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Indian Bearing Sector

Nonlinear motion in the medium term

The Indian Bearing Industry (Size-\$2bn/Rs170bn) clocked a 10-year CAGR of 9.3%. An aggregate revenue CAGR for the top three bearing players in the listed space has been 12% during the same period. As per the experts, the industry is likely to reach \$3.4bn by 2027. However, the next 12 to 18 months would be a mixed bag for the three leading companies (collective revenue market share 67%) on account of rising stress in the exports and likely cyclical slowdown in many user industries in domestic market. The same can be vouched from their last three quarterly results and management commentaries of Timken India and Schaeffler India. This will impact 45% or more of the higher margin revenue segments of the companies. Taking cognizance of this fact, we estimate, single digit revenue growth (last 2-year collective CAGR >35%) and a YoY decline in PAT (last 2-year collective CAGR >40%) for these companies in the current and the next fiscal year due to compression in margin and higher growth rate in depreciation than revenue, led by huge capex undertaken. Both these companies are export focused and also draw substantial revenue from industrial segment. However, revenue and PAT for SKF India to grow at an average higher single digit during same period. We initiate coverage on the sector with ADD on SKF India (TP: Rs5,764) while SELL on Timken India (TP:Rs2,222) and Schaeffler India (TP: Rs1,681).

Exports to remain a challenge for Timken India and Schaeffler India till the next 18 months

We estimate 15% YoY decline in higher margin exports for Timken India (25-30% revenue share,) and 5% for Schaeffler India (15-17% revenue share) for the current fiscal and flat for the next year on account of inventory correction drive in US and Europe. US accounts for 60% of Timken India's exports while Germany occupies 40% share in Schaeffler India's exports. Notably, in the US, Class 8 truck production and monthly net orders remained volatile with downward bias; also, the German economy is in the contraction phase since December 2022 quarter. We have seen the same is getting transmitted in the YoY exports growth rates for the last few sequential quarters for all three companies. The rates have come off and now entered in the negative territory. This will have highest impact on Timken India followed by Schaeffler India and lastly on SKF India. Exports contribution in the total revenue remained in single digit for SKF India. It uses exports only as an option to optimise plant utilisation.

Growth rates to moderate in pockets of domestic market in industrial & automotive space

The moderation in utilisation levels across wind energy, commodity industries are putting pressure on industrial revenue of bearing companies. A YoY quarterly aggregate revenue growth for industrial segment has come off from 47% in June 2022 to 5.7% in June 2023 quarter. Monthly IIP growth rate during the same period has also come off from 12.6% to 3.7%. We estimate an average 6% growth rate for aggregate industrial revenue till FY26. In the automotive space, after reporting a 12% YoY production volume growth in FY23, April-Aug 2023 period witnessed a substantial decline to mere 1.1%. Tractor and MHCV reported a YoY decline of 8.7% and 2.12% respectively. Moreover, MHCV segment is likely to face cyclical slowdown till FY26. Various rating agencies have moderated their outlook on volumes for MHCV, Tractors, 2W except PV. We noted these developments and have reduced average growth rates for automotive segment to 7% till FY26.

Higher depreciation growth than revenue and margin contraction to put pressure on PAT

We estimate 3-year average CAGR for depreciation at 16% as against revenue CAGR 9.2% and average EBITDA margin compression of 100bps over the next 3-years for all three companies. This will result in meagre 4.7% average CAGR for PAT; the maximum damage would be caused in FY24E and FY25E only.

Valuations appear rich as they continue to discount super normal growth of last two fiscals

The bearing sector witnessed a very high growth rate in the past three fiscals. Average CAGR for revenue and PAT has been 17% and 24%, respectively. However, the current valuations are not factoring in the likely subdued performance in the next two fiscals led by stress in exports and in few pockets of domestic industrial space. We estimate average revenue and PAT CAGR at 9.2% and 4.7% for the next three fiscals, respectively. Export contraction and stress in the industrial space might lead to a decline in PAT for Timken India and Schaeffler India except SKF India. We have valued Schaeffler India and Timken India on a 3-year average multiple while SKF India has been valued at premium to 3-year average valuation. We initiate coverage on the sector with ADD on SKF India (TP: Rs5,764) while SELL on Timken India (TP: Rs2,222) and Schaeffler India (TP: Rs1,681).

Thematic

India | Indian Bearing Sector

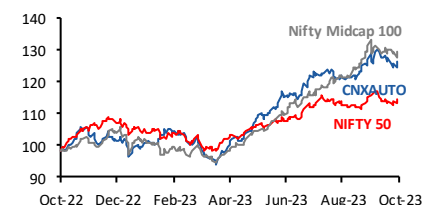
16 October 2023

NIFTY 50: 19,811

BSE Sensex: 66,473

Institutional Research

Nifty 50 vs Nifty Midcap 100 vs Nifty Auto



Source: Bloomberg

Company	Rating	CMP* (Rs)	Target price (Rs)
SKF India	Add	5,241	5,764
Timken India	Sell	3,060	2,222
Schaeffler India	Sell	3,131	1,681

Source: Centrum Broking, *as on 11 October 2023



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Exhibit 1: Comparative Financials and Valuation

Company	Rating	CMP (Rs)	TP (Rs)	EPS (Rs)			P/E(x)			Revenue (Rs mn)			EBIDTA (Rs mn)			PAT (Rs mn)		
				FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
SKF India	Add	5,241	5,764	115	126	136	45	42	38	47,630	51,933	57,648	7,995	8,648	9,447	5,701	6,222	6,731
Timken India	Sell	3,060	2,222	49	48	58	62	64	53	30,293	33,049	39,051	5,740	6,205	7,385	3,692	3,617	4,343
Schaeffler India	Sell	3,131	1,681	55	54	59	57	58	54	70,516	74,056	81,824	12,952	13,363	14,780	8,552	8,375	9,146

Company	CFO (Rs mn)			Capex (Rs mn)			RoE (%)			RoCE (%)			EBIDTA Margin (%)			CAGR FY23-FY26E (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	Revenue	EBIDTA	PAT
SKF India	1,154	3,102	3,199	1,105	839	789	22	21	20	22	21	20	17	17	16	10	8	9
Timken India	3,900	4,277	4,074	4,251	2,501	801	17	14	15	17	14	15	19	19	19	12	10	4
Schaeffler India	9,916	10,048	10,422	(4,217)	(5,210)	(4,351)	19	17	17	17	16	17	18	18	18	6	5	1

Source: Company Data, Centrum Broking

Executive Summary

No object in the world moves in linear or nonlinear circular motion without external force and bearing. In that sense, bearings have become the most essential component of any machinery in the world. There are handful of companies globally, which possess necessary technological competence to manufacture bearings of global quality. Hence, it's a club of selected ones. At present, as per our calculations, top three companies in the listed space in India (Schaeffler India, SKF India, Timken India) together occupy around 67% of the revenue market share (48% in FY16 excluding LUK and INA) of the Rs170bn Indian Bearing market.

Bearing is an industrial consumable which ensures continuous flow of business. However, this industry also faces downturn in the business. Consumable nature of the product keeps these companies afloat during downturn and helps flourish during an upswing.

We estimate that the Indian bearing industry might have to undergo downturn for the next 12 to 18 months owing to stress in the exports and some pockets in the industrial space. It will impact their financial performance in the current fiscal and in CY24E/FY25E as well.

The companies like Timken India and Schaeffler India would witness higher impact as growth and margin outlook of 45-50% of their higher margin revenue (exports + industrial - OEM and aftermarkets) would be under cloud. Hence, revenue growth is estimated to go down to single digits and PAT is likely to report marginal decline. Notably, SKF India has much lesser exposure to exports and has good amount of business on hand in industrial segment. This would allow the company to perform relatively better amongst peers by reporting double digit.

Exhibit 2: Next 4-year estimates of financial performance

Particulars	CAGR FY23 / CY22 to FY27E / CY26E (%)								
	Rev growth	EBIDTA growth	PAT Growth	Exports Growth	Avg EBIDTA Margin	Avg PAT Margin	Avg Export revenue share	Avg RoE	Avg RoCE
Timken India	13	12	7	5	19.2	11.9	21.6	16.3	16.1
Schaeffler India	7	7	4	10	18.3	11.8	15.8	18.2	18.0
SKF India	11	10	11	3	16.6	12.0	7.0	21.6	21.6

Source: Company Data, Centrum Broking

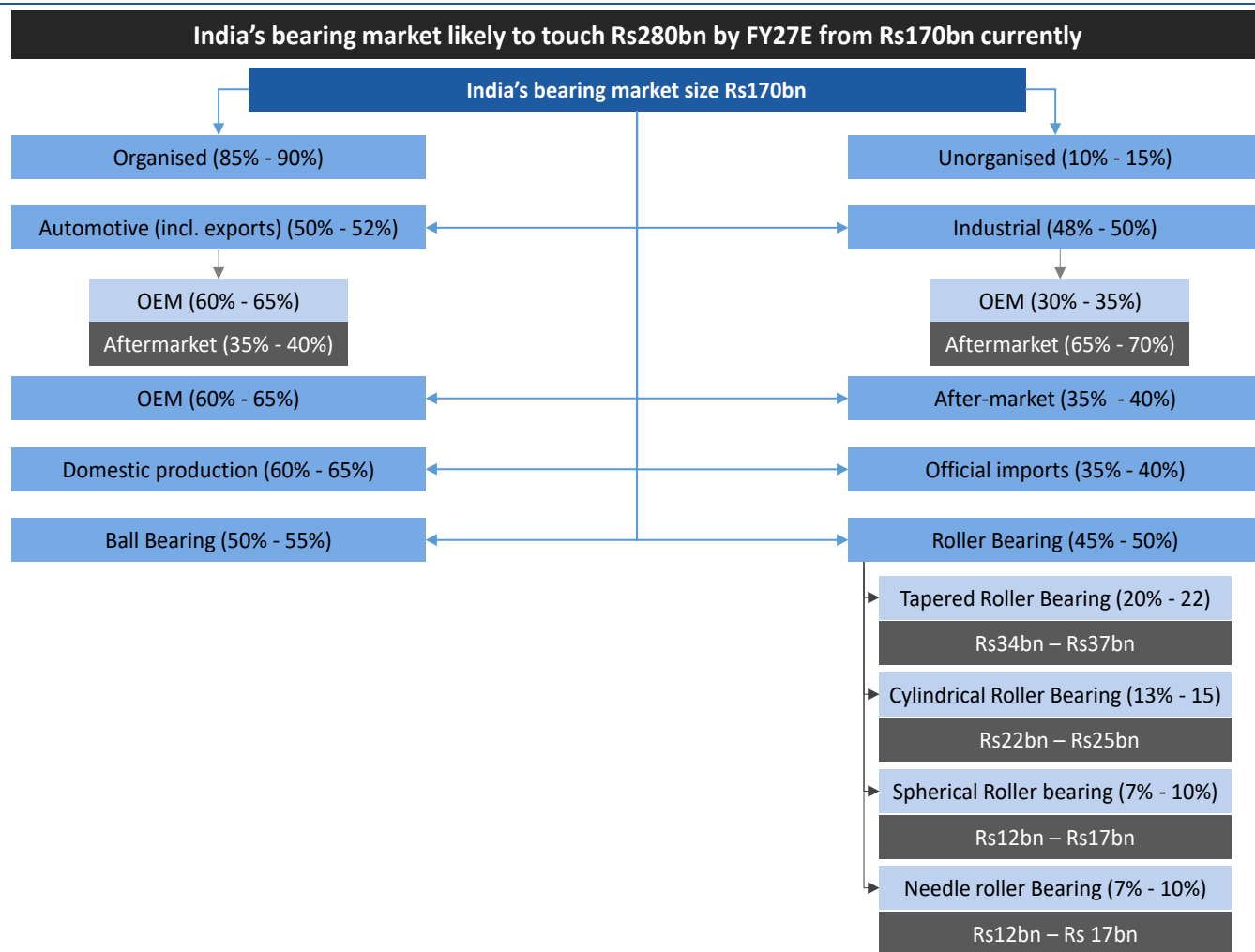
SKF India: We expect SKF India to do better on account of domestic focus, higher localization, very less presence in exports, better revenue mix & growth, margin performance and return ratios vs. peers in the next two fiscals. We estimate FY23-26E revenue CAGR of 10% and PAT CAGR of 9%; hence, the company deserves premium to the current 3-yr avg. one year forward PE of 32.9x. We assign current FY25E earnings multiple of 44x to 1H FY26E EPS of Rs131 to arrive at a Target Price of Rs5,764 and recommend **ADD**.

Timken India: A 45-50% of the revenue might have to face challenges till FY25 in terms of growth rate and margin. However, with commercialization of Rs6bn capex (2.5x Asset turn) and estimated revival, revenue and PAT for FY26E are expected to report a YoY growth of 18% and 20%, respectively. Hence, despite the medium-term turbulence, Timken India can regain its mojo from FY26E. Taking cognizance of the same, we have valued the company based on its last 3-year average earning multiple to reflect the trust in its capabilities. We recommend **SELL** with TP of Rs2,222 (42x 1H FY26E EPS of Rs53).

Schaeffler India: After posting CY20-22 revenue and PAT CAGR of 35% and 74% respectively, exports (16% revenue share) and industrial segment revenue (32% revenue share) have started reporting YoY decline since past few quarters. Recognizing the trend, management has guided for the subdued outlook for the coming quarters. However, improved localization led by commercialization of capex by CY25E will make the company more competitive in exports and in the domestic industrial space. Hence, we have valued the company based on its last 3-year average PE to reflect the trust in its long term capabilities. We recommend **SELL** with TP of Rs1,681 (30x 1H CY25E EPS of Rs56)

Bearing Industry size reached \$2bn in 2022

Exhibit 3: The Indian organised bearing industry break-up



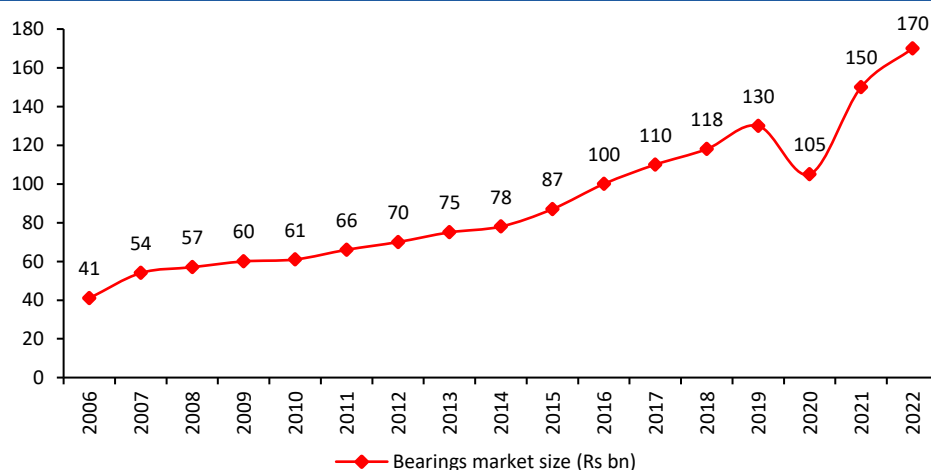
Source: Industry, Centrum broking

Exhibit 4: The Indian organised bearing industry clocked a 10-year CAGR of 9.3%

Particulars	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Bearings market size (Rs bn)	41	54	57	60	61	66	70	75	78	87	100	110	118	130	105	150	170
YoY growth (%)		31.7	5.6	5.3	1.7	8.2	6.1	7.1	4.0	11.5	14.9	10.0	7.3	10.2	-19.2	42.9	13.3

Source: Industry, Centrum Broking

Exhibit 5: Bearings market size



Source: Industry, Centrum Broking

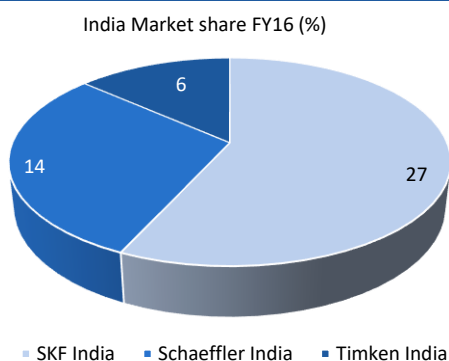
Comparing Market Share of Companies

Exhibit 6: Company-wide revenue market share

Company	India Market share FY16 (%)	Company	India Market share FY23 (%)
SKF India	27	SKF India	22
Schaeffler India	14*	Schaeffler India	33
Timken India	6	Timken India	11
Total	48		67
India Market size (Rs bn)	100	India Market size (Rs bn)	170

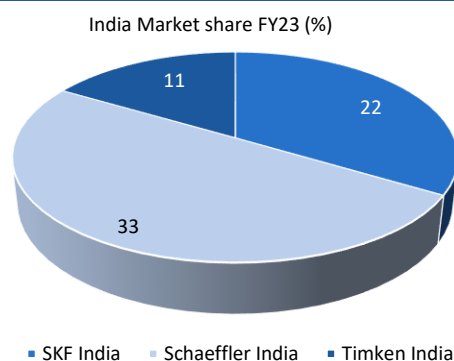
Source: Industry, Centrum broking Note: FY16 market share was of FAG prior to amalgamation with INA and LUK
Product revenue less exports is used to calculate market share

Exhibit 7: Player wise revenue market share – FY16



Source: Industry, Centrum broking

Exhibit 8: Player wise revenue market share – FY23



Source: Industry, Centrum broking

Exhibit 9: Market leadership landscape in individual bearing type

Particulars	Overall market share (%)	Specialized/Leadership	Market share in product (%) specialized	Nearest Competitor
SKF India	22	Deep groove ball bearing	22	Schaeffler India
Schaeffler India	33	Spherical and Cylindrical roller bearing	47	NEI, SKF India, Timken
NEI	15	Spherical and Cylindrical roller bearing	20	Schaeffler India, Timken
Timken India	11	Tapered roller bearing	40	NEI, Schaeffler India
NRB Bearings	5	Needle roller bearing	60	Schaeffler India

Source: Industry, Centrum broking

Exhibit 10: Bearing types, applications, players and market size

Bearing type	Applications	Players	Largest player with market share	Market size (Rs bn)
Deep groove ball bearing	Used in automobile for wheel and axle applications	SKF India, Schaeffler India, NEI	SKF India - 22%	85-93
Spherical roller bearing	Automobile suspension, drive shaft heavy machinery, gear boxes, railways	SKF India, Schaeffler India, NEI	Schaeffler India - 47%	12.17
Cylindrical roller bearing	Machine tools, transmission, wheel set for railways, pumps, compressors	NRB Bearings, SKF India, Schaeffler India, NEI	Schaeffler India - 47%	22-25
Needle roller bearing	Niche application in engine, gearbox, steering assembly, power transmission	NRB Bearings, Schaeffler India, SKF India	NRB Bearings - 60%	12.17
Tapered roller bearing	Front wheel, differential & pinion configuration machine tools, spindles, construction, metal	Timken India, SKF India, Schaeffler India, NEI	Timken India - 40%	34-37
Thrust roller bearing	Classifiers, extruders, pulp refineries machine tools	SKF India, Schaeffler India, Timken India	-	NA

Source: Company Data, Industry, Centrum Broking

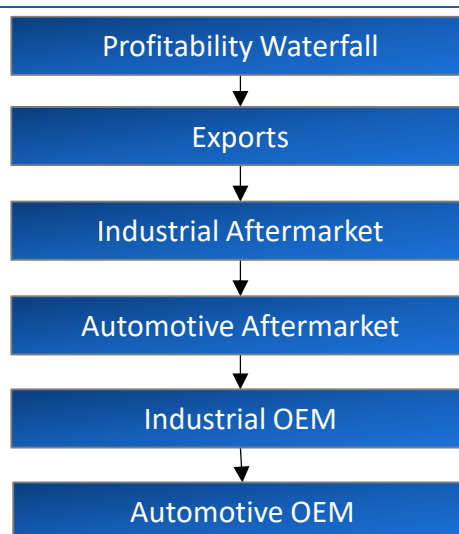
Comparing on Business Parameters

Exhibit 11: Comparing company domestic revenue growth rates with the industry

Product Revenue less Exports (Rs mn)	FY16	FY23	CAGR (%)
SKF India	27,038	37,929	5.0%
Schaeffler India	14,105	56,417	21.9%
Timken India	6,426	18,704	16.5%
NRB Bearings	5,482	8,131	5.8%
Menon Bearings	949	1,623	8.0%
National Eng Ind	23,229	24,918	1.0%
Market size	1,00,000	1,70,000	7.9%

Source: Industry, Company Data

Exhibit 12: Margin waterfall



Source: Company Data, Industry, Centrum Broking

Exhibit 13: Revenue Break-up

Revenue break up	SKF India	Timken India	Schaeffler India
Industrial	49%-50%	45%-50% **	50%-52%
Automotive	50%-51% *	50%-55%	48%-50%
OEM	55%	85	80%-85%
Aftermarket	45%	15	12%-15%
Exports	8%	25%-35%	15%-18%
Domestic	92%	65%-75%	82%-85%
*= Includes exports			
**= Includes railway			
NA=Not applicable			

Source: Company Data, Industry, Centrum Broking

Exhibit 14: Comparison on business aspects

Particulars	SKF India	Timken India	Schaeffler India
1 2W/3W/PV	Present	Not present	Present
2 Own manufacturing	Auto/Industrial (Very less)	Auto/Industrial	Auto/Industrial
3 Railway bearings	Traded	Own manufacturing of TRB at present SRBs and CRB currently imported	Own manufacturing TRB, SRB and CRB
4 Capex for next 2 years primarily to diversify products and improve localisation	Rs1-1.5bn per annum; also doing capex by funding unlisted group company's expansion plans in Industrial segment. Recently extended a line of credit of Rs2.5bn for 7 years	Rs6bn for setting up SRB and CRB plant at Bharuch It will commence operations from January 2025 Asset turn is 2.5x of capex	Announced Rs10bn capex between CY20-23 Further announced Rs5bn capex for CY24 which includes relocation of plant to India. Recently acquired digital platform Koovers for Rs1.5bn in all cash deal
5 Focus area	After markets and Industrial segment	Exports and Railways	Aftermarkets, Wind and Auto PV
6 Contribution of bearings and related revenue in the total revenue	100%	91%	60%
7 Share of Automotive in the revenue	Around 50%	Around 40%	Around 48%
8 Exports as % of revenue	8	30	15
9 Import/ Export	SKF is net importer and transactions are dominated in Euro	Timken is net exporter and transactions are dominated in USD	Schaffler is net importer and transactions are dominated in USD
10 Export composition	Mostly automotive	Automotive and Industrial	90% of exports is industrial
11 Export destinations	Europe 60% South East Asia 30%	US occupies 60% share, Europe 30%	Europe 50% (Germany 40%), South East Asia 35-40%, US 10-12%
12 Share of aftermarkets in the revenue	30 to 35%	15%	9%
13 Average share of Traded goods in the revenue (%)	39%	25%	27%
14 Major applications in the Auto segment	Wheel based	Differential and Transmission	Wheel, Differential and Transmission
15 Share of Railways in revenue	7- 8%	17-19%	6-7%
16 Indigenization / Localization level	Lowest amongst peers on overall basis	Higher than SKF and lower than Schaeffler	Higher than SKF but on overall basis
Industrial	35%	60%	65%
Automotive	95%	80%	85%
17 On line platform	Presence better than Timken	Not much focus	Just entered the space with an acquisition of KRSV
18 Condition Monitoring Programme	REP (Rotating Equipment Performance)	MILTEC	OPTIME
19 Remote Diagnostic Centre	RDC	NA	Quick Centre
20 Royalty / Trademark (Average of last 5 years)	Yes. Its 2.5% of total revenue	Yes. 2.25% of total revenue	Yes Its 2% of total revenue
21 Unlisted entity of parent in India	Yes	Yes	No
22 Contribution of unlisted entity to traded revenue	15-20% of the traded revenue comes from unlisted entity in India. It is mostly in industrial segment	Very minimal as unlisted entity makes products suited to US markets and mainly in exports	NA
23 Market share in Railways			
A) Passenger coaches, metros and locomotives	High double digit of 30-35%	Higher single digit to lower double digit	High double digit of above 20%
B) Freight	Mid-single digit	Around 45-50%	Minimal
24 Variable expenses share estimated in the total cost	Lowest amongst peers	Lower than Schaeffler but higher than SKF	Highest amongst peers

25 FY24, FY25, FY26 estimated Financial Performance

SKF India is estimated to perform better than peers led by large presence in and focus on domestic OEM and aftermarkets. India will still remain the fastest growing economy in the world with an estimated GDP to be more than 6% and estimated inflation to remain under RBI's tolerance zone. With most diversified revenue stream (no industry contributes more than 10%) spread across over 40 industries, margins will be more resilient than Timken India due to higher presence in aftermarkets and entry in freight application and improved localization (worst for dominant user segment of 2W has been over). There will be likely increase in Railway market share, expansion in after markets through increasing network

Timken's performance is likely to slow down as exports are showing definite signs of stress. The company has reported YoY decline in the last two sequential quarters, and the management expressed caution in the recent interaction. However, we believe it to be a medium-term headwind. Localization capex at Bharuch along with localization of supply chains will provide new cost effective SRBs and CRBs which might lead to arrest in the margin fall. However, this capex might put stress on financial position if sales get slowed down resulting in margin dilution. Main user segment MHCV in the 4 years from 75% of the current year. Furthermore, the company is likely to face cyclical downturn in FY24E focussing on aftermarkets through digital presence. It has recently, acquired online auto components distribution platform Koovers.

