're seeing it just that we have maybe seen some of the peak momentum we might have expected to?

A

Well, yeah, I would echo what you said there. I think when we started this year, we were pretty vocal about it as well. We said that we were – we did expect a rather soft or weak first half of the year in terms of demand, and then we were hoping for a somewhat stronger second half. Now, I think, you know, we have maybe moderated that view a bit Not much but a bit. We haven't really seen the any real signs of an uptick, but rather I believe that the best way to describe it right now is that we is that we think it's maybe have bottomed out, but we are yet waiting for it to start to turn up again.

Q

Thank you. That's very helpful. And then and then secondly it's more specific and it's probably for Niclas. Just on the comment on wages in terms of the 5% to 6% inflation, which I think some you talked to previously. But was I right in understanding that in the bridge kind of Q2 and Q2 there wasn't much of an effect of that? I mean, I assume that's going to be something that we start to see coming through in the coming quarters or if I misunderstood that dynamic.

A

Well, yeah. So exactly as you said, I mean, we have a give or take 5% to 6% underlying salary inflation. And what we have in the bridge as a cost effect from the bucket – bucket of salary – salaries is relatively unchanged.

So essentially, we have year-on-year basis, we have mitigated the impact of 5% to 6% underlying impact. And it's a – it's a number of actions that we've taken. You are well aware of what we did last year with our productivity efficiency program addressing especially kind of the – the white collar side of – of things.

But as you as you have seen Q1 also in Q2, we have continued that work. So, that's – we are quite happy with – with where we are, where or where we are with Q2 and will continue to work also going forward.

Q

Okay. Thanks. That was really helpful. In terms of the year-on-year effect, included within that is the efficiency measures in terms of head count. And therefore, actually, it's more potentially that you can kind of sustain not much of a headwind, at least as we kind of go through the next few quarters?

A

Correct. Correct.

Q

That's very helpful. Thank you very much.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Thank you, Andy. And the next question or questions will come from James Moore at Redburn Atlantic. James, please go ahead.

James Moore
Analyst, Redburn Atlantic

Q

Good morning, everyone. Yeah. Thanks for taking the questions. I wondered if I could get back to the – the 0% guidance for organic sales growth next quarter. It would play around with working days and price. It's not that easy because you're not saying much on price. It does look like volumes working day adjusted need to jump 3%, 4% Q-on-Q to achieve that. And yet, you're talking about stable. Do you think the volumes do need to increase Q-on-Q on a daily basis to achieve 0%? That's the first question. I'll come back for the second. All good.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Yeah. Let's start with the first question here and Niclas, would you shed some light here?

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

A

Yeah, I think, James, I'll reiterate the guidance. So, relatively unchanged. Exactly how the different components will land with volumes and price and mix. Let's see. But relatively unchanged is how we see Q3. So, I'll leave it with that.

James Moore
Analyst, Redburn Atlantic

Q

Okay. Can I try...

Sophie Arnius
Director-Investor Relations, SKF AB

A

The second question. Yeah.

James Moore
Analyst, Redburn Atlantic

Q

Yeah. If I could. Could I try to unpack the minus SEK 244 million organic impact on the bridge, which is of the volume price mix absorption. But when I look at inventories, that SEK 24,557, SEK 24, 552 million inventories, that SEK 24,557 million, SEK 24,552 million, so it barely moved Q-on-Q on a nominal basis, but have they changed on a local currency finished good spaces and was there any absorption impact in the bridge in the quarter?

And maybe you can help me as you don't want to give the exact numbers. I would have thought you might be SEK 0.5 billion of price mix. I just don't understand that minus SEK 244 million number. It does look to me as if you've got a much higher decremental margin on pure volume top line to pure volume bottom line. Is there anything going on behind that to SEK 244 million that you're seeing that would help us from the outside understand it?

A

Niclas, do you want to address this one?

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

A

Well, quite a...

A

But it was many numbers.

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

A

Quite a lot of details there, James, but in terms of absorption, no major impact as such. And maybe we need to go through the bridge and understand it then a bit more in detail separately. But the SEK 244 million is, of course, lower volumes, lower sales, and then a clearly positive price mix like you said.

James Moore
Analyst, Redburn Atlantic

Q

Okay. It's all right. Thank you very much.

A

Thank you, James. And let's go to Erik Golrang at SEB. Erik, please go ahead.

Erik Golrang
Analyst, Skandinaviska Enskilda Banken AB

Q

Thank you. I have two questions. And first one is coming back to your commentary there about potentially lower cost efficiency in the second half. And just so we understand the nature of it, is this simply a matter of one facility ramping while the other is still online so we get double cost at a certain period? And if so, I would assume that you don't really need demand don't really need them on recovering for that to improve at some point.

And then the second question is on CapEx which you now see coming down after a period of record spending I wonder what we can read into this in terms of capital allocation and capital priorities as we move into 2025. Thank you.

A

So, Rickard, do you want to start with the first one, and then Niclas, the second one?