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Source: Company Data, Industry, Centrum Broking

Exhibit 15: Comparing companies on financial parameters

CY19/FY20-CY22/FY23 (3-year)	Revenue CAGR	PAT CAGR	Average EBITDA margin	Average PAT margin	Average ROE	Average ROCE	Cash Conversion Cycle days	Average Fixed asset turn (x)
Timken India	20.0%	17.0%	20.0%	13.0%	17.4%	16.9%	112	1.7
Schaeffler India	16.0%	37.0%	17.0%	11.0%	15.7%	15.4%	68	2.6
SKF India	15.0%	22.0%	16.1%	11.0%	20.2%	20.3%	70	4.6
CY22/FY23-CY25E/FY26E (3-year)	Revenue CAGR	PAT CAGR	Average EBITDA margin	Average PAT margin	Average ROE	Average ROCE	Cash Conversion Cycle days	Average Fixed asset turn (x)
Timken India	11.6%	4.0%	19.0%	12.0%	16.6%	16.3%	121	1.9
Schaeffler India	6.0%	1.0%	18.0%	11.9%	18.5%	18.3%	64	2.6
SKF India	10.0%	9.0%	16.8%	12.0%	22.1%	22.1%	74	5.0
Total Revenue growth	CY20/FY21	CY21/FY22	CY22/FY23	CY23E/FY24E	CY24E/FY25E	CY25E/FY26E		
Timken India	12.8%	56.2%	27.4%	7.9%	9.1%	18.2%		
Schaeffler India	-13.6%	47.4%	23.5%	2.7%	5.0%	10.5%		
SKF India	6.0%	37.3%	17.5%	10.6%	9.0%	11.0%		
EBITDA margin	CY20/FY21	CY21/FY22	CY22/FY23	CY23E/FY24E	CY24E/FY25E	CY25E/FY26E		
Timken India	17.9%	23.2%	20.0%	19.0%	18.8%	18.9%		
Schaeffler India	14.3%	17.5%	18.8%	18.4%	18.0%	18.1%		
SKF India	15.7%	15.2%	17.4%	16.8%	16.7%	16.4%		
Gross margin	CY20/FY21	CY21/FY22	CY22/FY23	CY23E/FY24E	CY24E/FY25E	CY25E/FY26E		
Timken India	44.3%	45.8%	40.9%	40.3%	40.3%	40.1%		
Schaeffler India	38.0%	37.7%	38.1%	38.2%	38.0%	37.8%		
SKF India	41.5%	38.8%	40.4%	39.1%	39.1%	39.0%		
PAT margin	CY20/FY21	CY21/FY22	CY22/FY23	CY23E/FY24E	CY24E/FY25E	CY25E/FY26E		
Timken India	10.2%	14.8%	13.9%	12.2%	10.9%	11.1%		
Schaeffler India	7.7%	11.3%	12.8%	12.1%	11.3%	11.2%		
SKF India	11.1%	10.8%	12.2%	12.0%	12.0%	11.7%		
PAT growth	CY20/FY21	CY21/FY22	CY22/FY23	CY23E/FY24E	CY24E/FY25E	CY25E/FY26E		
Timken India	-41.8%	128.5%	19.5%	-5.5%	-2.0%	20.1%		
Schaeffler India	-20.9%	116.2%	39.8%	-2.7%	-2.1%	9.2%		
SKF India	3.0%	32.7%	32.8%	8.6%	9.1%	8.2%		

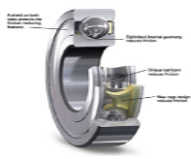
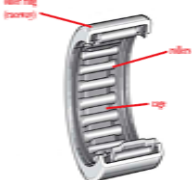
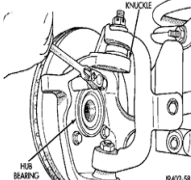
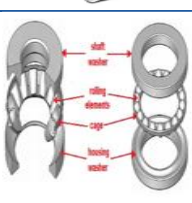
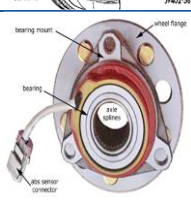
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CY19/FY20-CY22/FY23 (3-year)	Revenue CAGR	PAT CAGR	Average EBITDA	Average PAT	Average ROE	Average ROCE
RoE	CY20/FY21	CY21/FY22	CY22/FY23	CY23E/FY24E	CY24E/FY25E	CY25E/FY26E
Timken India	9.8%	21.8%	21.2%	16.7%	14.1%	14.7%
Schaeffler India	9.5%	18.5%	21.8%	18.9%	16.7%	16.6%
SKF India	17.2%	22.9%	24.8%	22.1%	21.2%	20.1%
RoCE	CY20/FY21	CY21/FY22	CY22/FY23	CY23E/FY24E	CY24E/FY25E	CY25E/FY26E
Timken India	9.7%	21.4%	20.1%	16.5%	14.0%	14.6%
Schaeffler India	9.6%	18.0%	21.5%	18.5%	16.6%	16.4%
SKF India	17.3%	23.0%	24.9%	22.2%	21.2%	20.1%
Cash conversion cycle (days)	CY20/FY21	CY21/FY22	CY22/FY23	CY23E/FY24E	CY24E/FY25E	CY25E/FY26E
Timken India	111	116	123	121	121	118
Schaeffler India	77	54	61	66	65	64
SKF India	62	68	75	69	75	77
FA turn (x)	CY20/FY21	CY21/FY22	CY22/FY23	CY23E/FY24E	CY24E/FY25E	CY25E/FY26E
Timken India	1.2	1.7	2.1	1.9	1.6	1.9
Schaeffler India	2.2	2.8	3.1	2.6	2.3	2.3
SKF India	4.1	4.8	5.1	4.9	4.9	5.0
Traded stock as % of revenue	CY20/FY21	CY21/FY22	CY22/FY23	CY23E/FY24E	CY24E/FY25E	CY25E/FY26E
Timken India	28.5	26.6	26.5	26.8	26.9	24.0
Schaeffler India	23.7	25.5	22.4	22.2	22.1	22.1
SKF India	35.8	41.4	36.1	37.5	37.5	37.5
Royalty/trademark Fee YoY growth (%)	CY20/FY21	CY21/FY22	CY22/FY23	CY23E/FY24E	CY24E/FY25E	CY25E/FY26E
Timken India	3.1	64.4	28.3	8.1	9.1	18.2
Schaeffler India	(8.6)	43.1	21.7	8.0	2.7	10.2
SKF India	(2.1)	32.3	15.3	13.4	9.0	10.9
Royalty/trademark Fee as % of revenue	CY20/FY21	CY21/FY22	CY22/FY23	CY23E/FY24E	CY24E/FY25E	CY25E/FY26E
Timken India	2.1	2.2	2.2	2.3	2.3	2.3
Schaeffler India	2.0	1.9	1.9	2.0	1.9	1.9
SKF India	2.6	2.5	2.5	2.6	2.6	2.6
Exports as % of revenue	CY20/FY21	CY21/FY22	CY22/FY23	CY23E/FY24E	CY24E/FY25E	CY25E/FY26E
Timken India	24.4	29.5	27.0	21.3	19.5	20.2
Schaeffler India	10.5	12.3	15.4	15.4	14.7	15.7
SKF India	7.2	11.1	8.0	7.6	6.8	6.5

Source: Company Data, Centrum Broking

Bearing: It is highly technical product

Exhibit 16: Type of bearings

Deep groove ball		Cylindrical roller		First generation bearing	
Tapered roller		Needle roller		Second generation bearing	
Spherical roller		Thrust bearing		Third generation bearing	

Source: Industry Data, Centrum Broking

Rolling element in the bearing decides the type of bearing

Roller bearings are of four major types TRB, SRB, CRB and NRB

Roller bearings have larger area of contact as compared to ball bearings, and hence, more load bearing capacity

Load bearing capacity and less frictions are important attributes of bearings

Basics of bearings – Rolling element differentiates the product

Bearings are ‘essential items’ required to reduce or eliminate the friction between moving parts. The bearings are classified into two types i.e., bimetal bearings and friction bearings. Bimetal bearings are made up of two metals i.e., steel and either aluminium alloy or lead based alloy or copper coating. There is a groove through which oil is passed under high pressure and that oil creates a paste or an oil film which does not allow the surface of the shaft which is rotating to get in touch with the inner surface of the bimetallic round strip called bearing. Full-round strip is called bush and half-round strip is called bimetal bearing. Bimetal bearings find application in crankshaft. Friction bearings can be classified based on the rolling element used in bearings into basic bearing family categories like deep groove ball bearings, tapered roller bearings, cylindrical roller bearings, spherical roller bearings, needle roller bearings, etc., and other special bearings for special applications.

Ball bearings are the most widely used bearings, constituting a significant segment of the market followed by tapered roller bearings. Roller bearings (tapered/cylindrical/spherical) have only linear movement.

Tapered roller bearing has a larger area of contact, and hence, has a higher load-bearing capacity. Tapered roller bearings are designed to handle both thrust and radial loads on rotating shafts, and are used to reduce friction where shafts, gears or wheels are in operation. Typical end-use industries include construction, metals and mining, paper mills, commercial trucks and power generation units.

Important attribute of a good quality bearing is that it can withstand combustion heat, torque, RPM and load of all types.

Bearings – Important attributes, parts of bearing and lifespan

Important attributes of bearings are high rigidity, light weight, low space requirement, capacity to handle extreme load, longer nominal rating life, less friction, lower bearing temperature, ability to operate at high speed, and low vibration and noise. There are four important factors in the manufacture of bearings i.e., quality raw material, proper heat treatment, final finishing or grinding and adhering to the set quality parameters. Broadly there are four parts of bearings i.e., inner ring, outer ring, rolling element and retainer. Retainer is used to keep rolling elements at equal distance. These parts are manufactured separately with accuracy and then assembled after detailed inspection. Lack of proper lubrication can reduce the life of a bearing by up to 50% and around 30% of premature failures in mechanical equipment are caused by poor or inadequate lubrication. Theoretical

Bearing is a very high precision product with tolerance running into microns

life of a bearing is infinite, but temperature is one of the important factors which determine the life of the bearings.

Bearings are a high precision product with measurements running into microns

Bearings are designed to have smaller dimensions, while supporting higher speed and load, and thus, constantly reduce parasitic losses. Bearing is a very high-precision product. The cost of the bearing depends on how accurately it gets manufactured. Therefore, in the entire costing of bearing, 30-50% is associated with accuracy or quality. The important parameter of bearing manufacturing is the boundary dimension. There are a few standardised bearings (e.g. bearing code 6,210) having same dimensions globally. The manufacturer has to control the tolerance within the limit of few microns (1 micron is 1000th part of 1 millimetre). The other parameter is internal accuracy. It simply means maintaining the roundness of the bearing within tolerance of a few microns while it is rotating. Surface finish plays a vital role in reducing the friction where the rolling element comes in contact of inner race and outer race. The machinery required for quality check or improving the smoothness of the surface has improved, which in turn increased the quality of the bearing. Thus, the quality of abrasives improved tremendously which increased the smoothness of surface finish.

Bearings are now equipped with sensors to capture important data on frictions, vibrations, rotation, temperature, etc.

Bearing is now emerging as an important component to capture data as it is equipped with sensors

New bearings are getting developed with criteria of weight optimisation, integrated solutions and with remote monitoring and diagnostics. The sensorised bearing unit – which integrates sensor, impulse ring and bearing – is a compact solution to record movement data for machine control. Data include temperature, vibrations, number of revolutions, speed, direction of rotation and relative position, as well as acceleration or deceleration. These sensors also can send a vibration signal to an on board processor to build a history of component condition and warn of an impending bearing or wheel problem or a derailment condition. The data acquisition unit handles the analysis and communication with the client's control system. The sensor signals from the bearing units will be used for the anti-skid brake system, the automatic train control and for the security system of the doors.

Bearings are undergoing changes in terms of materials used. Getting lighter in weight and ready to align with more heat and load

Changing bearing character in automotive segment

Bearings are undergoing technology shift in terms of raw materials used to manufacture them by becoming lighter in weight and ready to align with more heat and load. Bearings are getting upgraded with more components and accessories to allow vital data related to temperature, load, torque, speed, vibrations to be captured. Further, Gen3 bearing has been adopted at fastest pace than its previous 2 avatars. Lubrication is the most important aspect for the longevity of bearing life and its flawless functioning. It has undergone change now with HUB 3 bearings not requiring lubrication for lifetime or until few lakh kilometres of running. Bearings play an important role in OEMs' promise for certain kilometre of warranty.

Steel alloy forms 45-50% of the cost of bearings

Bearing manufacturing requires special steel alloy for specific applications

Chromium steel is widely utilised in the production of precision mechanical bearings due to its exceptional hardness, wear resistance, stiffness, fatigue life, and other properties in comparison to traditional bearings. Moreover, bearing manufacturers are using advanced materials such as tungsten carbide and ceramic to cater to the specific requirements of industries that operate in severe environments.

Steel and alloy steel form the basic materials for the manufacture of bearings and account for almost 45% of total costs. However, for local manufacturers it is in the range of 55-60%. This difference is on account of the global reach of multinational companies. The metal used for manufacturing bearing is of SAE52100 standard (Society of Automotive Engineering) or of EN31 series. This is steel with 1% carbon and 1.4% chromium used for grinding media. The other equivalent standards for steel for bearing manufacturing are BS 970:1991, German DIN100CR6, etc. However, SAE52100 is more precise than EN31. These grades are manufactured in India and are imported as well.

Alternatively, ceramics and plastics are used to make bearings

Various other types of raw materials are being experimented for specific applications

According to industry experts, the most important thing which is going to influence the bearing industry in future will be material science. There are a few industries like food & beverages, Electric Vehicle and abrasives where non-metal bearings – ceramic or plastic bearings are used. In the food and beverages industry, plastic bearings are used to tackle the corrosion problem. Moreover, food grade grease and seals are also used. Ceramic bearings are used in an abrasive environment, but in no way non-metal bearings will replace metal bearings.

Heating between 600-1,200 degrees Celsius and grinding are important process to reduce roughness

Proper heat treatment and grinding helps to reduce RA value

Broadly, the manufacture of a bearing has three main parts – heat treatment, machining/grinding and then assembling. There are at least four parts of any bearing i.e., inner case, outer case, rolling element and retainer. The heat treatment releases stress in the metal part. The structure also gets compacted or allows the metal part to get its desired shape. It helps to manufacture bearing within tolerance limit. The temperature required is between 650 degrees Celsius to 1,200 degrees Celsius. After the heat treatment it goes through a grinding process followed by polishing. Both these processes happen using abrasives. This process helps improve RA (roughness average) value; RA gives a good general description of height variations on the surface. The objective of improving RA value from the level of 0.06 micro-inches to 0.04 micro-inches is to reduce the friction to practically zero.

Improvement and advancement in bearing simply means reduction in friction

Advanced generation bearing simply means reduction in friction

Advance generation bearings mean manufacturers are trying to reduce the friction further by improving surface smoothness. Improvement in heat treatment methods improves the metal's stress carrying capacity which in turn increases the life of the bearing.

Difference between Gen1, Gen2 and Gen3 bearings

The bearings are also getting more sophisticated. The conventional solution featuring two individual bearings was replaced with a compact double row angular contact bearing with integrated seals. That was the evolution of first generation wheel bearings. Other wheel components such as knuckles and hub were then integrated with bearings, leading to development of second generation bearings. Currently, third generation bearings are in use. These bearings have integrated flanges, built-in ABS sensors with integration of magnetic encoder making the bearing capable of sensing the speed of the front wheel, effective sealing can facilitate optimised mounting which eliminates adverse influence because of manual errors. It offers a significant reduction in weight along with providing high-quality signal generation and transmission, and thus, contributes to reduction in fuel usage and emission.

Bearing industry – What's happening?

Near- to medium-term outlook is dim

Exports are declining since past few quarters

We are witnessing demand slackening in exports market (Revenue share – Timken India 25-30%, Schaeffler India 15-17% and SKF India 7-9%) owing to inventory correction across Europe and USA (combined share in exports 50-60%). This can be witnessed from the numbers released for the last three sequential quarters wherein leading bearing manufacturers with focus on exports, Timken India and Schaeffler India, have reported YoY decline. This decline came on the back of more than 6 sequential quarters of stupendous YoY growth in exports. Moreover, the management commentary in this regard has also been cautious for medium term.

On the domestic front there is weakness in some segments of automotive and industrial space.

YoY growth in industrial space has been tapering off

Schaeffler India has reported YoY decline in industrial space (32% revenue share) for last two sequential quarters. The management also commented about stress in industrial space and thereby weak financial performance in 2HCY23. We have taken note of these facts and our understanding also suggests that there might be demand slowdown from bearing perspective from large consuming sectors like wind energy, commodities, raw material, etc. Hence, we believe it is more to do with individual company's business model and client segment as well besides winning and losing tender based business. SKF India is present strongly in 2W and 3W and in the Drives sector in industrial space which is expected to do well. Thereby, SKF India has been guiding for near double digit growth in the current fiscal.

Exhibit 17: YoY exports growth rate (%)

Particulars	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23
Timken India					250	86	66	75	64	33	(32)	(24)	(35)
Schaeffler India				48	148	57	60	61	62	61	55	10	(4)
SKF India	(66)	(40)	(37)	1	159	96	117	115	52	(11)	(29)	(40)	9

Source: Company Data, Centrum Broking

Exhibit 18: YoY industrial growth rate (%)

Particulars	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23
Timken India		250	85	113	83	87	53	19	57	16
Schaeffler India	31	132	26	19	22	34	(0.1)	0.5	(9)	(2)
SKF India		103	20	15	37	41	33	33	8	13

Source: Company Data, Centrum Broking

Exhibit 19: YoY auto & Industrial distribution growth rate (%)

Particulars	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23
Timken India	192	22	33	40	33	18	26	(4)	3

Source: Company Data, Centrum Broking

Focus on localization, aftermarkets and services like condition monitoring have gained more prominence

What has changed in the industry?

The business approach has undergone few changes in the past few years. The new trends observed emphasize on localization not only of manufacturing of product but of supply chain as well. This has become prominent in the post pandemic world. Focus is on aftermarkets and use of digital channel to increase penetration. Third major area of interest for these companies now a days is opportunity from condition monitoring services through remote diagnostic services. Furthermore, these companies started extending uptime guarantee and certain performance targets, thereby creating huge profit potential for themselves by participating in the profits of the client. Another change observed is need to add more components and products apart from bearing to capture maximum value and to improve content per vehicle in automotive segment.

Companies are on localization drive; incurring large capex

Companies are not deviating from capex plans, acquisitions and plant relocation

Most of the efforts on the localization front are concentrated towards industrial bearings. Timken India has undertaken capex of Rs6bn (FY23 Gross block – Rs13bn) till Dec 2024 to start manufacturing Spherical and Cylindrical Roller Bearings from Bharuch plant to offer entire product range of own manufactured roller bearings. Schaeffler India has already announced capex of Rs10 bn (CY22 Gross Block – Rs21 bn) in 2021 till Dec 2023, further capex announcement of Rs5bn made for CY24. This includes relocation of plant to India to

take advantage of low cost manufacturing and exports in mind. SKF India is incurring Rs1bn-1.5bn capex (FY23 Gross block- Rs8.3bn) each year for the next 3-years. However, the company also incurs indirect capex by funding to its unlisted group company. They have recently approved and part funded the expansion plan in the mid and large size industrial bearing. The company has extended Rs2.5bn credit line with 7-year term. Out of that Rs1.2bn has already been disbursed.

Exhibit 20: Annual Capex plan

Capex (Rs mn)	FY19/CY18	FY20/CY19	FY21/CY20	FY22/CY21	FY23/CY22	FY24E/CY23E	FY25E/CY24E	FY26E/CY25E	FY27E/CY26E
Timken India	6,243	194	1,426	1,243	644	2,785	4,001	801	901
Schaeffler India	1,348	3,224	3,044	2,496	2,158	4,710	5,210	4,233	4,615
SKF India	213	913	440	971	759	1,239	839	789	539

Source: Company Data, Centrum Broking

Localization will would cut short the time to go to the market and improve cost structure

Advantages of localization are very obvious

All three multinational bearing companies have reduced their dependence on imported raw materials and have indigenised to a larger extent. These companies have developed local suppliers of quality steel which is the main raw material. This has also aided in margin expansion. The margin expansion over last 5 years has been due to localization, technology in supply chain, managing yield on steel (how many bearings can be produced from 1 tonne of steel), sales mix and reducing low profit business. Optimisation of logistic cost by establishing warehousing, plant locations near market (Timken India Raipur for gear box overhauling and Jamshedpur plant/SKF India set up of India Distribution Centre) is another advantage. One more trend observed is that they are diversifying channels, products, doing M&A, doing brownfield and greenfield expansions to de-risk business model tied to one particular market or region or segment and product. It helps in import substitution, reducing the lead time, to generate better returns on the business and not so much due to increase in size of opportunity.

Transfer pricing use Net Margin Method by using reference margin of comparable industries

Transfer pricing rules govern the margin for revenue from traded goods

Transfer pricing mechanism or regulations are used to determine the margins earned by trading entity. SKF India has 50% of the revenue coming from traded goods. Most of the other leading companies have 25-35% of the revenue from traded goods. These rules are open to interpretation, and thereby, stoke litigations. It is very difficult to predict margins on this portion of the revenue. Transfer pricing margins are dynamic in nature and always depend on reference margins of comparable industries. The bearing companies have to do this exercise every year. Margins depend on overall economic condition in a particular country, sector, industry, etc. Prevalent margins are applied to the traded goods transaction. Margins under transfer pricing rules are determined in proportion to the risk assumed in the transaction. Major portion of the margin is retained by manufacturing company and rest by trading company. As per FY23 guidelines, the gross margin was in the range of 15-20% while net margin was in the range of 6-8%. This method is also called the Net Margin method. The margins over and above determined by transfer pricing rules would be retained by manufacturing company. The process keeps happening throughout the year and companies keep close watch on the rates in each transaction to see if they are deviating from the reference rate. The transaction for the year gets closed at the end of the year and won't get carried over to the next financial year. Although trading margins determined by transfer pricing rules are lower than manufacturing margins, it offers the protection from making any losses as it would be borne by manufacturer. Moreover, working capital won't get blocked for too long and it helps in improving ROCE (return on capital employed). Hence, traded goods is margin depletive but ROCE accretive. However, cost efficiency is a challenge for traded products, there is not much of an opportunity that the company can do to bring down cost. This is because the Net Margin method takes into account the cost for manufacturing company and selling price of trading company. And trading company has no control over manufacturing company's cost.

The principle followed in the transfer pricing mechanism is margins will be in proportion to the risks assumed

Transfer pricing margins are dynamic in nature and always depend on reference margins of comparable industries. The bearing companies have to do this exercise every year. Margins depend on overall economic condition in a particular country, sector, industry, etc. Prevalent margins are applied to the traded goods transaction.

Indian bearing industry will continue to be dominated by leading global players

With the organised market size at Rs85-90bn as per latest estimates, India's bearing industry is skewed towards leading global players like SKF, Timken, Schaeffler and players of Indian origin like NRB Bearings and NEI (National Engineering Industry). The global players are present in India either through listed entities and or wholly-owned subsidiaries or joint ventures. The top five players (SKF India, Schaeffler India, NEI, Timken India, and NRB Bearings) enjoy around 86% market share. The organised sector primarily caters to OEMs

Market leadership

SKF India – Ball bearing

Schaeffler India – SRB and CRB

Timken India – TRB

which are predominantly in automotive, railways and other industrial sectors. The unorganised sector primarily caters to replacement market and continues to serve the very low-end market as well as it forms the core of counterfeit products. Technology edge on account of parentage, innovation and capacity to invest allow each of these large players to identify their respective niche area and concentrate on it to take lead in that product category.

Exhibit 21: Each player has core competency in terms of technology and leadership in a particular bearing type

Particulars	Overall market	Specialised/Leadership	Market share in product (%) specialised	Nearest competitor
SKF India	22	Deep groove ball bearing	22	Schaeffler India
Schaeffler India	33	Spherical and Cylindrical ball bearing	47	SKF India, Timken India
NEI	15	Spherical and Cylindrical ball bearing	20	Timken India
Timken India	11	Tapered roller bearing	40	NEI, Schaeffler India
NRB Bearings	5	Needle roller bearing	60	Schaeffler India

Source: Industry Data, Centrum Broking

We observed each company is entering into new products through local manufacturing. Also, they have started selling products and services other than bearings

Business boundaries are blurring; entry into adjacencies

All three companies known for their respective flagship products (Timken – TRB, SKF – Ball bearing, Schaeffler – SRB, CRB). Major part of their capacities have been dedicated for the same. However, in the recent past all of them have taken initiative to manufacture bearings other than their flagship product as part of diversification and expanding market share with an eye on the exports. Moreover, they have entered into adjacencies and started selling lubricants, couplers, shock absorbers, etc., to offer larger product bouquet for their distribution channel partners and sourcing potential for bearings sales.

Focus is on improving aftermarket reach through digital means and through brick and mortar way

Focus on aftermarkets through brick and mortar way and use of digital platform

Aftermarket is 30-35% of the total bearing market. Higher penetration in the aftermarkets either through brick and mortar channel or through online platforms, improves business prospects.

Exhibit 22: Distribution network

No of distributors	FY16	FY17	FY18	FY19	FY20	FY21/CY20	FY22/CY21	FY23/CY22
SKF India	125	125	200	300	440	455	680	700
Schaeffler India						330	330	330

No of dealers	FY21/CY20	FY22/CY21	FY23/CY22
Schaeffler India	33,000	33,000	33,000

Source: Company Data, Centrum Broking

SKF India has doubled its distributor counts in the past four years. The company is now present in more than 500 districts of the country out of total 700 odd district.

In addition to existing network of dealers and distributors, Schaeffler recently acquired KRSV Innovative Solutions Private Limited – it has B2B e-commerce platform – Koovers. Koovers supplies to over 7,000 workshops and has a portfolio of around 1.8 million parts from various manufacturers. Koovers recorded revenue of Rs777mn and started making gross profit. Schaeffler acquired 100% stake in the company for all cash consideration of Rs1,424mn (~2x FY23 revenue). This shows the determination of bearing companies to penetrate in the aftermarkets.

The general margin range for distribution channel in aftermarket segment is 20-35%. The manufacturers are giving discounts and offering schemes to distributors and retailers. Retailers are further passing on a part of the discount to end-users. In case of critical applications, automobile or machinery manufacturers do not compromise on quality of bearings and go for high quality names, but in peripheral activities they go for low-priced bearings.

Bearing is not buyer's market as price is not the only criteria

Bearing is not price driven component for most of the applications rather criticality of application is important

We do not think bearing is a buyer's market. If that was the case it would be a simple price gain and a race to the bottom. Then the cheapest bearing would have had the highest market share but that is not the case. The bearings from all three leading players are by no means the cheapest in the market, but they have the highest market share and it keeps on expanding. Hence, it is not at all a buyer's market. The cost of a bearing is very small in the larger scheme of things for a factory manager. It is a very small part of the machinery or an automotive vehicle, and hence, customers would not really go and risk the performance of

their vehicle or their machinery by buying the cheapest bearing. And the reason being the cost of failure would be higher. The loss of production, revenue and profits is more vs. the premium paid to leading brands at the beginning. The leading players are gaining share on technology, performance and availability. That has become an increasing point of differentiation today as compared to two years ago. With the recent supply chain disruptions during the COVID world and the current Ukraine war, etc., availability and reliability of supplies is a big differentiator for the companies who want to gain share.

The bearings are also getting more sophisticated

Technological advancement in bearings make it more sophisticated

The conventional solution featuring two individual bearings has been replaced with a compact double row angular contact bearing with integrated seals. That was the evolution of first generation wheel bearings. Other wheel components such as knuckles and hub were then integrated with bearings, leading to development of second generation bearings. Now third generation bearings are in use. These bearings have integrated flanges, built-in ABS sensors with integration of magnetic encoder in front wheel bearing, effective sealing and facilitate optimised mounting that eliminate adverse influences due to manual errors. It offers significant reduction in weight along with providing high-quality signal generation and transmission, and thereby, contributes to reduction in fuel usage and emission.

Services segment which includes condition monitoring is gaining greater importance each year

Services segment is getting used by companies to improve customer engagement and looking for participation in gains of client if deliver on promised performance threshold

Services segment is giving bearing manufacturers an opportunity to remain engaged with clients. Large clients of industrial bearings have realised the importance of reducing life cycle cost through regular maintenance. This has opened up a new revenue source for the domestic bearing manufacturers. Bearing companies have started selling various allied services like refurbishment, MRO, lubrication, etc., across various user industries. The market size for all these allied services has been estimated at 10x, the size of organised bearing market. SKF India has taken the lead in this segment by launching different services. They provide condition monitoring through remote centre using algorithms and machine learning 24/7. They call it Rotating Equipment Performance (REP). Timken India has set up gearbox refurbishment facility at Raipur and also has remote condition monitoring programme MILTEC. Schaeffler India has started focusing on reducing life cycle cost by providing solutions for preventive maintenance and condition monitoring through their programme OPTIME.

Exhibit 23: Services segment contribution in the revenue is on rising trend

Share of services revenue (%)	CY20/FY21	CY21/FY22	CY22/FY23	CY23E/FY24E	CY24E/FY25E	CY25E/FY26E	CY26E/FY27E
SKF India	1.5	1.8	2.2	2.6	2.7	3.1	3.5
Timken India	5.1	5.0	5.7	5.9	6.2	6.3	6.5
Schaeffler India	0.2	0.2	0.7	0.7	0.7	0.7	0.7

Source: Company Data, Centrum Broking

Exhibit 24: Services is the fastest growing revenue stream

YoY revenue growth of services (%)	CY20/FY21	CY21/FY22	CY22/FY23	CY23E/FY24E	CY24E/FY25E	CY25E/FY26E	CY26E/FY27E
SKF India	38	61	45	30	15	25	25
Timken India	8.2	54.7	43.7	12.0	15.0	20.0	20.0
Schaeffler India	18.1	43.8	264.7	8.0	5.0	10.0	15.0

Source: Company Data, Centrum Broking

Exhibit 25: Various services and products offered by companies other than bearings

Particulars	SKF India	Timken India	Schaeffler India
Other services offered	Solutions encompassing, seals, mechatronics lubrication system, MILLTEC services for 24/7 Replacement of part with technical support, life cycle management of steel and service solutions, management, repairs, aluminium mills, industrial lubrication solutions, refurbishment & maintenance gearboxes and bearings wipers, batteries, shock services, condition monitoring, refurbishment, providing absorbers, bearings repairs engineering consultancy, remote lubrication solutions like and refurbishment, diagnostic centre, Rotating seals, grease, lubricants Remote condition monitoring OPTIME contracts		

Source: Company Data, Centrum Broking

Industrial bearing manufacturing requires more technical skills and is capital intensive. Indigenization of industrial bearings is gathering momentum

Industrial bearings manufacturing is the focus area but requires different skills

Industrial bearings are different in many aspects as compared to automotive bearings. Industrial bearings have a low volume, customised nature, higher investment requirement, long homologation period, different manufacturing process, supply chain, etc. These are almost independent operations. Automotive bearings, on the other hand, are standardised, high volume, having a shorter homologation period and driven by OEM segment.

Homologation period is different for different sectors or industries. For example, in wind energy sector it is 18 months and in case of railways it is 36 months. Therefore, it depends on: (a) Application of the bearing, (b) Industry standards, (c) Consequential cost of failure of a product using that type of industrial bearing, and (d) Capacity of the bearing to operate reliably under extreme operating conditions. Therefore, it's different stroke for different sectors.

The scope for customisation of bearings is higher in industrial bearings than automotive bearings and as a result margins tend to be higher in industrial bearings rather than automotive bearings on a global level.

In aftermarket segment also, industrial bearings fetch a higher margin as against commodity automotive bearings on account of customised nature of industrial bearings and low volume. Also, the level of expertise required for identifying a quality industrial bearing is higher than what is required for an automotive bearing. Hence, many a times the motive for recommending automotive segment bearing from aftermarket segment may be the profit and not the quality.

Clients are becoming more demanding

Clients want more productivity, lower energy consumption, vibration, weight, noise and emission. Customers are asking for more competitiveness and responsiveness from bearing industry, which requires these companies to regionalise production bases closer to customers. With the renewed focus on quality, reliability and aftermarket segment, the bearing companies gained market share over the past decade.

Clients, mainly OEMs, have started asking for design and application engineering knowledge and assistance. In many applications, bearing can be a limiting factor in increasing the power density of equipment and also one of the first components to get damaged. Hence, working with customers to help them make optimum design choices is becoming an important customer expectation now. Further, with product liability and safety issues getting more stringent, customers are more demanding.

Product liability becomes a key aspect

Bearing manufacturers are also subject to the risk of liability arising out of product failure. However, in general, it has been observed that the product failure is not necessarily because of sub-standard quality of bearing. It may be on account of design fault or bearing material fault or wrong type of bearing used for the application. Suppose an OEM is using the new braking system, then there may be: (a) Fault in the design of braking, or (b) Use of sub-standard material in manufacturing the braking system, or (c) Locking happening which is not anticipated, or (d) Sudden rise or reduction in temperature, etc. These factors adversely impact braking system performance, resulting in vehicle recall. It is not necessarily on account of bearing failure. For example, if there is not much radial or thrust load and the OEM has used tapered roller bearing for that application, then that system may get failed. This doesn't mean that the quality of bearing is inferior. It is the application of the bearing that went wrong. The wrong type of bearing was selected for that application which is not suitable. Hence, most of the times it is design or raw material issue and not the quality of spare part issue. Many Europe and US-based OEMs use parameters which may not be suitable for Indian conditions, especially in case of rubber parts like bushes, etc.

Royalty payment for use of technology developed by parents

All leading multinational bearing manufacturers get access to technology of the parent and have to pay royalty for it. The royalty rates keep on changing. The royalty payment for most of the listed multinational bearing companies is in Indian rupees and based on revenue which is also in Indian rupees. Hence, there is no element of forex risk involved.

Renewed focus on quality and reliability by clients prompted them to ask for bearing companies participation right from designing and application engineering stage

Many a times wrong bearing used by client for a particular application leads to failure

Royalty and trademark fees to be paid to the parent for use of technology

Exhibit 26: Royalty and trademark fee as a % of revenue

	FY18/CY17	FY19/CY18	FY20/CY19	FY21/CY20	FY22/CY21	FY23/CY22
SKF India	2.9	2.7	2.5	2.6	2.5	2.5
Timken India	2.0	1.8	1.8	2.1	2.2	2.2
Schaeffler India	1.9	1.9	1.9	2.0	1.9	1.9

Source: Company Data, Centrum Broking

Exhibit 27: Royalty and trademark fee YoY growth %

	FY18/CY17	FY19/CY18	FY20/CY19	FY21/CY20	FY22/CY21	FY23/CY22
SKF India	15.0	2.3	(10.9)	(2.0)	32.3	15.3
Timken India	17.8	19.7	(3.6)	3.1	64.4	28.3
Schaeffler India	147.9	18.2	(5.9)	(8.6)	43.1	21.7

Source: Company Data, Centrum Broking

Exhibit 28: Technology partners of Indian bearing players

Indian company	Technology partner	Product
SKF India	SKF AB, Sweden	Ball/roller bearings
Timken India	Timken Co, USA	Roller bearings
Schaeffler India	Schaeffler Technologies AG, Germany	Ball/roller bearings
NRB Bearings	NADELLA, France	Needle roller bearing
NEI	NTN, Japan	Ball/roller bearings
Bimetal Bearings	Clevite Inc, USA and Repco, Australia	Engine bearings

Source: Company Data, Centrum Broking

Bearing industry is largely skewed towards global players in OEM space and for industrial bearings

OEM market has higher entry barrier for local players

Bearings have long homologation period and required extremely advanced technology with probative capex. Breaking into OEM space requires a lot of patience. Lack of technology edge and innovation are the main reasons. Smaller companies are not going through all the requirements of quality checks and do not invest enough in the equipment to manufacture a precise product. However, multinational companies do. The bearing company has to do equal amount of investment in quality management process and equipment.

Local manufacturers do not get pricing at par with leading multinational players despite the former offering more or less at par quality arguably. The perception of clients about local bearing manufacturers is that the cost or prices quoted by the Indian manufacturers - despite producing a bearing of comparable quality - should be at least 40% lower than the price of bearing of a multinational player. As a result, local manufacturers do not get an attractive price from clients.

Difference in quality of local and multinational players explains the price difference

The price difference between a bearing made by multinational company and local player is to the tune of 2.5x-3.5x

Local manufacturers mainly serve the aftermarket segment and have almost no presence in OEM segment. The largest aftermarket segment is automotive. Low price is the first point of attraction for a customer to buy such products manufactured by local manufacturers. The difference in prices of products of a local manufacturer and a multinational company is in the range of 2.5x-3.5x (suppose a local manufacturer's selling price of a bearing is Rs100, then a multinational company's price may be Rs250-400). However, it is argued that the quality difference between the two is not more than 2x. Customers who are not very quality conscious go for such bearings or Chinese bearings. Customers expect a huge price discount from local manufacturers compared to prices charged by multinational companies.

The main reasons for price difference are: (a) Quality perception about products manufactured by local manufacturers with no technology tie-up, and (b) Expectation of a substantial price discount as the user or buyer is fully aware of the cost structure of indigenous producers.

Local manufacturers have no presence in automotive OEM space and a very small presence in industrial OEM segment. Lack of technology edge and innovation are the main reasons. However, in automotive replacement market local manufacturers have been able to garner market share on account of the focus on small-sized and low-end mass consuming products, price-sensitive nature of aftermarket segment, large potential to sell counterfeit products and extending warranty/guarantee on the lines of multinational players.

Local manufacturers are fighting quality perception

Local manufacturers are restricting to small bearings in automotive segment and to the aftermarket

For the first three years, every manufacturer's product in industrial bearings segment looks the same. After three years it starts making noise and there is a high rate of failure. Hence, there is a growing trend in aftermarket segment towards reducing total cost of ownership (TCO). Customers are also looking for very short lead times which require a large number of stock-keeping units (SKUs). It needs huge investment which is out of reach for a majority of 300 odd local manufacturers of bearings. Moreover, local manufacturers are fighting with quality perception and customers are not ready to pay a deserving price. Therefore, local manufacturers are restricting themselves to small and medium-sized bearings.

OEMs have realized importance of quality vs. cost

Quality of bearing becomes the prime factor; ahead of cost

The level of robotics and automation in bearing manufacturing has increased, which resulted in reduced quality inconsistency and thereby lowered the rejection rate. OEMs have realised the importance of quality bearing supplies. Hence, they may squeeze bearing companies for a year or two, but then they won't get a reliable supplier. Going forward, two things will influence bearings – (a) Material science, and (b) Advent of new automobile technology (driverless car or car running on battery).

Nonmetal bearings like ceramic and plastic bearings have industry specific applications

Metal bearings will not be replaced by non-metal bearings

According to industry experts, the most important thing which is going to influence the bearing industry in future will be material science. There are a few industries like food & beverages and abrasives where non-metal bearings - ceramic or plastic bearings are used. In the food and beverage industry, plastic bearings are used to tackle the corrosion problem. Moreover, food grade grease and seals are also used. Ceramic bearings are used in an abrasive environment, but in no way non-metal bearings will replace metal bearings.

Homologation period for bearings in the industrial space are longer than automotive

Long homologation period provides entry barriers for a new entrant

Homologation of bearings is for both automotive and industrial bearings. Industrial bearings are not easy to homologate and take a longer time compared to automotive bearings. Homologation period could be between 12-36 months. Automotive bearings take around 6-12 months to homologate while wind energy sector takes 18 months and railways take 36 months. This is on account of long duration staged approval process wherein customers like to conduct various rigorous tests on the product for certain duration and on a certain number of batches before giving approval to start commercial production.

Exhibit 29: Homologation periods ranging from 6 to 36 months

Segment	Homologation period
Railways	36 months
Wind Energy	18 months
Automotive	6-12 months

Source: Industry, Centrum broking

Though all bearings look alike initially, low quality bearings fail faster

It is only after 36 months that one can differentiate between qualities of bearings

The life of a bearing deviates in OEM fitment and in aftermarket fitment mainly because of fitment conditions at OEMs and in the aftermarket segment. The bearing manufactured through proper manufacturing process has surely more potential to withstand extreme conditions than the bearing which has not been manufactured through a high-quality process. For the first three years, every manufacturer's bearing (industrial bearing) looks the same, but after three years only it starts making noise and there is high rate of failure, etc. The quality of machinery and quality of manpower are other criterions. Multinational companies, in addition to their own manufacturing facility, get many parts of bearings manufactured by vendors.

Macroeconomic indicators and bearing industry growth

Bearing sector correlation with GDP and IIP

Exhibit 30: Correlation between GDP growth rate and bearing industry growth rate has weakened further. Average GDP multiplier for bearing industry has gone down while for leading three bearing companies it has gone up.

Particulars	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023
A) GDP YoY growth (%)	3.84	4.82	3.8	7.86	7.92	7.92	8.06	7.66	3.09	7.86	8.5	5.24	5.46	6.39	7.41	8	8.26	6.8	6.45	3.87	(5.83)	9.05	7.24
B) Bearings YoY growth (%)							31.7	5.6	5.3	1.7	8.2	6.1	7.1	4.0	11.5	14.9	10.0	7.3	10.2	(19.2)	42.9	13.3	13.3
C) Large 3 players aggregate revenue growth rates (%)													(4.2)	(2.4)	10.3	17.7	(4.8)	47.9	19.5	(7.2)	(9.7)	39.4	21.1
Correlation (A:B)	(0.52)																						
Correlation (A:C)	(0.01)																						
For the bearing industry																							
Multiplier (x)						0.00	3.93	0.73	1.70	0.21	0.96	1.16	1.31	0.63	1.56	1.87	1.21	1.07	1.58	(4.97)	(7.35)	1.47	1.84
Average multiplier (x)	0.52																						
For the large 3 bearing cos																							
Multiplier (x)					0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	(0.8)	(0.4)	1.4	2.2	(0.6)	7.0	3.0	(1.9)	1.7	4.3	2.9
Average multiplier (x)	1.98																						

Exhibit 31: Correlation between GDP and Industry growth and revenue growth of companies 2004-2014

Particulars	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
A) GDP YoY growth at Factor cost (%)	3.84	4.82	3.8	7.86	7.92	7.92	8.06	7.66	3.09	7.86	8.5	5.24	5.46	6.39
B) Bearings YoY growth (%)						31.7	5.6	5.3	1.7	8.2	6.1	7.1	4.0	11.5
C) Large 3 players aggregate revenue growth rates (%)					24.3	42.0	12.5	5.4	0.4	33.2	24.5	(4.0)	(4.2)	(2.4)
Correlation (A:B)	0.37													
Correlation (A:C)	0.69													
For the bearing industry														
Multiplier (x)						3.34	0.58	0.57	0.25	0.98	0.72	1.04	0.89	2.45
Average multiplier (x)	1.29													

Note: *= Aggregate net revenue of SKF India, Timken India, Schaeffler India Source: Company data, CSO, Centrum Broking

Exhibit 32: Correlation between IIP and industrial segment revenue growth of companies

Particulars	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23
YoY Quarterly Industrial rev growth %	11.1	2.6	(7.4)	(9.2)	(17.8)	(61.4)	0.8	16.6	35.6	163.7	36.2	21.2	24.3	46.8	17.0	15.8	9.6	5.7
IIP = Quarterly Average YoY growth rate %	1.5	3.0	(0.4)	(1.3)	(3.8)	(35.7)	(5.6)	1.7	6.8	58.3	9.6	2.1	1.8	13.0	1.6	2.9	4.6	4.5
Correlation	0.45																	
Multiplier	7.5	0.9	19.6	6.9	4.7	1.7	-0.1	9.8	5.2	2.8	3.8	10.2	13.7	3.6	10.5	5.5	2.1	1.3
Average Multiplier	4.8																	

Note: *=Aggregate net industrial segment revenue of SKF India, Timken India, and Schaeffler India Source: Company data, CSO, Centrum Broking

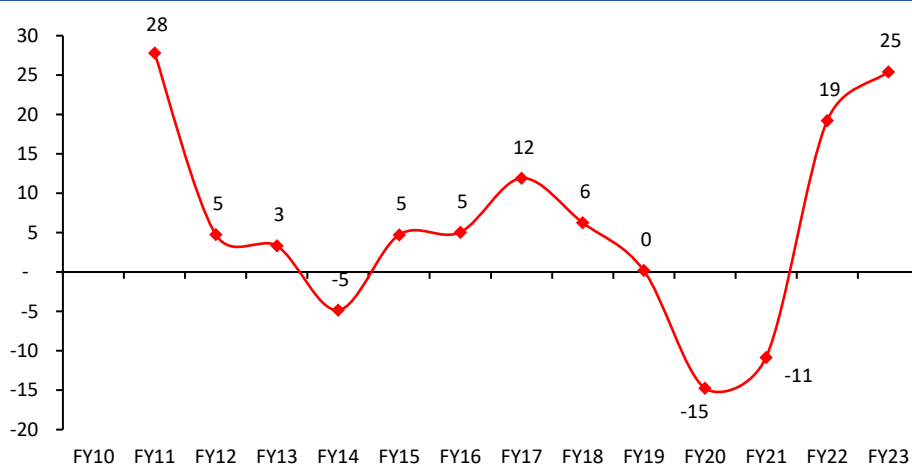
Automotive segment is the largest user segment globally

Automotive segment occupies 50% of the demand for bearings globally. All the three leading bearing manufacturers secure 40-47% of the revenue from automotive segment.

MHCV and LCV estimated to witness cyclical downturn while tractor's outlook is also not encouraging. In the space of PV, outlook is better with mid to high single digit volume growth being estimated. For 2W and 3W, the last few quarters have been better after disappointing performance in 2020 and 2021. These two segments are also estimated to report mid to high single digit YoY growth in the next few quarters. Timken India is expected to witness impact of slowdown in MHCV segment (22% of revenue) in the medium term.

Exhibit 33: PV production YoY growth bounced back (%)

PV reported the second highest recovery rate after MHCV

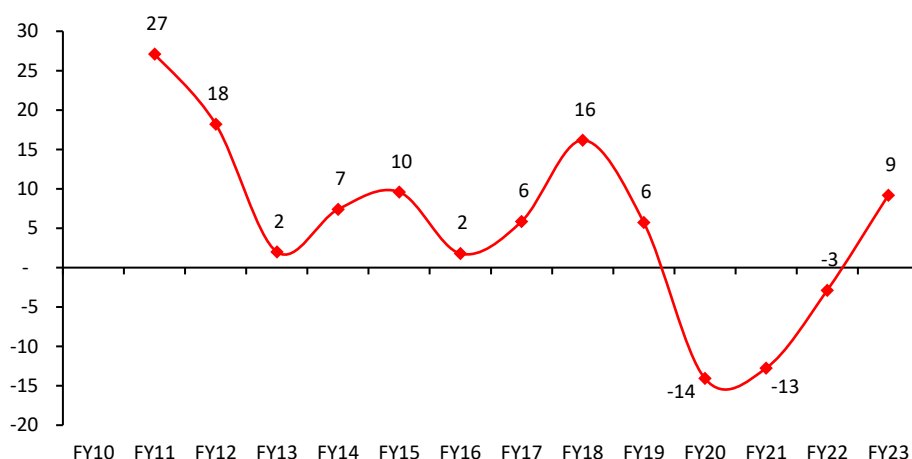


Source: Industry, Centrum broking

PV production grew 25% and 19% YoY in the last two fiscals, respectively; YTD July it is up by 7.4%. The demand outlook is good for PV. The production is estimated to grow at 8% each in FY24E and FY25E.

Exhibit 34: Bounce back in YoY growth in 2W production has been lower than PV (%)

2W segment has witnessed revival albeit at lower rate as against PV

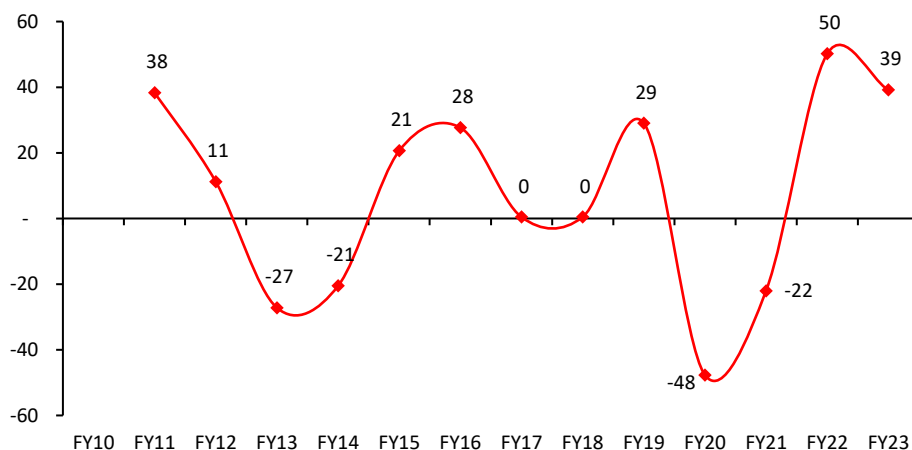


Source: Industry, Centrum Broking

2W production grew 9% and -3% YoY in FY23 and FY22, respectively. Worst seems to be over for 2W segment; YTD July it is marginally down by 1.5%. The demand outlook is moderate for 2W. The production is estimated to grow at 5% and 8% each in FY24E and FY25E, respectively.

Exhibit 35: YoY MHCV production growth appears to be heading for cyclical downfall (%)

MHCV is likely to face challenging times for the next four to six quarters after posting highest rate of recovery



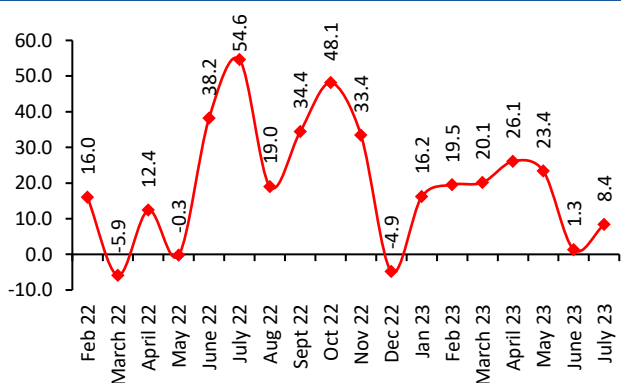
Source: Industry, Centrum Broking

Class 8 trucks in the US are in the slow lane

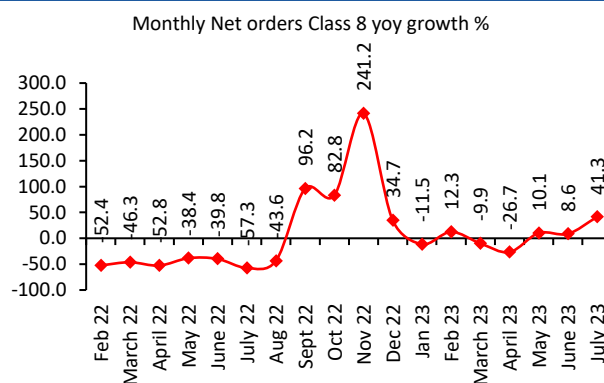
MHCV segment production registered a robust YoY growth of 39% and 50%, respectively in FY22 and FY23. MHCV is cyclical industry, past 12-year pattern suggests two years of boom followed by two years of decline. Also, FY23 growth rate has already started to decline; for FY24E and FY25E there is likely subdued growth or no YoY growth.