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

A

Yeah. And Erik, as I said, there is no drama in this. Clearly, also in this quarter, in the second quarter and also in the first quarter, we have experienced the same thing, a low demand environment while we have building a strong momentum in our regionalization. And you're right. As we move things, a factory that is receiving a new assortment will take some time to ramp up to get full effectiveness. So, that's kind of the dynamics here.

We have been able to manage that and cope with it in a number of quarters to sustain our margins and we're going to aim for the same also in Q3. We are saying that now we have lived with significant low volumes for quite a few quarters. And at the same time, we are seeing a good trajectory and pace in our regionalization.

And we don't want to stop that. We believe is the absolute right thing to do even though it may put some additional pressure on cost efficiency that we may or may not fully be able to compensate for. We're going to strive for it. We have demonstrated we have done it in the past and we're going to do everything we can in the future. We just want to be transparent and open about it. It's kind of these two things is something that we're going to wrestle with but it's the right thing to do and it's going to build a stronger company as we move forward.

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

A

And Erik, on CapEx. You might – some of you might or might not recall that in the last CMD, we also talked about CapEx long term, and we said that from 2025 roughly onwards, CapEx will start to come down. And actually, we have done that. We are there at that point one year ahead, you can say, now in 2024 when it starts to come down. And why is that? Well, we have done the big regionalization investments, putting the foundation in place in, for instance, China. Rickard mentioned, Mexico also. So, now it's more about ramping up. And that's where the inefficiency comes. They are not fully up and running. So, now it's more about shifting the volume there, ramping up the production.

But the big, big investments are done or we are done with. Then, what the consequences on capital allocation as such because we continue to pay dividend as planned, 50% of net profit. We continue to invest back. And it's not a dramatic decrease in CapEx as you foresee. And then we'll gradually, over time, probably look a bit more at M&A on the acquisition side also.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Thank you.

Erik Golrang
Analyst, Skandinaviska Enskilda Banken AB

Q

Very good. Thank you.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Thank you, Erik. There are many of you that wants to ask questions. So, we only have around 10 minutes left. So, let's limit it to one question now per person. So with that, let's see Tim Lee here from Barclays. Please go ahead.

Tim Lee

Q

Hi. Thanks for taking my questions. I just want to follow-up a little bit more on the margin pressure or large in terms of a cost pressure in the second half. And so, as you just mentioned that that's low major impact from cost in that section in the quarter. And does it mean that in the second half of the year when you see a lower production volume to come into perhaps shopping cost pressure, does it mean that there will be probably some more cost absorption in the coming quarter?

And in terms of the impact from the utilization, is it still something – I mean, the cost is mainly in the items affecting affordability or the low efficiency of the new percent plus you have a like a – an impact on the adjusted EBIT margin in the coming quarter?

Sophie Arnius

Director-Investor Relations, SKF AB

A

Nicolas, do you want to answer that shortly?

Niclas Rosenlew

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

A

Sure. Sure.

Sophie Arnius

Director-Investor Relations, SKF AB

A

Yeah.

Niclas Rosenlew

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

A

So, as we discussed here earlier, we do have a seasonality where we essentially produce a bit more in first half and then we produce a bit less in the second half. So like you mentioned, production volumes typically in Q3 as well as in Q4 are lower in second half. And therefore, we also have this margin seasonality. So the cost coverage is a bit lower in second half compared to first half, and that's quite natural and we foresee that to be the case also this year. No drama. No big differences to kind of long term SKF average is there.

When it comes to this shift, which we actually quite proud of how well we are running that now, so regionalization comes with many different words. But as just mentioned, we are ramping up some production facilities, for instance, in China and in Mexico, while we at the same time then ramp down, focus a bit more some other existing facilities like we did now announce when it comes to Germany in Q2. And that means that there's, I'm going to say, a slight inefficiency for the moment as we are ramping up and down. Things are not, you know, fully loaded, perfect. And that has a margin impact, slight margin impact. We shouldn't overdramatize it. It was a case in Q2. It will be a case – the case in Q3 and Q4 as well.

Tim Lee

Q

Yeah.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Thank you, Tim. Let's move on to the next question from Andre Kukhnin at UBS. Andre, please go ahead.

Andre Kukhnin

Q

I just wanted to take a step back and ask about the automotive margin target of 8% for 2025. Could you walk us through kind of the key building blocks for that from the current run rate? Is it a more significant rationalization of footprint there? Is there something that's already been done that maybe not yielding the result? Because we're seeing quite a gap there, obviously.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Can you elaborate on this one?

A

Yeah. Yes, that's clear. It was – you asked about the automotive operating margin, right?

Sophie Arnius
Director-Investor Relations, SKF AB

A

Yes.

A

80%.

Andre Kukhnin

Q

Yes, indeed.

A

All right. Thank you. Just to clarify. Now, the journey there continues. To simplify the strategic transformation that is ongoing with our automotive business is really to focus on three particular segments. First, it's really about making sure that we continue to develop our strong footprint and foothold in the EV personal vehicle market, where we are the clear market leader. And we have some unique offerings that enables both for the powertrain and super low friction that extends range.