Class 8 monthly production data has been soft and sentiment indicator data point of monthly net orders and YoY growth in monthly production for the past 18 months for Class 8 in US also shows weak sentiments as reflected in charts.

This is attributed to slowing down of demand in US on one hand and inventory correction drive on other.

Exhibit 36: Production of Class 8 trucks is in slow lane (%)

Source: Industry, Centrum broking

Exhibit 37: Sentiment indicator has also been volatile

Source: Industry, Centrum broking

Bearing cost as a percentage of vehicle price estimated to be stable between FY15-23

Exhibit 38: Bearing cost as a percentage of vehicle price in FY 23

Particulars	FY23 (No. in mn)	Average price (Rs mn/vehicle)	Market size (Rs mn)	Market size (Rs bn)
Passenger vehicles	4.56	0.65	29,65,229	2,965
Commercial vehicles	1.04	1.00	10,41,400	1,041
Three wheelers	0.53	0.20	1,05,065	105
Two wheelers	19.51	0.08	15,60,970	1,561
			Total	5,673
Total organised bearing market size (Rs bn)	170.00			
Auto segment share (%)	50%			
Auto segment share in organised bearing market (Rs bn)	85			
So bearing as % of price of vehicle	1.50			

Source: Industry, Centrum Broking

Exhibit 39: Bearing cost as a percentage of vehicle price in FY 15

Particulars	FY15 (No. in mn)	Average price (Rs mn/vehicle)	Market size (Rs mn)	Market size (Rs bn)
Passenger vehicles	3.22	0.40	12,88,069	1288
Commercial vehicles	0.70	0.70	4,87,958	488
Three wheelers	0.95	0.10	94,902	95
Two wheelers	18.50	0.04	7,39,999	740
			Total	2,611
Total organised bearing market size (Rs bn)	87.00			
Auto segment share (%)	50%			
Auto segment share in organised bearing market (Rs bn)	43.5			
So bearing as % of price of vehicle	1.67			

Source: Industry, Centrum Broking

The stability in the percentage indicates rising content per vehicle for bearing industry

We believe increasing use of roller bearings (TRB, SRB, CRB), product upgradation (bearing accompanies by other components), advancement in technology (Gen3, Sensorised bearings) has resulted in increase in content per vehicle. It also indicates, that the companies have been able to get raw material price pass through both with OEMs and in aftermarket. Higher localization of automotive bearings has also helped.

Contracts with clients especially Auto OEMs are for 1 year and gets renewed every year

Contracts with auto OEMs are typically for a year which then get renewed every year based on a mutual discussions. Price corrections if needed would be taken by both parties. Typically, these relationships go for 5-10 years but bearing company's contracts specifically are for a year and then they are renewed every year based on the situation at that time. Bearing companies have been able to pass on raw material price hike in the last 20 months almost entirely with some lag. This can be witnessed from extraordinary revenue growth for two consecutive fiscal years and margin expansion. However, it is easier on the aftermarket side and relatively a lot more difficult on the OEM side, both on the industrial as well as on the automotive. And between auto OEM and industrial OEM, it is easier in the case of auto OEM to pass on as the price increases as these are kind of already built-in – linked with steel prices.

Automotive industry's ambition for efficiency and mileage improvement lead to change in bearing technology

Automobile makers have started giving more/large warranty for mileage and certain components for their vehicles. Energy efficiency and low weight are key dimensions for automotive industry for achieving mileage and warranty parameters. This necessitates change in design of various components. Bearing is a major component which plays a crucial

Relationships with OEM continues for longer period of 10 years or so. However, contracts gets renewed every year post negotiations

Bearing is a major component which plays a crucial role in offering enhanced warranty on wheel-end

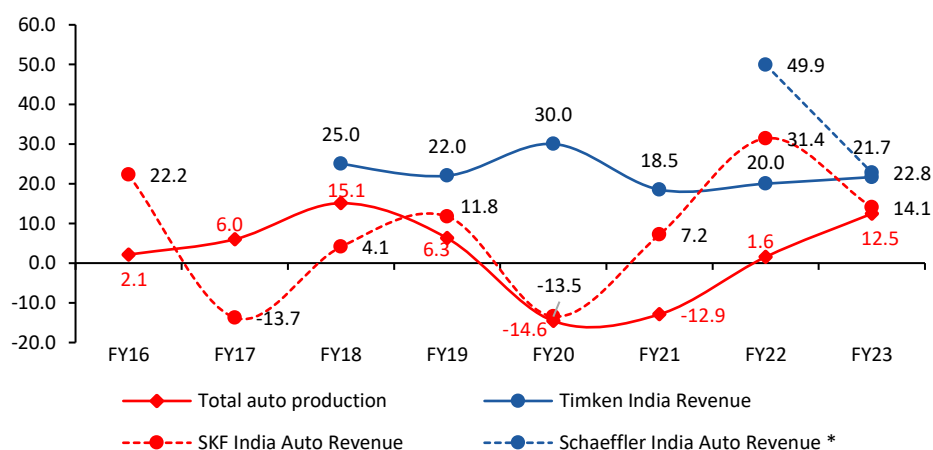
The shift to technologies like StopGo and ABS, warranties for components and mileage, and the drive to reduce weight along with emission reduction will force technology change in bearings

role in offering enhanced warranty, especially at wheel-end. Given the maintenance practices, overloading and road conditions, bearings even assume more prominence. Hence, technological changes in components are underway. Leading bearing companies are working with automotive OEMs to migrate to high quality new products so as to reduce costs. This will lead to product change. Thus, there is technological change happening and technology advancement is the order of the day.

The shift to technologies like StopGo and Anti-Lock Braking System (ABS), issuance of different warranties for components and mileage, and the drive to reduce weight along with emission reduction will force technology change in bearings.

Auto segment growth for bearing companies vs. auto industry growth differs

Exhibit 40: YoY growth of auto individual revenues vs. production growth (%)



Source: Industry, Company Data, *For CY21 and CY22

Growth trajectory for automotive revenue of the bearing company depends on which automotive model it is supplying bearings for

There are few factors that determine the growth trajectory for individual bearing company and the bearing industry i.e., sometimes growth depends on the model that the bearing company is serving. The bearing companies have different market shares in different models, different customers and then depending on which customer has done well, which model has done well, the growth rate for bearing company moves.

Few trends observed in automotive bearing segment

- Automotive OEMs expect bearings to have high rigidity with extremely light weight and low space requirement. It should have low noise and emission levels. The company can then handle high radial and axial load and can operate at high speeds with moderate vibration and noise. They also expect high quality products from bearing companies.
- OEMs' philosophy of controlling the machinery plays a crucial role in selecting the technology of bearings, whether first generation or third generation (sensorised) bearing. OEMs may follow the process of measuring the speed on either brake or wheel or shaft.
- Automotive OEMs are moving towards tapered roller bearings (TRBs) in a big way. Moreover, they are moving towards higher end of TRBs, which is also good. It will limit the competition primarily within Timken India, SKF India and Schaeffler India.
- The replacement cycle in commercial vehicles (CVs) has increased by two years. The maximum extension of replacement cycle happens with a higher tonnage range. Hence, when replacement also starts it starts with the highest capacity CV first.
- Higher tonnage CVs have excess axial and radial loads. Therefore, these vehicles are not only required to have simple TRBs but also should have more advanced or sophisticated TRBs, depending on the application and the sophistication that is built into the CV.
- Broadly, the way OEMs are specifying bearing requirement and getting fitted in any vehicle currently is undergoing a change. There are alternative places to place sensorised bearings to sense the speed, emission, etc. Thus, it depends on the OEM where it wants that bearing to be placed to sense the speed, condition of the wheel

Bearing should be able to handle high radial and axial load

Auto OEMs are moving towards TRB with sensors

Implementation of ABS give rise to HUB 3 bearings which are 2x to 2.5x the cost of GEN 1 bearings

Many auto OEMs who had unsatisfactory experience with Chinese bearings are shifting back to branded companies. Product liability is also a major factor

Bearings evolved over a period of time and now are equipped with other components and sensors

and its rotation Implementation of Anti-Lock Braking System (ABS) for CVs from October 2015 and for two-wheelers above 125cc engine capacity from April 2017 has given a boost to bearing companies having latest sensor technology and improve their realisation. The bearings used in ABS have realisation 3x that of the price of normal bearings although the number of ABS bearings will be one or two per vehicle. The GEN3HUB bearings which are also called as HUB GRID solution, to be fitted in PVs and CVs, have realisation 2x-2.5x that of GEN1HUB bearings with a likely better margin profile. These Hub Grid solutions are fitted for a lifetime and useful to OEMs to extend higher mileage warranty. Many CV OEMs started extending mileage warranty up to 1mnkm.

- Product liability is becoming a very important factor that is considered when automotive OEMs select an automobile component supplier. This has helped in improvement in bearing technology and sophistication. Many automotive OEMs which have tried low-cost Chinese bearings are now shifting back to leading players. This augurs well for leading manufacturers as their share in bearing market is on the rise.
- Lot of imports from China continue, primarily of low-end, small-sized ball bearings. Standard catalogue mass market products which do not require customisation have also impacted replacement market. Dumping by China, at an average 35% lower landed price than locally sourced bearings, resulted in imports from China posting a CAGR more than double the rate at which the domestic bearing industry grew.
- The bearings are also getting more sophisticated. The conventional solution featuring two individual bearings has been replaced with a compact double row angular contact bearing with integrated seals. That was the evolution of **first generation** wheel bearings. Other wheel components such as knuckles and hub were then integrated with bearings, leading to development of **second generation** bearings. Currently, **third generation** bearings are in use.

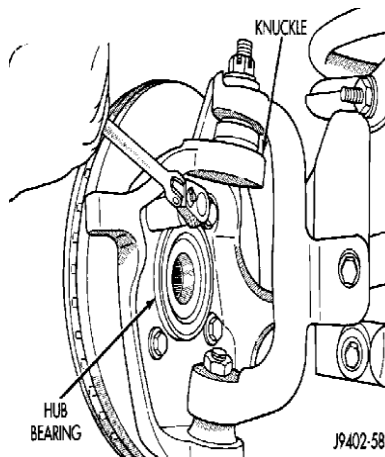
These bearings have integrated flanges, built-in ABS sensors with integration of magnetic encoder-making bearings capable of sensing the speed of front wheel, effective sealing and facilitate optimised mounting that eliminates adverse influences due to manual errors. The sensors could sense the speed, movements, etc. There are alternative places to sense this. Thus, it depends on the OEM where it wants that bearing to be placed to sense the speed, condition of the wheel and its rotation. It offers significant reduction in weight along with providing high-quality signal generation and transmission and thereby contributes to reduction in fuel usage and emission.

Exhibit 41: Pictorial depiction of evolution of bearings

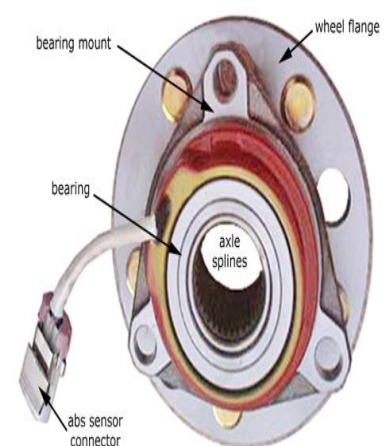
First generation bearing



Second generation bearing



Third generation bearing



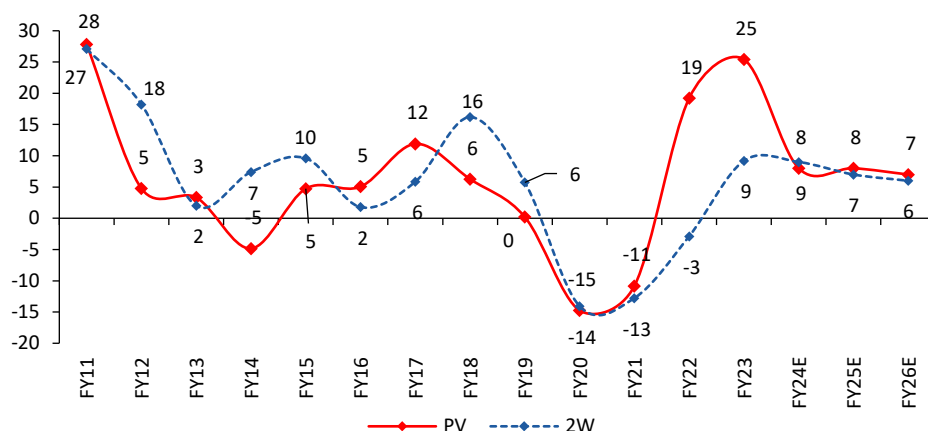
Source : Industry, Centrum Broking

Growth drivers for automotive segment

Growth drivers for automotive segment is OEM sales and penetration in aftermarkets

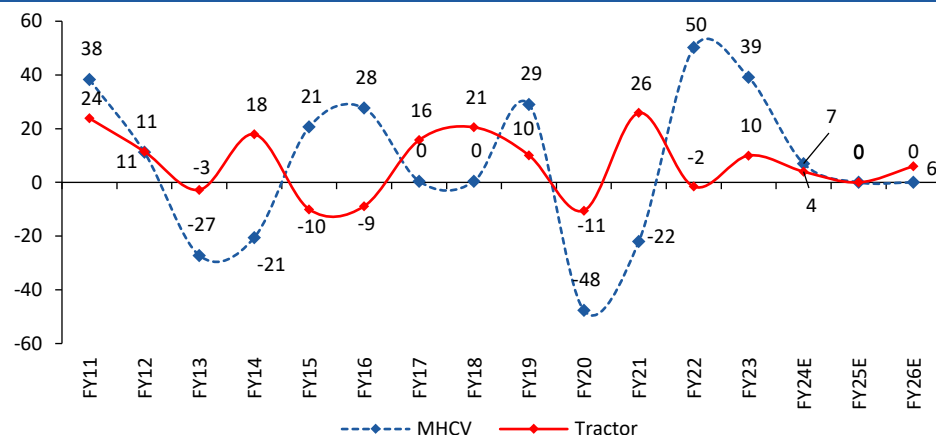
- Primary growth driver for bearing companies is volume growth across all automotive categories

Exhibit 42: YoY production growth rate %



Source: Industry, Centrum Broking

Exhibit 43: YoY production growth rate %



Source: Industry, Centrum Broking

Production assumption

(% YoY FY24E/FY25E/FY26E)

PV – 8 / 8 / 7

2W – 9 / 7 / 6

MHCV – 7 / 0 / 0

Tractor – 4 / 0 / 6

Aftermarket is 30-35% of total automotive market in India

- Another growth driver would be new product launches by both bearing companies and automotive OEMs.
- After markets is 30-35% of the total bearing market. Higher penetration in the aftermarkets either through brick and mortar channel or through online platforms, improves business prospects.

Exhibit 44: Schaeffler India has the largest dealer network while SKF India has distributor network in the aftermarkets

No of distributors	FY16	FY17	FY18	FY19	FY20	FY21/CY20	FY22/CY21	FY23/CY22
SKF India	125	125	200	300	440	455	680	700
Schaeffler India						330	330	330
No of dealers	FY16	FY17	FY18	FY19	FY20	FY21/CY20	FY22/CY21	FY23/CY22
Schaeffler India						33,000	33,000	33,000

Source: Company Data, Centrum Broking

SKF India has the largest presence amongst peers in aftermarkets in India

- SKF India has doubled its distributor counts in the past four years. The company is now present in more than 500 districts of the country out of total 700 odd district.
- In addition to existing network of dealers and distributors, Schaeffler recently acquired KRSV Innovative Solutions Private Limited, which has B2B e-commerce platform – Koovers. Koovers supplies to over 7,000 workshops and has a portfolio of around 1.8 million parts from various manufacturers. Koovers recorded revenue of Rs777mn and started making gross profit. Schaeffler acquired 100% stake in the company for all cash consideration of Rs1,424mn (~2x FY23 revenue). This shows the determination of bearing companies to penetrate in the aftermarkets.

EV is an opportunity more talked about but will take longer than expected

EV volumes have clocked impressive CAGR on low base but its volume share is still far lower in total

Exhibit 45: Despite witnessing good performance, EV is still having low penetration

Category	FY18	FY19	FY20	FY21	FY22	FY23	CAGR %
E-2 Wheelers	2004	28006	26829	44798	252550	727370	225%
E-3 Wheelers	91970	116031	143051	90898	172543	401882	34%
E-4 Wheelers	2242	2407	2404	5201	19782	48105	85%
E-Buses	149	745	928	373	1611	1917	67%
Grand Total EV	96365	147189	173212	141270	446486	1179274	65%
Total 2W, 3W, PV, MHCV	28,540,076	30,222,453	25,835,445	22,208,076	22,502,663	25,272,073	-2%
EV share %	0.3	0.5	0.7	0.6	2.0	4.7	

Source: Industry, Centrum Broking

Number of bearings per vehicle would go down but value per vehicle will remain same or higher as EV bearing prices are much higher than non EV bearings

Hybrid bearings will be used in EV wherein rolling elements will be of ceramics while cage is of steel and metal

Emergence of EV would end the market for engine application bearings; however bearings required for wheel based application will continue to exist

Bearing companies have started selling new products required for transmission system in EVs to improve content per vehicle

Value of bearings per vehicle remains the same or even more although bearings count will go down

EV will reduce the number of bearings required in engine as there won't be any engine but a motor. However, the bearings required on transmission and on wheels of the vehicle will be required. Notably, electrification needs lower friction, lesser noise, higher insulation on the bearings, etc. So, the type of bearing will change and therefore the price point of the bearing will change.

Bearings will become more sophisticated technologically

EV plays a huge role in reducing emissions, but the powerful electrical motors that they use can be damaging to bearings. This can be overcome with hybrid bearings, which combine steel rings with rolling elements made from silicon nitride, an effective electrical insulator. This means that hybrid bearings can insulate the housing from the shaft in both AC and DC motors, as well as in generators. As a ceramic material, silicon nitride also exhibits low density, high strength, stiffness, toughness and hardness. Hybrid bearings have higher speed capabilities and provide a longer service life, under identical operating conditions, than equally sized, all-steel bearings. They also withstand excess vibration and oscillation, and, under these conditions, it is often unnecessary to preload the bearing or apply special grease.

Who will win the EV game – disrupters or established players?

Our understanding suggests that established players will take the lead and the new age disrupters will blow away once the crutches of subsidy under FAME programme goes away. SKF India and Schaeffler India are working closely with established players to co-develop bearing types especially suited for electric vehicles. These bearing companies have advantage of technology parentage. Their parents are already vendors for companies like Tesla. Further, Tata, Mahindra and SKF India are jointly developing products, for example, Tata Nexon Electric – bearing companies are their key partners on the bearing suppliers front, both on the combustion engine as well as electrical vehicle engine.

Bearing companies with wheel based applications will be impacted less

There won't be any engines in EVs and the power trains will be very different, and hence, the gear boxes in power trains would be very different for electrical vehicles compared to Internal Combustion (IC) engine. Hence, bearing manufacturers that are primarily into engine and transmission applications will be impacted the most; they will have to bring bearings suitable for EVs. However, there won't be any impact on the bearing manufacturers who are predominantly into wheel based applications. SKF India is the largest bearing player in the wheel based applications in India for 2 wheelers.

Schaeffler India has developed some mechatronics and components for EVs besides bearings

Schaeffler has started getting business in 2-wheeler and passenger vehicle segment. They have won a Euro 300mn 7-year contract to develop 2-in-1 e-axle clutch EV in passenger vehicle segment. It would be an electric motor coupled with gear box along with power

electronics that go with it. Schaeffler will provide gear box and electric motor designed by them. This product at present is getting imported in India. However, the company aims to start production of the same by 2025. Might go for PLI for this product.

EV segment opens opportunities for bearing companies to manufacture gamut of products

Bearing companies can increase their content per vehicle by entering into new products for EV segment. They possess requisite technology to manufacture those products. The list of products include high power density motor for e-axle, controllers that goes into motors, transmission system that can be integrated with motor, hydraulic lash adjuster planetary gearboxes, thermal management system, lubrication systems, digitalisation, and condition monitoring system.

Industrial Bearing Segment

Indian industrial bearing space occupied 50% share of the market vs. 70% of developed world

Industrial bearing segment is an umbrella term to coagulate sectors like railways, metro trains, wind energy, machine tools, MRO, textile machines, industrial gearboxes, steel, cement, food & beverages, etc. Practically, every industry requires bearings, either directly or indirectly.

It has huge potential and currently occupies around 50% of the organised bearing market in India. In the developed world, industrial segment commands larger share nearing 70% of the bearing market.

The growth of this segment depends on the level of capex in the industrial space and capacity utilisation in the manufacturing space in the economy.

Perspective of bearing companies about this segment in the near to medium term

SKF India to outperform peers in terms of growth in the industrial space with double-digit growth. Its peers will record subdued numbers for the next few quarters

The definition of industrial segment is different for different bearing players. However, if one takes into account large sectors from the perspective of bearing industry, sectors like railways, Drives sector is doing well. However, the sectors like wind, commodities, raw material have started witnessing signs of slowdown. SKF India is confident of achieving lower double-digit growth in industrial segment in FY24 while Schaeffler India and Timken India are sounding cautious on this segment for the next 4-6 quarters. In fact, the last two sequential quarters have been weak for these two companies for this segment. We are estimating late recovery in the industrial segment revenue growth rate of Timken India and Schaeffler India while SKF India is likely to face challenging situation in the industrial segment revenue growth rate.

Growth drivers for industrial bearings

Higher capacity utilization and new capex are main growth drivers for the industrial bearings

Rapid industrial growth led by new capacity expansion in the economy along with higher capacity utilisation and investment in infrastructure like railways, metro trains, mining, power generation, defence, etc., will be the growth drivers for industrial bearings. The focus of organisations should be on life cycle cost of their assets as opposed to a mere 'first cost' focus. This calls for a collaborative approach between the users, OEMs and technology suppliers, right from the design stage to operation & maintenance and refurbishment across the entire life cycle of an asset.

Industrial segment bearings are characterised by large in size, low in volume and customised in nature

Indian bearing needs higher investments and more technological capabilities to manufacture

Industrial segment bearing is characterised by large size, high realisation and margins, need for customisation, low production volume and large variety or types. Industrial bearings have higher technology and capex requirement. The manufacturing process is more complicated. The homologation period of industrial bearings is longer than automotive bearings. All these factors make it difficult for bearing companies to decide whether to go for own manufacturing or import the bearings.

Growth rates of SRB and CRB are more dependent on industrial segment

SRBs and CRBs are used where applications are harsher in the sectors like metal, wind, mining, railways, etc.

India is investing a lot in railways, mining, power gen, pulp, paper, metal, wind, etc., with long term perspective. There are applications in freight wagons, passenger coaches of railways, wind, metal, gear, port cranes, etc. SRBs are known to be self-aligning bearing. Thus, wherever the applications are harsh SRBs run nicely. CRB used in the similar field of metal, wind, gear drives, port cranes on critical applications.

Bearing companies are giving huge thrust on the localization of industrial bearings

Timken India is incurring capex of Rs6bn, SKF India is doing capex of Rs2.5bn in its unlisted subsidiaries and Schaeffler India is incurring capex of Rs10bn for capacity expansion and plant relocation. All these capex are for localization of SRB, CRB and TRB

Schaeffler India amalgamated with INA and LUK few years back and brought large size industrial bearings into the company, and then started incurring capex to expand their capacities. It has recently announced relocation of plant to India for industrial bearings. Timken India is incurring capex of Rs6bn for SRB and CRB. It will be commercialised from the beginning of 2025. SKF India has loaned Rs2.50bn to the unlisted subsidiary of parent which is engaged in manufacturing of large size industrial segment bearings.

High quality industrial bearing should have following features

A quality industrial bearing has low friction and offers higher load rating

A good quality industrial bearing has low friction which minimises power loss in industrial transmission. It offers higher load-rating capability in minimum space.

Automotive bearings are high volume and standardized in nature while industrial bearings are low on volume and customized in nature.

Homologation period for industrial bearings is longer than that of automotive bearings. Railways takes 36 months while wind energy takes 18 months

Complicated, heavy investment driven and technologically advanced nature of industrial bearings keeps small players out of large size industrial bearing manufacturing

Decisions on investment for industrial bearings in India by listed entities of the multinational manufacturers are taken keeping in mind market potential

Industrial bearings are sold directly to OEM as well as through distributors in the aftermarkets

China prefers a market with large volumes and standardized products. And hence, not having much presence in India in the industrial bearing segment

Industrial bearings and automotive bearings are different from each other on many aspects

Industrial bearings are different compared to automotive bearings. Industrial bearings have a different manufacturing process in which production volume is low, but of application-specific customised nature products only. Production of industrial bearings requires higher investment in respect of long homologation period, supply chain, etc. Hence, manufacturing industrial bearings is almost an independent operation.

Industrial bearings is a patience game on account of a long homologation period

Industrial bearings are not easy to homologate and take a long time i.e., it could run between 12-36 months. This is on account of long duration staged approval process wherein the industrial customer likes to test, approve and then make the decision to buy and after this the bearing manufacturer goes for commercialisation. For example, in the case of wind energy sector it is 18 months and in case of railways it is 36 months. Therefore, it depends on: (a) The application of bearing, (b) Industry standards followed, (c) Consequential cost of failure of the product using that type of industrial bearing, and (d) Capacity of the bearing to operate reliably under extreme operating conditions.

Industrial bearings to OEMs is out of the reach for local bearing manufacturers

Railways, steel plants, wind energy generators, oil & gas, machine tool sectors, etc., are large OEM consumers of industrial bearings. As discussed earlier, industrial bearings require a lot of customisations and is a low volume game with a long homologation period. All these factors translate into requirement of huge investments and becomes prohibitive for a local manufacturer to enter the industrial OEM segment. Hence, lack of world class infrastructure and technology keeps local manufacturers out of the arena of OEM suppliers of industrial bearings. Hence, these players are not there in large industrial OEM contracts of clients.

What are the factors that determine investment decisions?

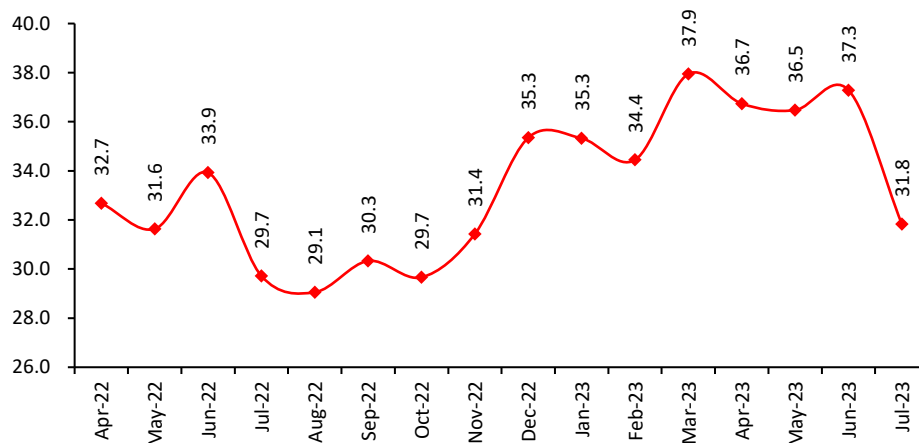
Industrial bearing is a different cup of tea as compared to automotive bearing. Industrial bearings have totally different manufacturing process, supply chain, etc. These are almost independent operations. Therefore, the investment decision is based on where it is most logical to set up the plant. Many bearings cannot be manufactured in India because the tooling costs are prohibitive and the volume is not enough to justify the investments. Moreover, particularly in the case of industrial bearings, the bearing company has to build the infrastructure first and then get the sample batch of bearings manufactured for a long duration homologation process. The stage of commercial production is reached only after the product gets approved by the client. In aftermarket segment, the state of market demand is also an additional influencing factor. Therefore, considering all these factors it takes almost seven to eight years for the industrial bearing factory to come into the black. All these factors need to be considered before deciding the investment.

Distribution of industrial bearings

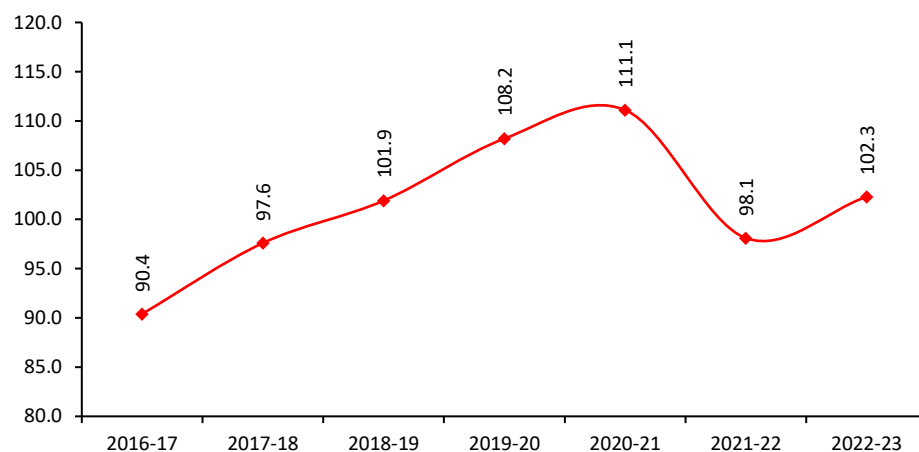
The distribution of industrial bearings is done by manufacturers to OEMs directly. If the bearing is imported, it takes anything between six weeks to six months, depending on the size and complexity and the diversity of the bearing. In aftermarket segment, the companies have a vast distribution network. These distributors have stocks available with them and bearing manufacturers are aware of the rolling schedule of demand and production. Hence, it takes one week to four weeks to deliver the product through the distribution network.

China is not a threat in industrial bearings segment

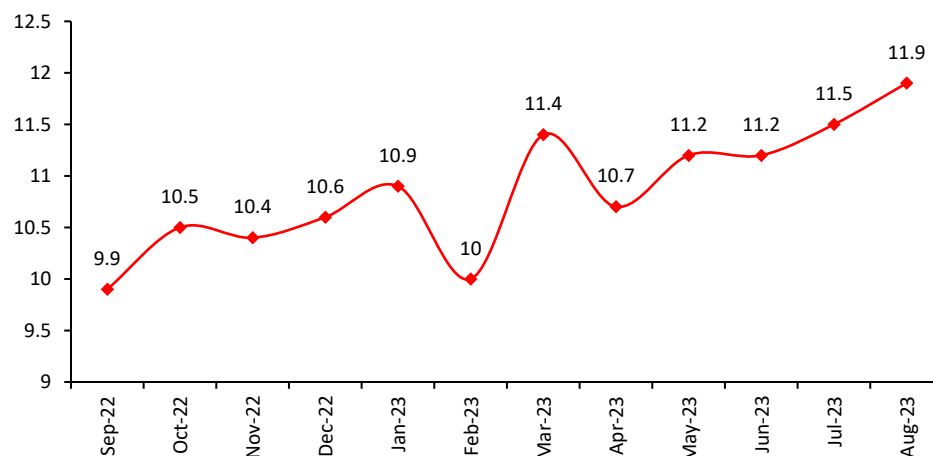
China is a champion in the production of large scale stereo-typed bearings which are used in the automotive space. Chinese suppliers have got some success in supply to OEMs as a few Indian automotive OEMs have set up procurement offices in China. However, industrial bearings are more customised in nature with a low volume. Chinese manufacturers are not present in a big way in India in this segment. On the OEM side, it's more difficult for them. The aftermarket is relatively easy to penetrate on account of the distribution base, but certainly not a cakewalk. Industrial bearing companies are required to have business relationships, technical competency and also their local set-ups to constantly remain in touch with clients and markets. The industrial bearing market is a different cup of tea altogether.

Exhibit 46: Monthly cement production (mn tn)

Source: Industry, Centrum Broking

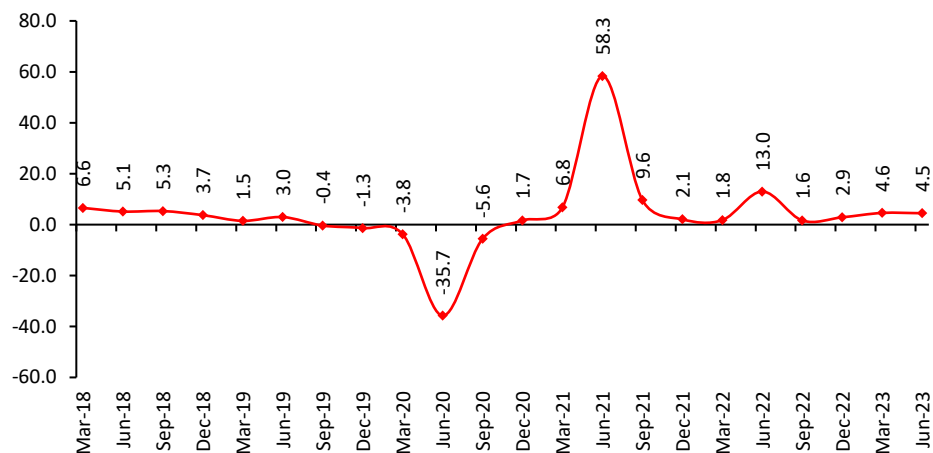
Exhibit 47: Steel production annual (mn tn)

Source: Industry, Centrum Broking

Exhibit 48: India Steel production in mn tn

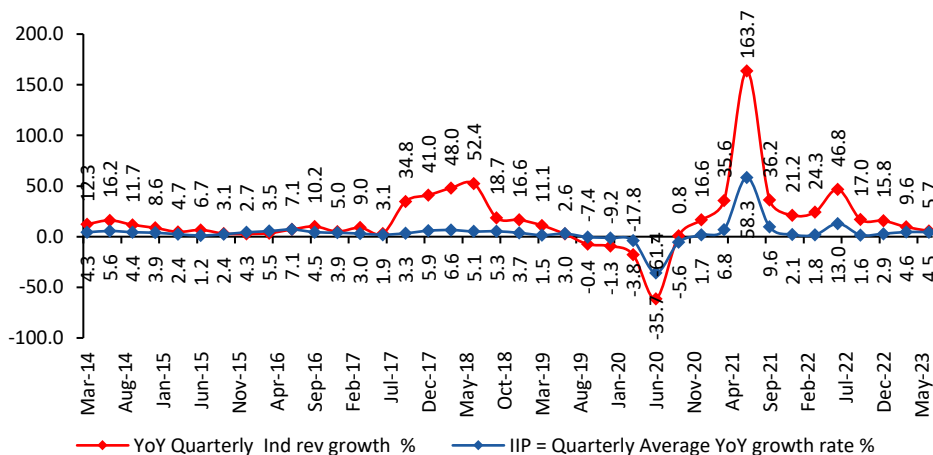
Source: Industry, Centrum Broking

User industry annual production data points out stagnation or range bound production

Exhibit 49: IIP Quarterly Average YoY growth rate %

Source: Industry, Centrum Broking

IIP has been range bound. Moreover, its correlation with industrial revenue of 3 companies has been 0.45. However, industrial revenue growth rate of bearing companies has surpassed IIP growth rate many times in the past

Exhibit 50: IIP YoY growth vs. YoY industrial revenue growth of 3 companies (%)

Source: Industry, Centrum Broking

Railways is the second largest user industry of bearings in India after automotive sector

Freight application bearings occupy 55-65% share in the total railway opportunity

Annual addressable market size has moved up from Rs10bn in 2016 to Rs15bn by 2023

As per various industry sources, the annual market size of the India Railway sector is Rs15bn to Rs18bn; it has moved up from Rs10bn in FY2016. It includes various bearings, seals, couplers, sub-assemblies with axle boxes, traction motors and other components. This can be also gauged from the fact that combined revenue of all three companies (Timken India, Schaeffler India, SKF India) from Railway sector has been around Rs12bn for FY23/CY22.

We have tried to estimate the annual size of the Railway bearings in India, however, lack of availability of exact data on various components, orders placed by private sector, etc., we could estimate annual market size up to Rs9.3bn.

The freight segment has the largest share (60-65%) and passenger (incl. Locomotive) segment has (35-40%) share in the total railway bearing market.

Exhibit 51: Types of bearings and its applications in railway segment

Bearing Type	Application in Railway Segment
D Class	Freight application on Meter Gauge
E Class	Freight, Axle load 22.9 tonne, Broad Gauge
High Capacity E Class	Freight, Axle load 25 tonne, Broad Gauge
K Class	Freight, Axle load 32 tonne and above, Broad Gauge
G Class	Locomotive, Axle load 40 tonne, Broad Gauge
GG Class	Locomotive, Axle load above 40 tonne, Broad Gauge

Source: Industry, Centrum broking

Exhibit 52: Mapping the railway opportunity

Particulars	Estimation of no of bearings demand	Opportunity (Rs mn)	Basis
	(Annual estimation in Mn units)		
Refurbishment	0.6	3,000	(0.6 mn bearings@Rs 5000 per bearing)
New freight wagons	0.24	2,880	30000 wagons(90,000/3)*8 bearings*Rs 12,000 per bearing
New passenger	0.05	576	6000 coaches*8bearings*Rs 12,000 per bearing
Replacement in Freight	0.15	1,800	150,000 bearings*Rs 12,000 per bearing
Replacement in Passenger	0.04	480	40000 bearings*Rs 12,000 per bearing
Locomotives*	200	60	200 locomotives* Rs 300,000 per locomotive
Metro Cars*	100	20	100 cars*Rs 200,000 per car
DFC freight wagons	0.02	492	3000 wagons*8bearings per wagons*Rs 20,500 per bearing
Total		9,308	

Source: Industry, Centrum Broking *= No of Cars

Exhibit 53: Timken is the largest revenue earner from railway sector

Railway segment revenue estimate FY23/CY22	(Rs mn)
Timken India	4,810
SKF India	3,010
Schaeffler India	4,120
Total	11,940

Source: Company Data, Centrum Broking

The Indian Railways is planning to augment the freight wagon population by 90,000 wagons between FY23-25. Out of that, order for 20,067 wagons has already been placed. Additionally, announcement to start new 400 Vande Bharat trains in January 2023 will boost the demand for bearings.

Out of 90,000 wagons purchase plan announced in 2022, Railway has allotted a tender for 20,000 wagons to Texmaco

Freight wagon order placement has been volatile

Freight segment is the fastest growing and largest sub segment

Total freight wagon population is over 3,15,000 wagons as of March 2022. The demand for freight application bearings emanates from two sources i.e., (a) Demand for new wagons, and (b) Demand for the refurbishment of bearings. Freight wagons uses Class E Tapered Roller bearings and have just migrated to High capacity Class E bearings. The freight wagons have moved from 22.9 tonne axle load to 25 tonne axle load. As per estimates, the bearing refurbishment demand is Rs3bn per annum. As per industry experts, India is required to add/replace 30,000 freight wagons per annum. India's present manufacturing capacity is 30,000 wagons. The recent announcement of Indian Railways to procure 90,000 wagons between FY23-25 gives strong revenue visibility for bearing players. At the current price, it offers total opportunity of Rs8.70bn

Exhibit 54: Indian Railway's wagon procurement has been bit inconsistent

Particulars	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Freight Wagons Ordered (Nos)	8,111	2,044	13,379	2,629	14,039	12,743	14,911	556	3,799	2,700	51,229	900
yoy growth (%)		-74.8	554.5	-80.3	434.0	-9.2	17.0	-96.3	583.3	-28.9	1797.4	-98.2

Source: Indian Railways, Centrum Broking

In Railway, the lowest price bidder wins. Lean and own manufacturing will help in becoming L1 and still have good margin. Timken India has been successful in executing this

Railway freight business is not very margin accretive for few players

Railway business is tender based business where L1 gets maximum share of the business. SKF India has admitted that this business for them is not very profitable. We believe this has been on account of the competition from players like Timken India and National Engineering Industry. They have local manufacturing for Tapered Roller bearings with depreciated assets which helped them to make good profits even in highly competitive tender based business. Moreover, Timken India has very early taken lead in localising supply chains including for alloy steel sourcing. SKF India and Schaeffler India have recently localised manufacturing of this product. Timken India, being a global leader in Tapered Roller bearing possesses the skill of manufacturing it at comparatively lower cost. Schaeffler India, sometime back admitted that they don't have a good product to offer at this cost.

Freight application data in the table is only part of the total consumption

We have mined the data on freight bearings to see Timken India and National Engineering Industry together captured entire business for the past Five years

Exhibit 55: Annual freight bearing order details CTRB E Class and K Class

Particulars	Product	Unit	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Freight Bearings Ordered	CTRB - all types	No	0	95,466	124,080	0	218,125	336,355	83,188	128,556	71,003	0	179,659	75,210	147,726
yoy growth		%			30.0			54.2	-75.3	54.5	-44.8			-58.1	96.4
Total Order Size		Rs mn	0	961.34	1293.45	0	2344.84	3724.12	931.60	1487.07	959.01	0	2294.78	1018.19	1884.57
yoy growth		%			34.5			58.8	-75.0	59.6	-35.5			-55.6	85.1
Avg Rate		Rs per unit		10,070	10,424		10,750	11,072	11,199	11,568	13,507		12,773	13,538	12,757
yoy growth		%			3.5			3.0	1.1	3.3	16.8			6.0	-5.8
DFC Bearings Ordered	K Class	No						25,200							
Total Order Size		Rs mn						516.88							
Avg Rate		Rs per unit						20,511							

Source: Indian Railways, Centrum Broking

Timken India is by far a leader with 60% market share in the freight application bearing

Share of each company in CTRB Class E

Timken India occupies more than 50% share on an average; SKF India and Schaeffler India are marginal players

Exhibit 56: Timken India is leader with 60% market share in 2023

Particulars	Product	Unit	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Timken India's share	CTRB	No	0	95,466	76,811	0	130,875	134,541	39,930	42,852	42,602	0	71,864	30,084	88,636
		%		100.0	61.9		60.0	40.0	48.0	33.3	60.0		40.0	40.0	60.0
SKF India's Share	CTRB	No	0	0	0	0	0	0	5823	0	0	0	0	0	0
		%		0.0	0.0		0.0	0.0	7.0	0.0	0.0		0.0	0.0	0.0
Scaeffler India's Share	CTRB	No	0	0	5,909	0	0	0	10,815	21,426	0	0	0	0	0
		%		0.0	4.8		0.0	0.0	13.0	16.7	0.0		0.0	0.0	0.0
NEI' share	CTRB		0	0	41,360	0	87,250	201,814	26,620	64,278	28,401	0	107,795	45,126	59,090
				0.0	33.3		40.0	60.0	32.0	50.0	40.0		60.0	60.0	40.0

Source: Indian Railways, Centrum Broking

Exhibit 57: Grease Seals opportunity is small in size

Particulars	Product	Unit	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Grease Seal	Grease Seal	Nos	4,99,000	3,99,352	5,32,911	4,10,403	4,30,825	12,74,455	6,82,223	8,33,538	8,90,755	2,68,624	4,36,598	7,73,274	5,86,890
yoy growth		%		-20.0	33.4	-23.0	5.0	195.8	-46.5	22.2	6.9	-69.8	62.5	77.1	-24.1
Order Size	Grease Seal	Rs mn	120.90	60.61	73.29	45.14	43.28	146.31	79.36	98.62	269.60	6814.99	38.95	241.80	148.23
yoy growth		%		-49.9	20.9	-38.4	-4.1	238.1	-45.8	24.3	173.4	2427.8	-99.4	520.8	-38.7
Realisation	Grease Seal	Rs per unit	242	152	138	110	100	115	116	118	303	25370	89	313	253
yoy growth		%		-37.4	-9.4	-20.0	-8.7	14.3	1.3	1.7	155.8	8282.1	-99.6	250.5	-19.2

Source: Indian Railways, Centrum Broking

SKF India is more into seals rather than in freight application bearings**Exhibit 58: Share of each company in Grease Seals business**

Particulars	Product	Unit	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Timken India's share	Grease Seal	No	199,600	107,835	279,735	164,161	150,789	509,781	272,889	333,415	356,302	134,312	122,248	309,309	50,936
		%	40%	27%	52%	40%	35%	40%	40%	40%	40%	50%	28%	40%	9%
SKF India's share	Grease Seal	No	299,400	29,1517	253,176	246,242	280,036	764,674	409,334	500,123	534,453	0	283,789	0	359,411
		%	60%	73%	48%	60%	65%	60%	60%	60%	60%	0%	65%	0%	61%
Scaeffler India's	Grease Seal	No	0	0	0	0	0	0	0	0	0	0	0	0	0
		%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
NEI's share	Grease Seal	No	0	0	0	0	0	0	0	0	0	134,312	30,561	463,965	176,543
		%	0%	0%	0%	0%	0%	0%	0%	0%	0%	50%	7%	60%	30%

Source: Indian Railways, Centrum Broking

SRBs and CRBs are now replaced by CTRBs in passenger coaches and locomotives

Refurbishment of bearings is Rs3bn p.a. opportunity

Metro coaches – opportunity is small at present

Locomotives are now shifting to TRBs and offers Rs600mn p.a. opportunity

Passenger coach opportunity is yet to pan out in the meaningful way though potential is huge

India's passenger coach population has been more than 84,000 cars, and the most of these cars are using Spherical Roller bearings. However, over a period of last one decade, the Indian Railway has started to add new LHB Coaches (Linke Hofmann Busch) for all new generation trains like Shatabdi, Rajdhani, Tejas and now Vande Bharat. These trains are capable of running at 130km/hour as against existing speed of 70km/hour. This mega shift has resulted in replacement of Spherical Roller bearing by Cartridge Tapered Roller bearing (Class E bearings). Schaeffler India and SKF India have been the leaders in this segment. However, on account of migration to Tapered Roller bearing, Timken India is also now in reckoning. India can make 6,000 passenger cars per annum and is required to replace at least 6,000 old coaches by LHB to change the entire fleet in the next 14 years. All three leading bearing companies are suppliers to LHB coaches. The realisations per bearing also moved up because of this shift.

Refurbishment of bearings is a high margin business

The annual opportunity size estimated for freight wagons is Rs3bn. Over and above, passenger cars, locomotives, metro coaches also require their bearings to undergo refurbishment once in every four years. Refurbishment enhances the life of bearing at less than one fourth of the cost at Rs4,000-5,000 per bearing. Indian Railway earlier used to do it on its own. However, they have started outsourcing this activity which prompted these leading bearing players to run a refurbishment facility within Railway facilities to avoid logistic cost and time lag.

Metro is upcoming segment with export potential, however, present opportunity size is not that big

With Rs200,000 bearing opportunity per metro car, annual size gets restricted to Rs40mn for 200 cars per annum. All three leading players are supplying to metro coaches in India. The size of opportunity gets expanded with export of metro coaches from India.

Locomotive segment offers Rs600mn per annum opportunity

GE and Alstom are manufacturing 100 diesel and electric locomotives each every year. All three players are supplying bearings to these manufacturers. With Rs300,000 per locomotive cost, the total bearing opportunity is Rs600mn per annum.

DFC is certainly going to be a big opportunity worth Rs1bn p.a. once it becomes fully operational. The realisations for K Class bearings are 70% higher than E Class bearings

Dedicated Freight Corridor (DFC) is on slow track but potentially Rs1bn p.a. opportunity

DFC is not fully operational as yet sans completion of loop lines. However, India Railways in 2016 bought 22,500 K Class bearings, all three companies received the orders and supplied. The price per K Class bearing is almost double that of normal E Class freight bearing. However, there has been no progress on this front in the last 6 years. As per industry experts, India required 6,000 DFC wagons every year. This gives an annual opportunity of nearly Rs1bn for bearing players. Timken India has the highest share in the first set of order.

Exhibit 59: DFC vs. normal freight wagon comparison

Features	Existing	On DFC
Axle load	22.9tn/25tn	32.5tn/25tn for track superstructure
Track loading density	8.67tn/m	12tn/m
Maximum speed	75kmph	100kmph
Stacking	Single stack	Double stack

Source: Dedicated Freight Corridor

Exhibit 60: Share of each company in Class K; Timken India is the leader

Particulars	Product	Unit	2016
Timken India's share	K CLASS	No	11760
		%	46.7
SKF India's Share	K CLASS	No	4320
		%	17.1
Schaeffler India's Share	K CLASS	No	1200
		%	4.8
NEI		No	7920
		%	31.4

Source: Indian Railways, Centrum Broking

Ease in certain criteria by Indian Railways certainly helped SKF India and Schaeffler India in shortening their mandatory homologation period for freight application bearings

Indian Railways keep modifying qualifying criteria and tender process periodically

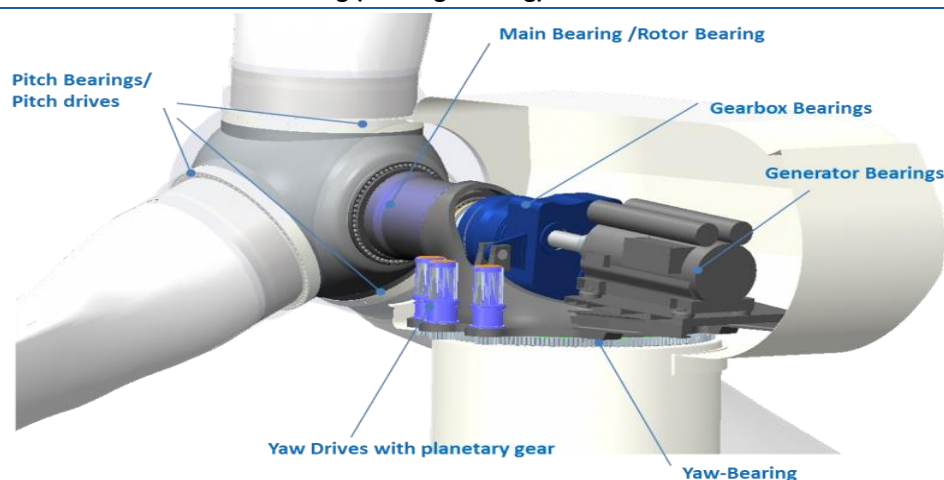
The product and the bearing plant must have AAR (American association of railroads) Certification. All three leading players have that certification in place. It opens export window also for them.

- The homologation period of 36 months can be reduced for development trial period of 24 months if the same company has a similar bearing in a plant outside India which is supplying to Indian Railways, the time for approval of the plant in India when they start making the same bearings is short circuited; hence, one does not go through the full two-year development cycle, but the cycle becomes much smaller.
- Indian Railways has decided to buy the basic freight bearing differently. Earlier there used to be a single tender contract for both new wagons as well as maintenance requirement; and on single tender, they used to decide everything. Now, they have decided that the wagon builders will buy their own bearings and railways will only focus on their maintenance requirement.
- Bearing companies used to get payment from railway in 7 days but bearing companies now have to accept Letter of Credits (LCs) from private wagon players. Earlier, Railway used to give free supply of bogies, bearings steel to wagon makers and they just have to fabricate and send back. But now private wagon makers have to buy raw material and components on their own which puts a lot of pressure on them in terms of working capital management. Hence, bearing companies now insist on upfront payment or credit line.