Clearly, something that OEMs values and we sell – we have a very, very good, you know, progress there. We are keen in that regard to walk away from some of the ICE business, especially for smaller personal vehicles, and that's ongoing. So, the shift in personal week is one part of the equation. The second is where you have a strong position in heavy commercial vehicles.

We intend to further leverage that and continue to build on that. And third, we – we want to further enhance our vehicle aftermarket position where I think we are a number two globally in the vehicle aftermarket and we do see significant growth opportunities there.

These three together is the kind of the cornerstone and foundation of the transformation towards the 8% operating margin. And it's not a straight line and I understand your question, even though I think that, you know, the – the 5.4% operating margin, given the these massive shift in volume over the last quarters, is a pretty strong performance. But we are confident that we are targeting and progressing towards the 8% target by – by 2025. So, those are the key kind of building blocks to get there.

A

Thank you, Rickard. Let's move on to the next. Sorry, Andre, if there are any follow ups, let's take that offline. We would need to move to the next person in line here to ask a question. And that's Andreas Koski from BNP Paribas. Andreas, please go ahead.

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)

Q

Thank you and good morning. Firstly, can you just clarify and confirm that you said that you do not expect any big deviations from the long-term margin seasonality between H1 and H2 despite those cost inefficiencies. And my question really was about the demand situation. You expect demand to remain generally unchanged in Q3 compared to Q2, but you could – could you say the daily sales rate during the second quarter compared to the first quarter and month by month, did you see any sequential weakness or strength in Europe, Asia or North America during the second quarter? Thank you.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Niklas, do you want to take those questions here?

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

A

So, on the kind of – if we start with the second one. I would refer back to what Rickard said here earlier instead of going through kind of day by day what happened in Q2. Things have stabilized and remained relatively stable. As you know, I mean, we have big differences between different industries. Aerospace doing fantastically, been doing less well. We also have big differences between the geographies. As you saw, India doing quite well and China driven by wind, less so.

So, yes, there are differences, of course. But by and large, we see that things have – sales have stabilized, and now I talk sequentially on these sort of levels. And Andreas, sorry. Remind me of the first one, the seasonality. Thank you.

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)

Q

Just it's been quite a lot of questions about the cost headwinds from...

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

A

Yeah. I fully understand.

about the cost headwinds from cost efficiency?

A

Yeah. Yeah. Yeah. That's fully understand. I mean, yeah, normal seasonality, whatever you however you want to see that but – but normal seasonality. And on the cost pressure, let's not make it more dramatic than it is. As Rickard said just want to be open in terms of what's happening and it's actually quite interesting. We have excellent momentum actually shifting to volumes now. And, of course, long term, slightly longer term, that should come with a very positive good leverage. Short term, yes, it means that we are not fully loaded and therefore not as efficient as we will be in the future. And that has some impact on our margins.

A

Correct. And if I may just add and draw attention to what I said during my presentation, we have seen in EMEA a situation where organic growth have the kind of worsened a little bit compared to Q1 this year. And we saw the opposite in Americas. So, I think that's also the information that we can share.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Thank you. And our final question will come from Klas Bergelind from Citi. Please go ahead. Klas, please go ahead.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

Thank you, Sophie. I'm sorry I was late on the call. So, maybe you've touched on this. But Niclas, I just want to ask a couple of questions on the bridge. Price looks to be higher than I thought, and I'm trying to understand how much of that was mix versus fuel pricing and why? And if you could tell us if the price mix not given the number, but if it was higher year-over-year in the second quarter versus year-over-year in the – in the first quarter.

And then on the logistics costs, given the higher freight rates because of the Red Sea dispute. Looks to be a headwind now. Understand that the impact there was shorter lead time versus raw mat. Do you think you can see most of the increase here already or do you foresee any more increase sort of year-over-year into the third quarter? Thank you very much.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Niclas.

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

A

On price mix, both price and mix are positive. And what comes to kind of the sequential movement of year-on-year price mix, gradually it will shift down. What varies is, of course, mix by quarter and but it's a gradual shift but overall holding up reasonably well. And again, just to give you an idea, similar levels Q1, Q2 but again, maybe we foresee that gradually going down.

And then on the logistics and Red Sea, yes, there was a minimal effect in Q2, a bit bigger in Q2, sorry – in Q1, a bit bigger in Q2. No drama, but a bit bigger. And depending on where, you know, what happens in the world and where the cost levels stay, we expect logistics to be, you know, year-on-year higher.

Sophie Arnius
Director-Investor Relations, SKF AB

A

Thank you. And that ends the Q&A session. And before we end this call, Rickard, do you want to sum up this quarter?

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

Yes, thank you. And to reiterate what I've said, we are creating a more competitive company. Once again, we demonstrate an ability to hold our margins despite a rather softer demand environment. We continue to deliver on our strategic framework, and we are doing the tactical things related to price, related to mix cost and portfolio management and at the same time, investing in our future in terms of strong supply chains and investing in innovation clearly position us well for profitable growth once demand turns.

So, I think that's the key message that I want to leave you with. I'm going to wish you a wonderful summer and I also want to thank you for your participation today. I know we're not the only company releasing numbers in this country today, so I appreciate that you took the time to be with us this morning. Thank you.