Railways has allowed private wagon builders to source components and bearings on their own. This has increased financial risks for bearing companies. So bearing companies adopted a policy of limited credit period or work against Letter of Credit

Wind is high on potential; low on profitability

Exhibit 61: Wind turbine bearing (slewing bearing) and cross section of wind turbine



Source: Industry, Centrum Broking

Latest commentary by major wind application players draw optimistic picture

Wind sector is still not doing well though some optimism has emerged in the recent past

Schaeffler India management shared the data point of 16% sequential growth in the wind equipment production in the country for June 2023 quarter. However, this has come after four consecutive quarters of sluggish growth.

There are five to six applications of bearing in a wind turbine

Wind energy segment uses high-technology, large diameter bearings. There are five to six applications of bearings in a wind turbine such as the blades, generator, gear box, main rotor shaft, pitch arrangement, etc.

Wind bearing must operate reliably under extreme operating conditions

Wind sector in India has paralyzed on account of low tariffs

Wind application bearings must operate reliably under extreme operating conditions like high dynamic forces with extreme peak loads and minimal loads, sudden load reversals and widely fluctuating operating temperatures. Wind energy OEMs face challenges like downtime on account of grease leakage from slewing bearings. Players like SKF India have successfully worked with wind energy OEMs to overcome such problems.

SKF India and Schaeffler are leading players in wind application bearings

Bearing manufacturers supply bearings to gear box makers for the wind turbines

Earlier, wind energy bearings used to be imported, but SKF India has successfully penetrated this market and has become the largest player in India. Another big player in wind energy space is Schaeffler India. Both these companies offer a range of products and services like condition monitoring systems, lubricants, and mounting and maintenance tools which allow wind energy OEMs to achieve low operating costs for wind turbines. Their know-how encompasses the entire power train system and ranges from simulation, planning, manufacturing; installation to support services. This augurs well for wind energy OEMs in terms of reduction of lead time and getting local application support partner for routine problems including grease leakages from slewing bearings

Localization of wind turbine happened over a period of time

Long homologation period requires strong technological competence

Homologation period for wind turbine is around 18 months. Hence, high technological competence, continuous technology support requirement along with a long homologation period acts as an entry barrier for local manufacturers.

Wind segment opportunity for bearing companies more depends on export demand than domestic

Increase in the size of wind turbines from sub megawatt to now up to 5 megawatt will increase market size of bearings for wind market in India

Wind sector outlook is complex as it depends on the range of gear boxes and different regions have different developments. Europe and India are not doing well while China is booming.

India's local consumption is almost minuscule. It is going to come up now. Given the fact that India has mostly sub-megawatt means 250 kilowatt-type windmills which had a small gearbox.

Currently most of the gearboxes which are made in India are generally exported. For example, Flender, ZF, Siemens, Gamesa, etc., are exporting to the European markets, even to China, because the European wind market is going to be competitive. The European gearbox makers in Europe will be competing with the Chinese wind market. So best cost countries will remain very important. Bearing manufacturers in India are currently serving those gearbox makers and looking forward as the Indian local wind consumption comes up. And if it is going to be offshore shift from onshore, there will be increase in the size of turbines to 4-megawatts, 6-megawatt, 8-megawatt in India as well.

Chinese gearbox maker started plant in India with exports in mind

China windmill market is not slowing down. They are consuming gearboxes from other parts of the world as well. And now Chinese gearbox maker – Nanjing High Speed Gear Manufacturing Co is making gearboxes in Chennai for export purpose.

India's domestic potential market would be 20,000 gear boxes

India will require 20,000 gear boxes and allied equipments if Government of India hits the plan of their wind energy.

Windmills driven by gearbox require higher number of bearings than direct shaft driven

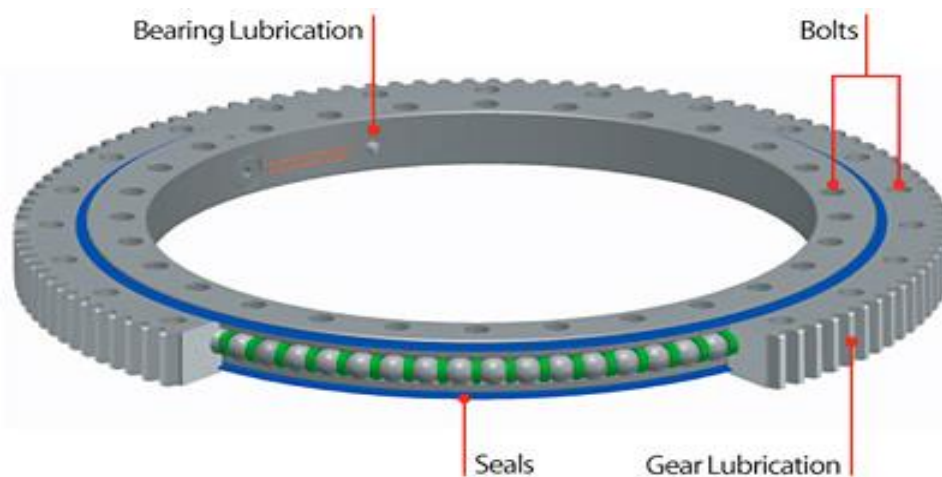
What changes is that whether it is a gearbox-driven windmill or it is a direct drive. Direct drive will have a master bearing on the direct shaft, which will be very big and if it is gearbox-driven then it will have multiple bearings because it will have many stages which require bearings at each stage.

One of the largest players SKF India admitted that wind business is not making money for them

SKF India has re-strategized their wind business, and is now focussing on profitable growth in this segment. Wind segment revenue share has been in the range of 6-8%; and the company admitted in 2021 that they were making losses in high single digit on wind business. Hence, it decided to take new order in the wind segment only if the company earns money on it.

Wind bearing is not profitable for all manufacturers

Exhibit 62: Slew Bearing



Source: Industry, Centrum Broking

Sale of services and adjacencies having huge potential in the long run

Bearing companies are using other services and product offerings as a tool to enhance customer engagement

Service segment is a great tool which gives bearing manufacturers an opportunity to remain engaged with clients. Large clients of industrial bearings have realised the importance of reducing life cycle cost through regular maintenance. This has opened up a new revenue source for the domestic bearing manufacturers. Bearing companies have started selling various allied services like refurbishment, MRO, lubrication, etc., across various user industries. The market size for all these allied services has been estimated at 10x, the size of organised bearing market. SKF India has taken the lead in this segment by launching different services. They provide condition monitoring through remote centre using algorithms and machine learning 24/7. They call it Rotating Equipment Performance (REP). Timken India has set up gearbox refurbishment facility at Raipur and also has remote condition monitoring programme MILTEC. Schaeffler India has started focusing on reducing life cycle cost by providing solutions for preventive maintenance and condition monitoring through their programme OPTIME.

Bearing companies are offering condition monitoring services and performance enhancement assurance contracts in lieu of participation in gains. The companies have set up remote diagnostic centers equipped with algorithms and machine learning technology to offer these services. It helps process industry to avoid unplanned downtimes and avoid losses

- Performance contracts are a little different, they are based on outcomes, so the performance contract could be for uptime guarantees, could be for availability, reliability, etc., and those are based on outcomes there. It has an option value to share the profits if the guaranteed performance benchmark has been achieved.
- Each player is focusing on other complementary products and services to improve client engagement to boost sales of bearings and to diversify revenue stream. It includes seals, mechatronics, bearing mounting/dismounting/alignment, lubrication systems, shaft alignment, condition monitoring, failure analysis, comprehensive maintenance management, etc.
- This will enable an increasingly larger role as a preferred partner to a wide spectrum of clients in the industry.
- In aftermarket segment, bearing manufacturers undertake service projects at client locations through a range of condition monitoring services which minimizes the risk of breakdown, consequent damages, and thus, allow clients to achieve reduction in downtime. The total cost of ownership gets reduced through predictive maintenance practices. For example, around 30% of premature failures in mechanical equipment are caused by poor or inadequate lubrication. Automating this aspect ensures replenishment at the correct interval, at all points where it is required and with the correct quantity.
- We have been given to understand that the current addressable market in India is growing at a high double-digit rate every year.
- As per the rule of thumb, the potential of service segment is estimated 10x the size of organised anti-friction bearing market globally.

Bearing companies have added more products like lubrication system, batteries, wipers, shock absorbers, couplers, mechatronics etc. to enhance offerings

Exhibit 63: Services segment revenue share (%)

Particulars	CY20/FY21	CY21/FY22	CY22/FY23	CY23E/FY24E	CY24E/ FY25E	CY25E/ FY26E	CY26E/ FY27E
SKF India	1.5	1.8	2.2	2.6	2.7	3.1	3.5
Timken India	8.2	54.7	43.7	12.0	15.0	20.0	20.0
Schaeffler India	0.2	0.2	0.7	0.7	0.7	0.7	0.7

Source: Company Data, Centrum Broking

Exhibit 64: Services segment revenue growth (%)

Particulars	CY20/FY21	CY21/FY22	CY22/FY23	CY23E/FY24E	CY24E/ FY25E	CY25E/ FY26E	CY26E/ FY27E
SKF India	38	61	45	30	15	25	25
Timken India	5.1	5.0	5.7	5.9	6.2	6.3	6.5
Schaeffler India	18.1	43.8	264.7	8.0	5.0	10.0	15.0

Source: Company Data, Centrum Broking

Exhibit 65: Services and products offered by companies

Other services offered	Solutions encompassing seals, mechatronics lubrication system, technical support, life cycle management, repairs, refurbishment & maintenance services, condition monitoring, engineering consultancy, remote diagnostic centre, Rotating Equipment Performance contracts (REP)	MILLTEC services for 24/7 management of steel and aluminium mills, industrial gearboxes and bearings refurbishment, providing lubrication solutions like seals, grease, lubricants, etc.	Replacement of part with service solutions, lubrication solutions, wipers, batteries, shock absorbers, bearings repairs and refurbishment, Remote condition monitoring OPTIME
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Source: Company Data, Centrum Broking

Valuations and outlook

Why the difference in the valuations of these companies historically?

Following points led to difference in valuation multiples

Criticality of technology

Margin superiority of Timken over others

Export is the highest margin business

Traded goods valued at transfer pricing mechanism. So lower share of traded revenue in total would be better

The largest share of 60% in freight application bearings for railways

Larger presence in key Auto OEMs gives Schaeffler India an upper hand vs SKF India

2W bearings are the most commoditized products in which SKF India is the largest player which puts it in the bottom of valuation hierarchy

Investors have given higher weightage to revenues from exports and railway freight wagon segment

Although the companies initiated in this report generate major portion of their revenue from bearings manufacturing, their business models, strengths and focus areas are different, and hence, the market has assigned different valuations to them based on their performance. Timken India has historically been commanding industry leading earnings multiple followed by Schaeffler India and then SKF India, owing to the following reasons.

- **Type of bearings:** Timken India and Schaeffler India primarily manufacture Roller bearings (TRB, SRB and CRB) which are technologically challenging to make and used in critical applications where load bearing capacity requirement is higher. They are not commoditized as yet, and hence, command higher margins. SKF India, the largest Ball bearings player supplying mainly for 2W in automotive segment. Those are easy to duplicate and become commoditized. This product faces a lot competition from Chinese imports.
- **Margin superiority:** Both, Timken India and Schaeffler India secured higher margins than SKF India. Timken India remained a leader on this parameter as well. However, on account of better Total Asset turn (due to lesser capex intensity vs. other two) and better Total Leverage, SKF's return ratios were notch higher than rest of the two.
- **Exports:** Timken India remained the largest exporter of bearings amongst the peers. Moreover, exports share in the revenue remained largest (25-30%) vs. others (in the range of 7-8%). In the margin water fall, exports command the highest margin.
- **The lowest traded revenue in Industrial space:** Timken India's traded portion remained at 25% as against 39% of SKF India and 27% of Schaeffler. Traded goods get valued at transfer pricing mechanism which is complicated and keep investors guessing on margin front.
- **Leadership in Railway freight segment:** Although Railway freight business is a tender based business, it's a high margin business as there are high entry barriers. Timken enjoys 60% market share there. Railway occupies 17-18% share in revenue. SKF India and Schaeffler India hardly had any presence in this segment till some time back.
- **Schaeffler enjoyed better position in PV segment:** Schaeffler India had HUB 3 bearings used in PV which SKF didn't have till some time back. This product helped Schaeffler India to get many OEM contracts which aided its margins. Moreover, Schaeffler has been doing business with Korean OEMs in India.
- **SKF association with highly competitive 2W segment perceived as less technology oriented:** SKF draws highest revenue from 2W segment and that too from wheel based applications. Those products are commoditized and margins are also low. In the aftermarkets, SKF India has to face the brunt of spurious products as well as Chinese competition. The company's lack of presence in the largest PV player in India for many years sans latest technology bearing and with Korean auto OEMs (2nd largest players) is viewed negatively by the market. This has impacted its valuations.
- **Revenue composition:** Timken India draws 25-30% from exports while 12-15% from MHCV both in OEM and aftermarket put together. Moreover, highly profitable Railway segment contributes 17-18%, these are higher margin segments. While SKF India draws 11% revenue from 2W which is mostly wheel based applications, 20% from auto OEMs, 7% from Railways and 8% from wind which are low to negative margin business. Schaeffler India draws the most of automotive revenue from engine, chassis and transmission applications which put the company in the better position than SKF India in terms of margin even after major portion is coming from OEM business. Higher margin exports has also reached to 17% share in revenue.

Exhibit 66: Average PE Ratio

Schaeffler India	3 year	5 year	10 year	SKF India	3 year	5 year	10 year	Timken India	3 year	5 year	10 year
Average PE (x)	29.3	30.1	31.2	Average PE (x)	32.7	31.8		Average PE (x)	42	37.1	36.6

Source: Bloomberg, Centrum Broking

Stress in exports and few pockets in the industrial space to put pressure on the revenue

Continued capex with long term objective of localization will lead to higher growth in depreciation as against growth in the revenue will result in sub optimal PAT growth

What is likely to change in favor of SKF in the next 12-18 months?

The reasons for premium valuations for Timken India and Schaeffler includes their focus on higher margin exports and critical application bearings for Railways, MHCV, Off-highway vehicles and heavy industries. The main revenue sources for Timken India and Schaeffler India (40-45% of the revenue) namely exports, MHCV and industrial segment have started showing visible signs of stress. In fact, exports growth has been negative for the last 2-3 consecutive quarters for these companies. Further, MHCV and many sectors in the industrial space (commodities, wind, etc.) are likely to face either cyclical slowdown or maintenance capex slow down due to stagnated capacity utilisation. Moreover, the managements have hinted at suboptimal to negative growth outlook for these segments in the near to medium term. However, their outlook has come much later than the numbers which have already started reflecting the weakness. Both segments together occupy more than 40% revenue share for both these companies. Hence, it will put pressure on revenue growth and thereby on margins for the current fiscal and the next one. Moreover, both these companies embark on major capex drive for the next 12-18 months. Any delay in recovery in exports market could further impact financial recovery. However, we have factored in turnaround from FY26E for these companies. SKF India, on the other hand, has very less presence in exports and in automotive space it is mainly present in 2W, which has shown a volume growth of 9% last year. The same will grow this year as well; albeit at low single digit. So, all in all, SKF will grow steadily over the next 12-18 months while other two might face some downturn. Additionally, SKF India has adopted indirect way to incur capex in the Industrial space by extending line of credit to unlisted subsidiary of parent in India, thereby, secured its balance sheet. Hence, we believe SKF India will outperform in the medium term and deserves some premium to its last 3-year average earnings multiple.

Exhibit 67: Comparing financial performance for last four years vs. next four years

CAGR for FY19 / CY18 to FY23 / CY22 (%)									
Particulars	Rev growth	EBIDTA growth	PAT Growth	Exports Growth	Avg. EBIDTA Margin	Avg. PAT Margin	Avg. Export revenue share	Avg. RoE	Avg. ROCE
Timken India	14	18	27	18	20.2	12.61	25.9	16.9	16.4
Schaeffler India	11	15	20	23	16.2	9.9	11.8	16.2	15.9
SKF India	9	11	12	15	15.0	11.1	8.7	20.0	19.9

CAGR FY23 / CY22 to FY27E / CY26E (%)									
Particulars	Rev growth	EBIDTA growth	PAT Growth	Exports Growth	Avg. EBIDTA Margin	Avg. PAT Margin	Avg. Export revenue share	Avg. RoE	Avg. ROCE
Timken India	13	12	7	5	19.2	11.9	21.6	16.3	16.1
Schaeffler India	7	7	4	10	18.3	11.8	15.8	18.2	18.0
SKF India	11	10	11	3	16.6	12.0	7.0	21.6	21.6

Source: Company Data, Centrum Broking

- **FY19-23:** For Timken and Schaeffler, the Total Asset Turn and Total Leverage have been lower than SKF despite the higher PAT and EBIDTA margin, and hence, RoE and RoCE have been lower than SKF.
- **FY23-27:** Schaeffler's avg. PAT margin is expected to improve in next 5-year vis-à-vis last five years. If you remove CY20 from the calculation, margin would have increased by 110bps. The company has amalgamated LUK and INA and hence the EBIDTA margin for CY18 and CY19 took a beating. However, post pandemic the company could recoup past erosion in margin and improve it subsequently. In fact, the net margin has been 12.8% for CY22 which will go down and settle at 11%.
- **FY23-27:** For Schaeffler India, despite the EBIDTA and PAT margin expansions, the PAT CAGR has been muted due to almost halving of revenue CAGR to 7% and increase in depreciation at a CAGR of 16% vs. revenue and EBIDTA CAGR of 7% and 7%, respectively.

- **FY23-27:** For Timken India, lower revenue CAGR, higher depreciation and decline in other income will result in lower PAT CAGR (in FY23, the forex gains of Rs220mn in Rs531mn other income) between FY23 to FY27.

Exhibit 68: Average PE ratio

Schaeffler India	3 year	5 year	10 year	SKF India	3 year	5 year	10 year	Timken India	3 year	5 year	10 year
Average PE (x)	29.3	30.1	31.2	Average PE (x)	32.7	31.8		Average PE (x)	42	37.1	36.6

Source: Bloomberg

SKF India: The company has the most diversified revenue stream amongst peers with hardly any sub-sector or sub-segment having double digit share in the total revenue. Despite the cyclical business, the company has always been profitable both on the operating and net level over CY96-FY23. The company has generated positive cash flow from operations each year over the same period. The company remained net debt free since CY2006. The company enjoys strong technology support from parent. It has strong presence in the aftermarket and derives 35-40% revenue from aftermarket. The company is currently not at much risk of strong headwinds in revenue and margins. This has been on account of lesser exposure to exports vs. peers on one hand and drawing large revenue from 2W in auto space (30% of automotive segment), which has shown a volume growth of 9% last year. The same will grow this year as well. Additionally, SKF India has adopted indirect way to incur capex in the industrial space by extending line of credit to unlisted subsidiary of parent in India, thereby secured its balance sheet. Hence, we believe SKF India will outperform in the medium term.

We expect SKF to do better on account of domestic focus, improving localization, very less presence in exports, better revenue mix and growth, margin performance and return ratios vs. peers in the next two fiscals, and hence, deserves premium to the current 3-year avg. one year forward PE of 32.7x.

We assign current FY25E earnings multiple of 44x to 1HFY26E EPS of Rs131 to arrive at a Target Price of Rs5,764 and recommend ADD.

Exhibit 69: Average PE ratio

SKF India	3 year	5 year
Average PE (x)	32.7	31.8

Source: Bloomberg

Exhibit 70: SKF India - PE ratio

Source: Bloomberg, Centrum Broking

Exhibit 71: SKF India Financial Performance

Y/E March (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E	FY27E
Revenue	36,659	43,049	47,630	51,933	57,648	64,536
YoY (%)	37.3	17.4	10.6	9.0	11.0	11.9
EBITDA	5,555	7,494	7,995	8,648	9,447	10,890
EBITDA (%)	15.2	17.4	16.8	16.7	16.4	16.9
PAT	3,951	5,248	5,701	6,222	6,731	7,841
YoY (%)	32.7	32.8	8.6	9.1	8.2	16.5
FDEPS (Rs)	79.9	106.1	115.3	125.9	136.1	158.6
RoE (%)	22.9%	24.8%	22.1%	21.2%	20.1%	19.7%
RoIC (%)	28.1%	34.3%	29.3%	28.0%	29.5%	33.4%
P/E (x)	66.7	50.3	46.3	42.4	39.2	33.6
EV/EBITDA (X)	46.2	33.5	31.3	28.9	25.9	21.9
CFO	571	6,902	1,154	3,102	3,199	3,802
Free CF	245	6,453	49	2,263	2,410	3,263
FCF yield (%)	0.1	2.4	0.0	0.9	0.9	1.2
EBITDA to CFO conversion (%)	10.3	92.1	14.4	35.9	33.9	34.9
Cash Conversion Cycle (days)	68	75	69	75	77	77

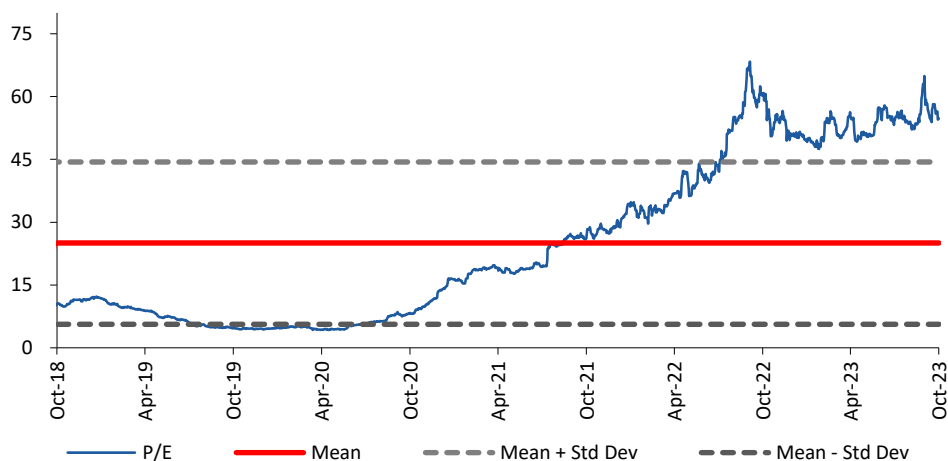
Source: Company Data, Centrum Broking

Schaeffler India: We have witnessed a YoY revenue decline in industrial segment and exports (together 47% of the revenue) in the latest few sequential quarters of CY23 which has resulted in muted 6% YoY revenue growth in 1HCY23. Schaeffler India draws the most of automotive revenue from critical and higher margin engine, chassis and transmission applications. The company commands higher EBITDA margin than its nearest competitor SKF India, despite the comparatively lower gross margin and higher share of OEMs in the automotive revenue. Higher margin exports have also reached to 17% share in the revenue. The company has shown improvement in localization level from less than 65% to now 75% over past few years. The market perceived amalgamation with LUK and INA as a sign of better corporate governance. All these have put Schaeffler India at a premium valuation than SKF India. However, taking clue from the last few consecutive quarterly results and the sound bites from the management expressing caution on H2CY23 performance and likely medium term stress in exports as well as in industrial space (both put together 47% of the revenue), we estimate decline in revenue growth rate and in margin resulting in marginal decline in PAT for the next two fiscals. However, ongoing capex will improve exports and industrial business in domestic market from CY25 onwards. And hence, we have valued the company based on its last 3-year average earning multiple to reflect the trust in its capabilities. We recommend Sell with TP of Rs1,684 (30x 1HCY25E EPS of Rs56).

Exhibit 72: Average PE ratio

Schaeffler India	3 year	5 year	10 year
Average PE (x)	29.3	30.1	31.2

Source: Bloomberg

Exhibit 73: Schaeffler India – PE Ratio

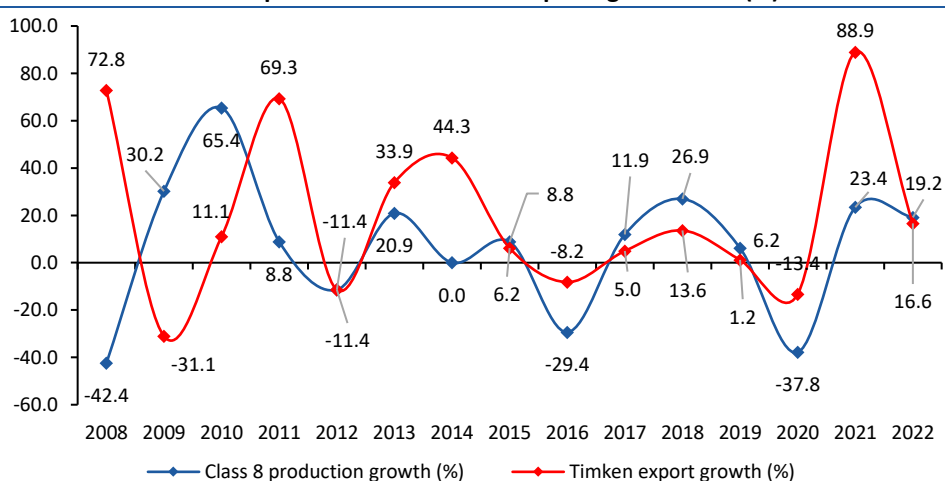
Source: Bloomberg, Centrum Broking

Exhibit 74: Schaeffler India Financial Performance

Y/E March (Rs mn)	CY21	CY22	CY23E	CY24E	CY25E	CY26E	CY27E
Revenue	55,605	68,674	70,516	74,056	81,824	91,195	1,02,391
YoY (%)		23.5	2.7	5.0	10.5	11.5	12.3
EBITDA	9,715	12,944	12,952	13,363	14,780	16,821	18,977
EBITDA (%)	17.5	18.8	18.4	18.0	18.1	18.4	18.5
PAT	6,291	8,792	8,552	8,375	9,146	10,420	11,763
YoY (%)		39.8	(2.7)	(2.1)	9.2	13.9	12.9
FDEPS (Rs)	201.3	56.3	54.7	53.6	58.5	66.7	75.3
RoE (%)	18.5%	21.8%	18.9%	16.7%	16.6%	17.0%	17.2%
RoIC (%)	27.1%	29.0%	24.9%	22.4%	23.1%	24.5%	25.7%
P/E (x)	80.2	57.4	59.0	60.3	55.2	48.4	42.9
EV/EBITDA (X)	50.5	37.8	37.7	36.4	32.7	28.5	25.0
CFO	4,647	7,505	9,916	10,048	10,422	11,857	13,205
Free CF	1,231	2,160	4,275	4,338	6,321	7,037	7,825
FCF yield (%)	1.2	0.4	0.8	0.9	1.3	1.4	1.6
EBITDA to CFO conversion (%)	47.8	58.0	76.6	75.2	70.5	70.5	69.6
Cash Conversion Cycle (days)	54	61	66	65	64	64	63

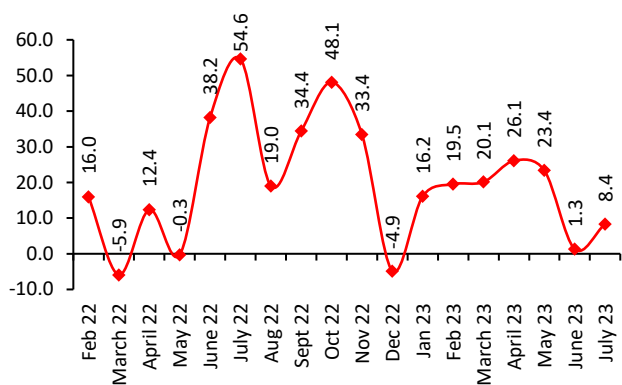
Source: Company Data, Centrum Broking

Timken India: Last three sequential quarters (Q3FY23, Q4FY23, Q1FY24) reported a huge YoY decline of 34%, 24% and 32% respectively in exports revenue which historically occupied 30% share in the revenue.. The management has cautioned stress in exports; albeit with some delay. Auto (20% of revenue), Aftermarkets (17% of revenue) and Industrial (excluding Railways) segment (17% of revenue) for Timken India shown signs of slowdown in the last two sequential quarters. We estimate an average YoY revenue growth of mid-single digit for these segments for FY24E and FY25E. Hence, around 45% of high margin revenue has been showing clear signs of sub optimal to negative growth which is reflected from last two sequential quarters as well as management's action of taking plant shut down putting forth reason of demand slowdown in the month of August 2023. Around 60% of the exports happened to US both for auto and industrial segment. Our analysis of Class 8 truck production and Timken India's export growth rate results in strong correlation of 0.6%; the chart below shows how Timken's exports revenue mimic Class 8 production graph with certain lag.

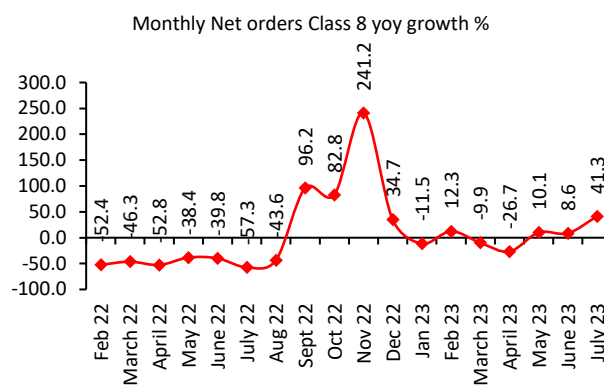
Exhibit 75: Class 8 annual production vs. Timken exports growth rate (%)

Source: Industry Data, Centrum Broking

Furthermore, sentiment indicator data point of Monthly Net Orders and YoY growth in monthly production for the past 18 months have been volatile for Class 8 in US also shows weak sentiments as reflected in charts.

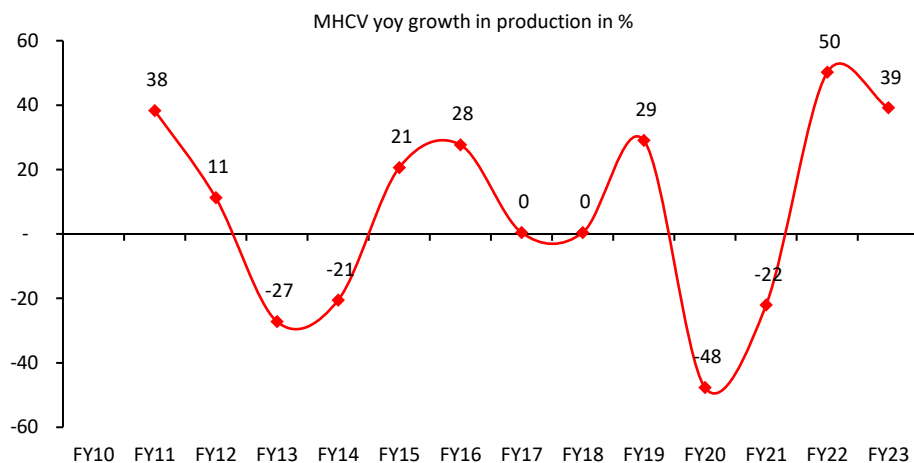
Exhibit 76: Production of Class 8 trucks is in slow lane (%)

Source: Industry, Centrum broking

Exhibit 77: Sentiment indicator has also been volatile

Source: Industry, Centrum broking

In the domestic automotive space, MHCV in auto is expected to undergo cyclical show down in the next two fiscals as per the historical performance. CV production in Q1FY24 declined 1% YoY.

Exhibit 78: MHCV annual YoY growth in production in %

Source: Industry, Centrum Broking

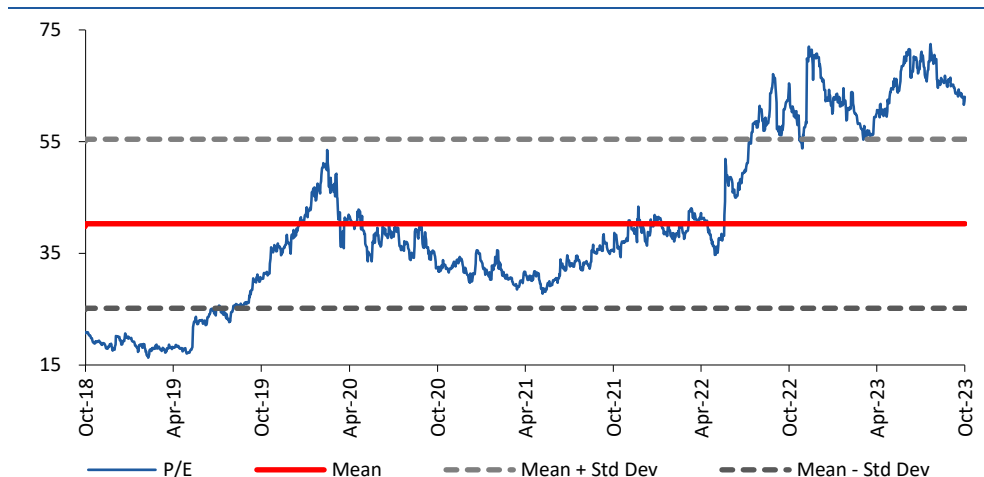
Estimated MHCV and exports decline put Timken at the risk of flat to marginal revenue growth for FY24E and FY25E with compressions in margin resulting in YoY decline in PAT for FY24E and FY25E. We believe that current valuations (55x FY26E earnings) are not adequately reflecting the tough period ahead. However, strong bounce back on account of new capacity coming on stream for SRB and CRB, which otherwise Timken India didn't have in its quiver, would allow Timken India to expand its own manufactured product range and thereby capture additional revenue both in domestic and export markets. Hence, despite the medium term turbulence, Timken can regain its mojo from FY26E. And hence, we have valued the company based on its last 3 year average earning multiple to reflect the trust in its capabilities. We recommend Sell with TP of Rs2,222 (42x 1HFY26E EPS of Rs53).

Exhibit 79: Average PE Ratio

Timken India	3 year	5 year	10 year
Average PE (x)	42	37.1	36.6

Source: Bloomberg

Exhibit 80: Timken India - PE Ratio



Source: Bloomberg

Exhibit 81: Timken India Financial Performance

Y/E March (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E	FY27E
Revenue	22,032	28,066	30,293	33,049	39,051	45,573
YoY (%)	56.2	27.4	7.9	9.1	18.2	16.7
EBITDA	5,107	5,604	5,740	6,205	7,385	8,772
EBITDA (%)	23.2	20.0	18.9	18.8	18.9	19.2
PAT	3,271	3,907	3,692	3,617	4,343	5,200
YoY (%)	128.5	19.5	(5.5)	(2.0)	20.1	19.7
FDEPS (Rs)	43.5	51.9	49.1	48.1	57.7	69.1
RoE (%)	21.8%	21.2%	16.7%	14.1%	14.7%	15.2%
RoIC (%)	21.4%	20.1%	16.5%	14.0%	14.6%	15.1%
P/E (x)	70.4	58.9	62.3	63.6	53.0	44.3
EV/EBITDA (X)	45.1	40.8	39.9	36.6	30.4	25.1
CFO	329	3,412	3,900	4,277	4,074	4,755
Free CF	(432)	2,940	(350)	1,776	3,274	3,855
FCF yield (%)	(0.2)	1.3	(0.2)	0.8	1.4	1.7
EBIDTA to CFO conversion (%)	6.4	60.9	67.9	68.9	55.2	54.2
Cash Conversion Cycle (days)	116	123	121	121	118	121

Source: Company Data, Centrum Broking

Risks

- Bearing is technology oriented product and Indian listed subsidiaries pay royalty on the sales for technical knowhow to the parent. Any large upward revision in the rate would put margins under pressure.
- Localization capex is undergoing at rapid pace. Any non-commensurate increase in revenue could impact margins and return ratios.
- Most of the leading companies have 25-35% of the revenue from traded goods. The margins in this segment is governed by transfer pricing rules. These rules are open to interpretation, and thereby stokes litigations. It is very difficult to predict margins on this portion of the revenue.
- Steel alloys form more than 55-60% of the cost of the product. These are special alloys for which supply chains have been localised to certain extent. However, any disruption in the supply and/or prices can potentially damage the financial growth of the companies.
- The arrangement of selling in India only through listed entity can be changed and unlisted subsidiaries of parent companies can start competing with respective listed entities.

SKF India

Localization is the key

SKF India is the 2nd largest and most diversified player with an estimated market share of ~22% each in the domestic organised bearings market and in the largest category - ball bearings segment (50-55% of bearing industry). None of the sub-sectors contribute more than 10% to the revenue. The company has guided for double digit growth for the current and the next fiscal. We believe this might be on account of the lower presence in the stressed export market and contracts on hand in the domestic market. The company is positive on PV, LCV, and 3W space for the current and the next fiscal. On industrial front, company is positive on Drives space, which includes products like pumps, compressors, motors, fluid power, etc. We expect SKF India to outperform its peers till FY25E on account of domestic focus, higher localization, very less presence in exports, better revenue mix & growth, margin performance and return ratios. We estimate FY23-26E revenue CAGR of 10% and PAT CAGR of 9%. Thus, SKF India deserves premium to the current 3-year average one year forward PE of ~33x. We assign current FY25E earnings multiple of 44x to 1HFY26E EPS of Rs131 to arrive at a Target Price of Rs5,764 (10% upside) and recommend ADD.

FY23-26E to witness revenue CAGR of 10% led by Drives segment

Industrial segment revenue grew 15% YoY in Q1FY24 led by 30% growth in the railway business. The company expects the same to continue for rest of FY24E. Moreover, it is witnessing a strong demand in drives sector (pumps, compressors, motors, etc.) in industrial space; and in the automotive segment, the company is seeing growth in PV, 2W, 3W and LCV business. We estimate revenue CAGR of 10% for FY23-26E period.

FY23-26E to see EBITDA margin at 16.6%

EBITDA margin witnessed an improvement of ~500bps over CY12 to FY23 from 11-12% to 16-17%. This can be attributed to localization, change in distribution strategy, rationalization of freight and other costs, savings on cycle time, improved sales mix, etc. The long-term guidance is for 16-20% range. Calculated trading margin for FY23 at 26% would more or less be maintained till FY26E. We estimate FY23-26E EBITDA margin at 16.8% on stable gross & trading margins and controlled operating cost.

Network expansion and higher services revenue growth till FY26E

Focus on aftermarkets has resulted in doubling of distributors from 300 to 700 between FY19-23. It would aid revenue growth in higher margin aftermarkets. The services revenue to clock a higher CAGR of 23% led by more contract wins in Rotating Equipment Performance (REP).

Localization of industrial bearings to improve from 35% level to more than 60%

Localization of industrial bearings (mostly in unlisted subsidiary of parent) will be a major step in improving revenue share of industrial bearings to targeted 70% from the current level of ~50%. The company is making efforts to increase the localization from current 35% to more than 60% over next few years. It has already achieved 95% localization level in automotive segment.

Financial and valuation summary

YE Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenues	36,659	43,049	47,630	51,933	57,648
EBITDA	5,555	7,494	7,995	8,648	9,447
EBITDA margin (%)	15.2	17.4	16.8	16.7	16.4
Adj. Net profit	3,951	5,248	5,701	6,222	6,731
Adj. EPS (Rs)	79.9	106.1	115.3	125.9	136.1
EPS growth (%)	32.7	32.8	8.6	9.1	8.2
PE (x)	65.6	49.4	45.4	41.6	38.5
EV/EBITDA (x)	45.9	33.3	31.1	28.7	25.7
PBV (x)	13.7	11.1	9.2	8.5	7.1
RoE (%)	22.9	24.8	22.1	21.2	20.1
RoCE (%)	23.0	24.9	22.2	21.2	20.1

Source: Company, Centrum Broking

Please see Disclaimer for analyst certifications and all other important disclosures.

Initiating Coverage

India | Indian Bearing Sector

12 October 2023

ADD

Price: Rs5,242

Target Price: Rs5,764

Forecast return: 10%

Institutional Research

Market Data

Bloomberg:	SKF IN
52 week H/L:	5,535/3,960
Market cap:	Rs259.1bn
Shares Outstanding:	49.4mn
Free float:	47.4%
Avg. daily vol. 3mth:	30,486

Source: Bloomberg

SKF relative to Nifty Midcap 100



Source: Bloomberg

Shareholding pattern

	Jun-23	Mar-23	Dec-22	Sep-22
Promoter	52.6	52.6	52.6	52.6
FII	6.4	6.5	6.5	6.4
DII	29.4	29.1	29.0	29.0
Public/other	11.6	11.8	12.0	12.0

Source: BSE



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Thesis Snapshot

Centrum vs. consensus

YE Mar (Rs mn)	Centrum FY24E	Consensus FY24E	Variance (%)	Centrum FY25E	Consensus FY25E	Variance (%)
Revenue	47,630	48,648	(2.1)	51,933	55,365	(6.2)
EBITDA	7,995	8,589	(6.9)	8,648	9,944	(13.0)
PAT	5,701	6,348	(10.2)	6,222	7,875	(21.0)

Source: Bloomberg, Centrum Broking

SKF India versus NIFTY Midcap 100

	1m	6m	1 year
SKF IN	(0.8)	22.4	13.2
NIFTY midcap 100	(1.7)	37.8	34.6

Source: Bloomberg, NSE

Key assumptions

YE Mar	FY24E	FY25E	FY26E
YoY Growth %			
Total Exports (FOB)	5	(2)	5
Total Auto	9	8	8
Total Industrial	12	12	13
Sale from Service	30	15	25
Other operating income	15	10	15

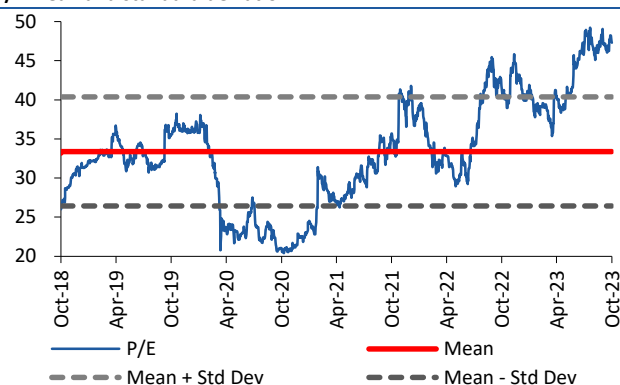
Source: Centrum Broking

Valuations

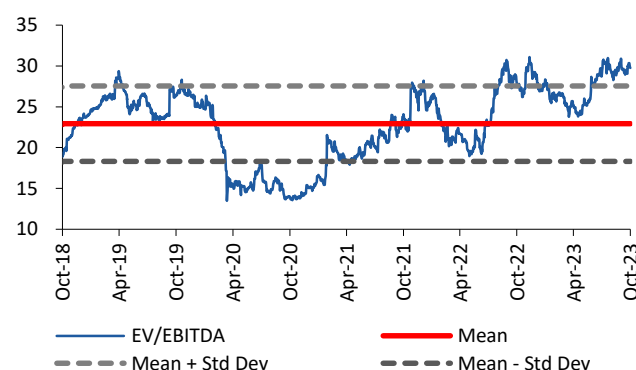
The company is estimated to achieve double digit revenue growth with lesser contraction in margins on account of the lower presence in the stressed export market and contracts on hand in the domestic market till FY25E. We estimate FY23-26E revenue CAGR of 10% and PAT CAGR of 9%, and hence, SKF deserves premium to the current 3-year average one year forward PE of ~33x. We assign current FY25E earnings multiple of 44x to 1HFY26E EPS of Rs131 to arrive at a Target Price of Rs5,764 and recommend ADD.

Valuations	Rs/share
1H FY26E EPS	131
Last 3 year average PE (x)	33
Target Multiple (Current FY25E) (x)	44
Target price (Rs)	5,764

P/E mean and standard deviation



EV/EBITDA mean and standard deviation



Source: Bloomberg, Centrum Broking

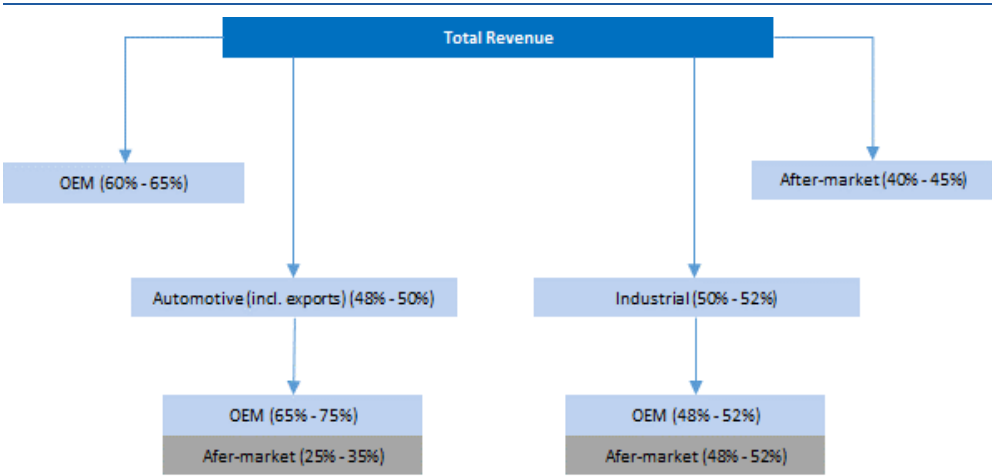
Peer comparison

Company	Mkt Cap (Rs mn)	CAGR (CY22/FY23-CY25E/FY26E)			P/E (x)			EV/EBITDA (x)			CY22/FY23	
		Sales	EBITDA	EPS	CY23E/FY24E	CY24E/FY25E	CY25E/FY26E	CY23E/FY24E	CY24E/FY25E	CY25E/FY26E	RoE (%)	ROCE (%)
Schaeffler India	5,04,693	6.0	5.0	1.0	56.9	58.1	53.2	36.3	35.1	31.5	21.8	21.5
SKF India	2,60,845	10.0	8.0	9.0	45.8	41.9	38.8	31.3	28.9	25.9	24.8	24.9
Timken India	2,08,046	11.6	9.6	4.0	62.3	63.6	53.0	39.9	36.6	30.4	21.2	20.1

Source: Company Data, Centrum Broking

Revenue break-up and business structure

Exhibit 82: OEM and Industrial revenue evenly placed



Source: Company Data, Centrum Broking

Investment rationale

The largest player in Deep Groove Ball Bearing (DGBB) with most diversified revenue stream

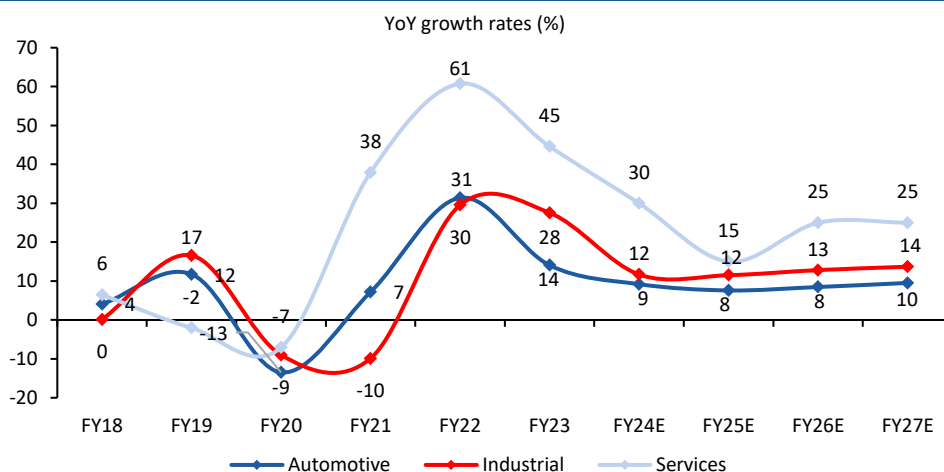
SKF India is the largest player in the aftermarkets in India. It faces a lot of competition from Chinese spurious products specially on wheel based applications

We believe, SKF India to clock highest PAT CAGR till FY25E amongst peers

SKF India is the largest player in DGBB segment with market share of ~22%. The company has the most diversified revenue stream with none of the sub-segments of either automotive or industrial verticals contributing more than 10% to the revenue. The company serves more than 40 industries. However, the company faces tough competition from spurious products and imports from China in the aftermarkets at lower end of the price points especially on wheel applications and domestic appliances categories. The company is one of the largest organised players in aftermarkets with an estimated 35-40% revenue coming from aftermarkets and 60-65% from OEMs.

We estimate a revenue CAGR of 11% between FY23-27E for SKF India led by steady average 9% revenue growth in the automotive segment and average 15.5% revenue growth of industrial segment while services sector will clock average revenue growth of 28% over FY23-27E.

Exhibit 83: Segmental revenue growth rates; Services segment to grow at highest rate

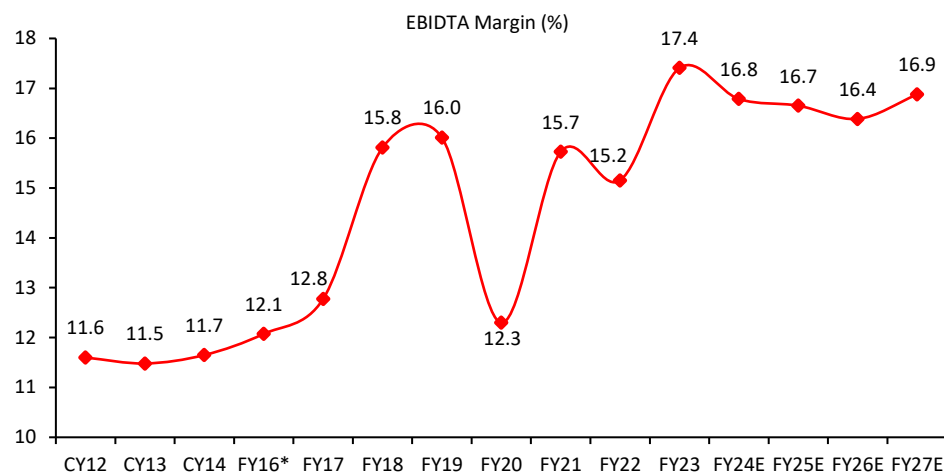


Source: Company Data, Centrum Broking

SKF India witnessed huge margin expansion over the past 10 years; will sustain the trend

EBIDTA margin expansion of over 500bps over the last decade is the consortium of many factors

Reasons for margin expansion in last 10 years includes localization, Indian Distribution Center – regional warehouse started in Pune to avoid imports from Singapore for industrial bearings to save on cycle time, efforts made for rationalization of freight and related costs along with improved sales mix. Furthermore, an expansion in the EBITDA margin over the past 10 years could be attributed to – (a) Change in structure of the business, (b) Focus shifting to higher profitability products, (c) Focus on aftermarket by improving penetration and, (d) readiness of the customer to pay premium pricing for quality and assured supply with least lead time. This change has become more prominent post pandemic due to supply chain disturbance experienced by the clients, and (e) margin improvement on traded goods governed by transfer pricing rules.

Exhibit 84: EBITDA margin trajectory for last 15 years

Source: Company Data, Centrum Broking

Growth drivers for FY24E and beyond – drives space led by infrastructure, and automotive aftermarket

Growth drivers include drives business on industrial side; PV, 3W, LCV on automotive side and improving market penetration on aftermarkets side

The company believes that long term India growth story is going to be infrastructure led. Accordingly, they are focusing on segments which will get influenced. The company is positive on sectors like heavy industry, construction, drives, which are basically pumps, motors, fluid power, textiles, etc. The company believes these sectors will grow at a much faster pace compared to other sectors. The company is making significant investments in the industrial space. In the automotive space, the company is positive on 3W, PV and LCV. The company follows the strategy of reach, range and availability, which is auguring well for growth in the automotive aftermarket in a big way. The penetration in the automotive aftermarket was earlier around 50% which has now increased to 70%. The management experienced that availability can play a very important role in the aftermarket. Hence, it is closely working with the distributor network as well as retail network to create a strong availability at the distributor end, in order to improve its market share.

Unlisted entity (SKF Engineering) is aiding SKF India; not detrimental to minority shareholders

There is no overlap of any products between the two companies. Hence, large size industrial bearings and certain sizes of TRB gets manufactured in SKF Engineering and not in SKF India.

There are various advantages for the clients of SKF India, as they can save on import duty and logistics cost. The biggest advantage to industrial OEM clients is inventory reduction and cut in lead time. There is reduction of 8-weeks in the delivery schedule to the clients post localization of production in industrial segment as against imported route. SKF could offer wider range of products and services. There is no overlap of any products between the two companies. Hence, large size industrial bearings and certain sizes of TRB (tapered roller bearings) gets manufactured in SKF Engineering (unlisted entity) and not in SKF India. For example, TRB up to 200mm are manufactured in SKF India while TRB of at least 400mm are manufactured in SKF Engineering.

Almost 40% revenue for SKF Engineering comes from lubricants while 60% from industrial and seals.

At present, SKF Engineering is running on low capacity utilizations owing to the sharp drop in demand from the wind segment globally over the past five years. Further, SKF Engineering had to revamp its product offerings and currently has a revenue of ~Rs7bn of which 60-65% share come from supplies to SKF India and balance being exports to US railways. A 40% revenue comes from lubricants while 60% from industrial and seals.

Exhibit 85: SKF India has a total 14% of traded revenue coming from SKF Engineering

Particulars	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23
Total Traded Revenue	13,335	11,807	10,847	13,326	12,987	11,257	15,540	20,948
YoY growth %		(11.5)	(8.1)	22.9	(2.5)	(13.3)	38.0	34.8
Purchase from SKF Engineering	1,435	1,714	1,312	1,701	2,137	1,512	2,356	3,023
YoY growth %		19.4	(23.5)	29.7	25.6	(29.3)	55.8	28.3
as a % of traded revenue	10.8	14.5	12.1	12.8	16.5	13.4	15.2	14.4

Source: Company Data, Centrum Broking

The option of merging with SKF Engineering is not feasible as the plant is having low utilization level and lubrication business has lower low

SKF India has decided to extend line of credit to SKF Engineering worth Rs5 bn, out of that Rs1.20bn has been disbursed.

The loan has been extended as there is a capability difference between two entities and SKF India cannot make those products in listed entity. But it can trade into those products and thereby earn assured margin without blocking capital and clock higher RoCE

The company supplies to LHB coaches of Train 18, Vande Bharat, etc. It commands 30-40% share in the passenger coach and locomotive segments. However, it has almost negligible presence in freight application bearings

As per the annual report for FY23, the company has refurbished 16,905 bearings in FY23 and 20,179 bearings in FY22

However, SKF India has to work on its costing as railway business is a tender based business wherein price is the deciding factor to get the business

The option of merging with SKF Engineering is not feasible for two reasons i.e., lubrication sales are relatively much lower margin business compared to a bearing business and the utilization of that factory is relatively at a low end compared to what it should make.

SKF India extended line of credit to unlisted entity – a reasonable strategy

The company has been extending loans since the inception of unlisted entity at various points in time. These are transparent transactions and have been in the best interest of minority shareholders. The company has taken approval to extend line of credit to SKF Engineering upto Rs5bn, out of that Rs1.20bn has been disbursed. The tenure is 7-years, and the rate of interest is 7-year GSec+150bps. The company is setting up new channels within the same plant for specific products like SRBs, like medium sized DGBBs.

Why has the company extended the line of credit? There are benefits of that. One being there is a capability difference. SKF India, has a different set of capability versus a capability of unlisted entity. They can make large size bearings, whereas SKF India cannot. Even if SKF India decides to manufacture those large size bearings, they have to put in lot more money than what they would put in the unlisted entity, because they already have the capability.

And hence SKF India decided to incur capex in this unlisted entity for industrial bearings and thereby protect its balance sheet as industrial bearings are low volume, high cost and longer homologation products. Any sub optimal demand can create huge stress on financials of the listed entity. By trading in the industrial bearings produced in the unlisted entity, SKF India could have assured trading margin, no capital blocking for longer period and thereby higher RoCE.

The company is qualified to supply Class E and Class K bearings for freight applications

SKF India has strong presence in passenger coaches, locomotives and metro side of the business. The company supplies to LHB coaches of Train 18, Vande Bharat, etc. It commands 30-40% share in the passenger coach and locomotive segments. The company has supplied Class K bearings for freight application for 32.5 tonne axle load wagons to be run on Dedicate Freight Corridor. SKF India is supplying grease seals for freight wagons and is the largest player in this product category. However, it has almost negligible presence in freight application bearing. The company has admitted that Railway is a low margin business for them. They are trying to restructure this business. The company has identified refurbishment of railway bearings as an emerging opportunity. As per the annual report for FY23, the company has refurbished 16,905 bearings in FY23 and 20,179 bearings in FY22. The company has established Solution Factories at four places in the premise of railways to avoid time lag and reduce logistic cost. Refurbishment of bearings is a good margin business. The company is further exploring the possibility of Rotating Equipment Performance (REP) or condition monitoring business opportunity with railways. The company believes, this value added or innovative service will help it secure more business in other products. However, SKF India has to work on its costing as railway business is a tender based business wherein price is the deciding factor to get the business. These bearings are getting manufactured in the unlisted entity in Ahmadabad which has got AAR certification (American Association of Railroads).

Exhibit 86: SKF India is marginal player in freight application bearing

Particulars	Product	Unit	2017
SKF India's Share in Freight wagon segment	CTRB	No	5823
		%	7

Source: Indian Railways, Centrum Broking

Exhibit 87: SKF India is the largest player in grease seal business

Particulars	Product	Unit	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Grease Seal	Seal	Nos	2,99,400	2,91,517	2,53,176	2,46,242	2,80,036	7,64,674	4,09,334	5,00,123	-	-	2,83,789		3,59,411
Order Size		Rs mn	69	108	70	68	80	219	119	148	0	0	72	0	166

Indian Railways, Centrum Broking

SKF India has an ambitious target of securing 15% of the revenue from Services segment

The business potential for other allied services and products is 10x the size of bearings market globally, as per experts. The companies use them as a tool for customer engagement. It also allowed SKF India to work together with client right from idea generation and designing

SKF India does not classify bearings sales arising by virtue of providing services into services segment

REP contracts are to ensure certain predetermined targets get achieved. It could be achieving speed, lesser downtime, lowering of emission, energy conservation, etc.

The company offers condition monitoring services, and predictive maintenance through Remote Diagnostic Center. The company runs algorithms and takes the help of artificial intelligence and machine learning along with sensors equipped bearings

The business potential for other allied services and products is 10x the size of bearings market globally, as per experts. SKF India is moving beyond bearings to complement with other services and products. The company is focusing on value creation for the customer. However, services segment is not offering very high revenue potential as compared to bearings at present. Its significance lies in the fact that these products and services offer an opportunity to SKF India to remain engaged with client for longer period of time. This also allowed SKF India to work together with client right from idea generation and designing. All these initiatives augur well in boosting bearings sales. SKF India does not classify bearings sales arising by virtue of providing services into services segment. This is the reason why revenue from services appears lower. Currently, revenue from services segment is 2.6% of the revenue. The company is targeting to take it to 15% of the revenue over a period of time.

The company has come out with a programme called Rotating Equipment Performance (REP) contracts whereby it enters into a contract with client to ensure certain predetermined targets get achieved. It could be achieving speed, lesser downtime, lowering of emission, energy conservation, etc. Now approach here is to provide total solution rather than just selling bearing. The purest form of REP contracts would be the contract in which SKF India assures performance enhancement to the client and thereby demanding a just share in the incremental gains. The company is targeting the clients wherein the cost of downtime or failure will be far more than the cost of bearing replacement.

The company offers condition monitoring services, predictive maintenance through Remote Diagnostic Center which they have established in 2018. The company runs algorithms and takes the help of artificial intelligence along with sensors equipped bearings at client's place to detect likely failure of bearings in terms of timing by analyzing temperature, vibrations, RPM, etc. SKF India provides solutions and services encompassing rolling bearings, seals, mechatronics, lubrication systems and other services like technical support, life cycle management, repairs, refurbishment & maintenance services, condition monitoring, asset efficiency optimization, engineering consultancy and training. All these solutions allow reduction in emission and improve efficiency of the plant and machinery under contract.

Exhibit 88: Services segment revenue growth would be highest on low base

Particulars							
Segment revenue (%)	FY21	FY22	FY23	FY24E	FY25E	FY26E	FY27E
SKF India	1.5	1.8	2.2	2.6	2.7	3.1	3.5
YoY revenue growth of							
Services segment (%)	FY21	FY22	FY23	FY24E	FY25E	FY26E	FY27E
SKF India	38	61	45	30	15	25	25

Source: Company Data, Centrum Broking

Transfer pricing rules govern the margin for revenue from traded goods

Transfer pricing use Net Margin Method by using reference margin of comparable industries

Transfer pricing margins are dynamic in nature and always depend on reference margins of comparable industries. The bearing companies have to do this exercise every year. Margins depend on overall economic condition in a particular country, sector, industry, etc. Prevalent margins are applied to the traded goods transaction.

Transfer pricing mechanism or regulations are used to determine the margins earned by trading entity. SKF India has 50% of the revenue coming from traded goods. Most of the other leading companies have 25-35% of the revenue from traded goods. These rules are open to interpretation, and thereby stoke litigations. It is very difficult to predict margins on this portion of the revenue. Transfer pricing margins are dynamic in nature and always depend on reference margins of comparable industries. The bearing companies have to do this exercise every year. Margins depends on overall economic condition in a particular country, sector, industry, etc. Prevalent margins are applied to the traded goods transaction. Margins under transfer pricing rules are determined in proportion to the risk assumed in the transaction. Major portion of the margin is retained by manufacturing company and rest by trading company. As per FY23 guidelines, the gross margin was in the range of 15-20% while net margin was in the range of 6-8%. This method is also called the Net Margin method. The margins over and above determined by transfer pricing rules would be retained by manufacturing company. The process keeps happening throughout the year and companies keep close watch on the rates in each transaction to see if they are deviating from the reference rate. The transaction for the year gets closed at the end of the

The principle followed in the transfer pricing mechanism is margins will be in proportion to the risks assumed

Out of 30-35% of localization of industrial bearings, 10% comes from in-house manufacturing in the listed entity itself while 15% is purchased from unlisted entity in India and rest 10% comes from supply chain localization

The company target to increase localization level to 60% for industrial bearings

year and won't get carried over in the next financial year. Although trading margins determined by transfer pricing rules are lower than manufacturing margins, it offers the protection from making any losses as it would be borne by manufacturer. Moreover, working capital won't get blocked for too long and it helps in improving ROCE (return on capital employed). Hence, traded goods are margin depletive but ROCE accretive. However, cost efficiency is a challenge for traded products, there is not much of an opportunity that the company can do to bring down cost. This is because the Net Margin method takes into account the cost for manufacturing company and selling price of trading company, and trading company has no control over manufacturing company's cost.

Localization level for automotive segment reached 95% while it is at 35% for industrial segment

Localization is not only confined to manufacturing but also to supply chain. SKF India started as an automotive bearing manufacturer and has been able to reach the localization level of 95%. However, industrial bearing is different business altogether than automotive. It is low in volume, longer on product homologation and takes more years to become profitable than automotive. Indian domestic market is not large enough for SKF India to undertake manufacturing of industrial bearings in the listed entity. Hence, industrial bearing manufacturing started in unlisted wholly owned subsidiary of parent SKF AB. This is first step in the localization of otherwise imported industrial bearings. Along with this, SKF India has also started manufacturing certain small size industrial bearings. Both put together, current level of localization has reached 35%. The related party transaction data analysis shows that 14-15% of the traded goods are sourced locally from unlisted entity while 10% is made in SKF India. Rest 10% localization has been on account of other components and alloy steel localization. The company aims to increase localization level in industrial bearings to 60% in the next few years. The advantages associated with localization includes lower cycle time, better availability of the product, savings on freight or logistic cost, etc.

Exhibit 89: Traded revenue details

Particulars	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23
Total Traded Revenue	13,335	11,807	10,847	13,326	12,987	11,257	15,540	20,948
YoY growth %		(11.5)	(8.1)	22.9	(2.5)	(13.3)	38	34.8
Purchase from SKF Engineering	1,435	1,714	1,312	1,701	2,137	1,512	2,356	3,023
YoY growth %		19.4	(23.5)	29.7	25.6	(29.3)	55.8	28.3
as a % of traded revenue	10.8	14.5	12.1	12.8	16.5	13.4	15.2	14.4

Source: Company Data, Centrum Broking

SKF is incurring a capex of Rs1bn to Rs1.5bn for FY24E

Notably, 60-70% capex is for industrial segment while 20% is for auto, drives and construction segments. Further 20% will be for maintenance. Localization in indirect manner will keep balance sheet asset light; localization of steel has now reached 65%.

Improving footprint in the aftermarket

SKF India has been a leader amongst peers in terms of presence and reach in the aftermarket. However, the company is making continuous efforts to increase the reach. The annual report data shows the company has increased its numbers of distributors to 700 as of March 2023. The same was 125 in March 2016. The company is now present in 500 districts out of 700 odd districts in India.

Exhibit 90: Distributors network growth

Particulars	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23
Total No of distributors	125	125	200	300	440	455	680	700

Source: Company Data, Centrum Broking

Exports is not a priority but an opportunity to utilize spare capacity, if any

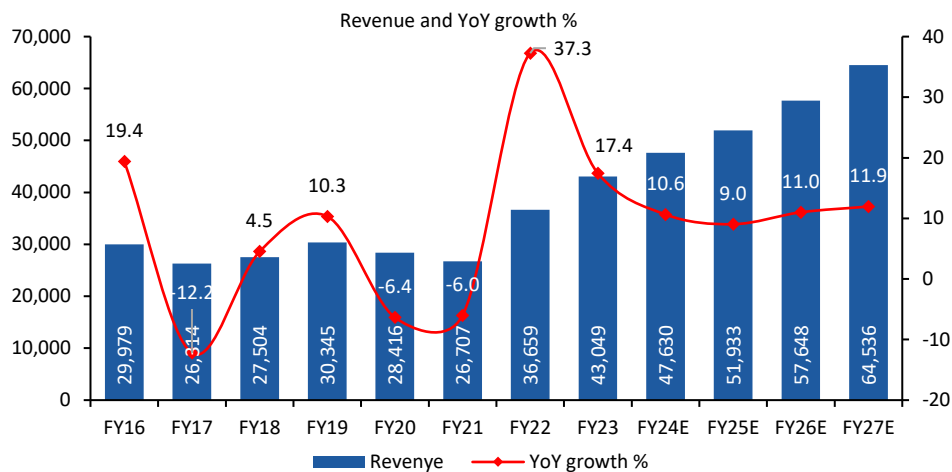
Exports is not the focus area for SKF; the group's philosophy is localization and regionalization. SKF India does not intend to export beyond Europe and South East Asia. SKF group has regionalized supply chain given the volatility seen in the last few years. India and South East Asia has been considered as one region and that is where SKF India predominantly focused on in terms of growing our market.

The company is not focused on exports. In fact, it looks for opportunities out of India only to keep its spare capacity working

Financial performance

Exhibit 91: Net sales and growth rate

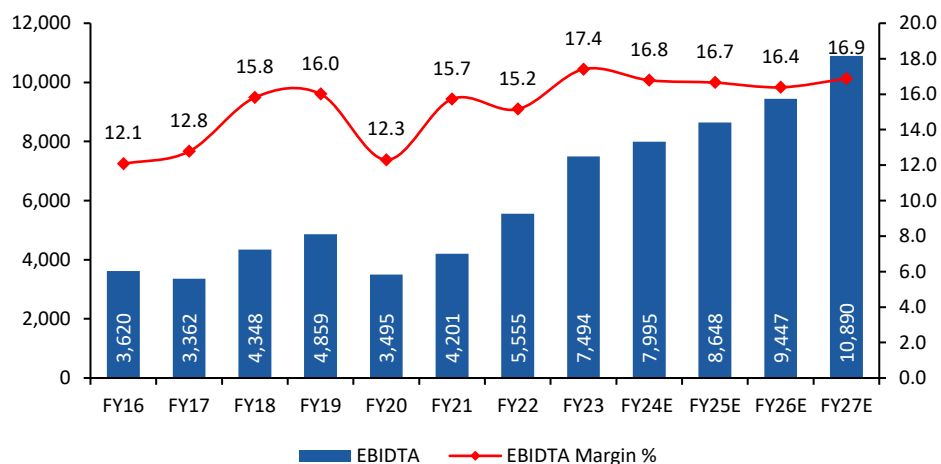
The company estimated to clock double digit YoY growth in FY24E and in FY26E



Source: Company Data, Centrum broking

Exhibit 92: EBIDTA and EBIDTA margin

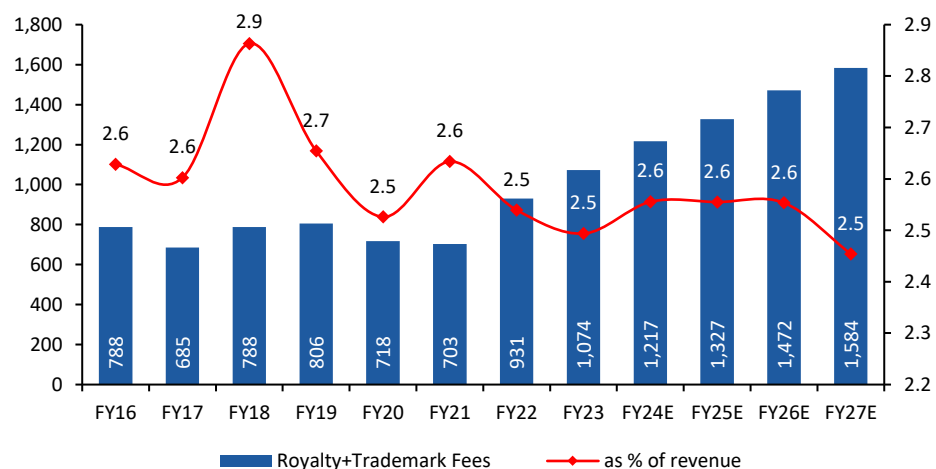
EBIDTA margin estimated to hover around 16.5%



Source: Company Data, Centrum broking

Exhibit 93: Royalty + trademark as % of revenue

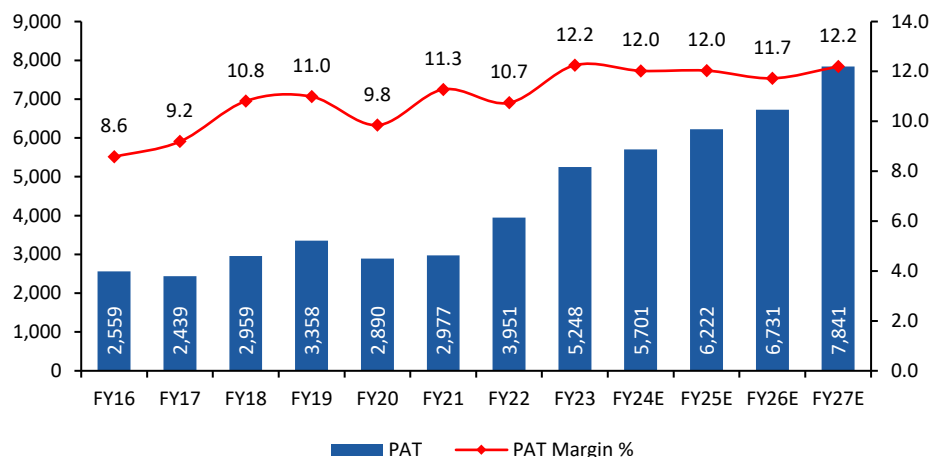
More localization would keep Royalty and trademark cost around 2.5% of the revenue



Source: Company Data, Centrum broking

Exhibit 94: PAT and PAT margin

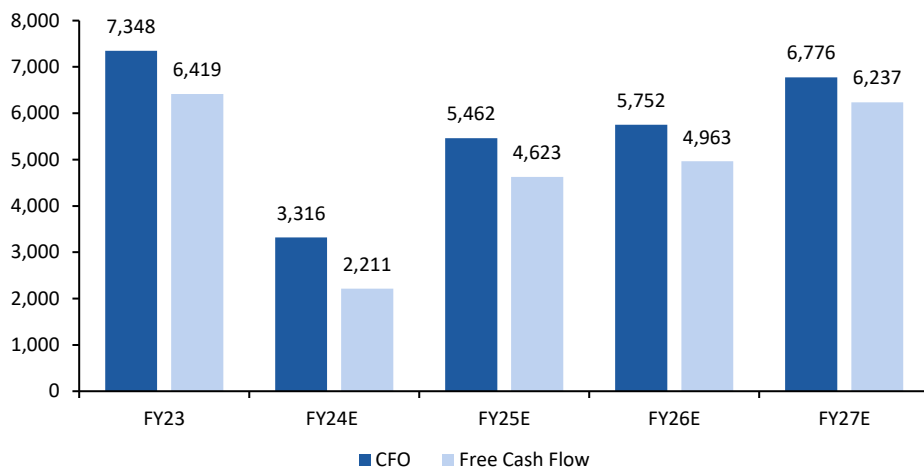
PAT margin would likely to remain around 12%



Source: Company Data, Centrum broking

Exhibit 95: Cash flow, Free Cash flow (Rs mn)

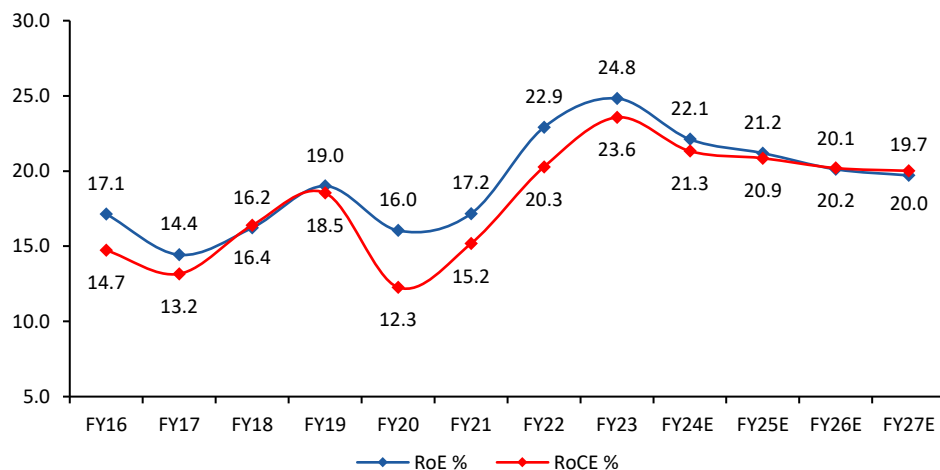
Healthy Cash Flow generation on account of steady profit growth and moderate capex



Source: Company Data, Centrum Broking

Exhibit 96: RoE and RoCE

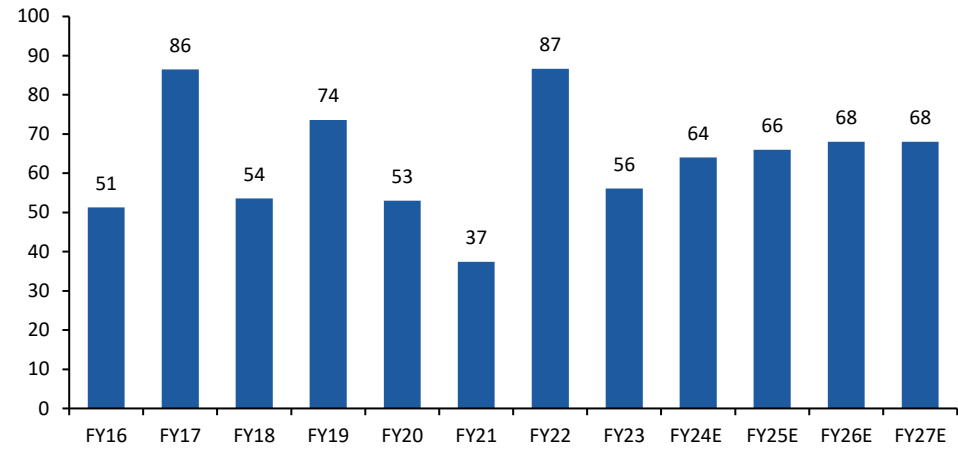
RoE and RoCE will have slight deceleration but would remain between 20-21% till FY26E



Source: Company Data, Centrum Broking

Exhibit 97: Cash conversion cycle (Days)

Slight increase in inventory days owing to India Distribution Center will keep cash conversion cycle around 65-68 days



Source: Company Data, Centrum broking

Outlook and valuation

The company has the most diversified revenue stream amongst peers with no sub-sector or sub-segment having double-digit share in the total revenue. Despite the cyclical business, SKF India has always been profitable both on the operating and net level over CY96-FY23. The company has generated positive cash flow from operations each year over the same period. The company remained net debt free since CY2006. The company enjoys strong technology support from parent. It has strong presence in the aftermarket and derives 35-40% revenue from aftermarket. The company is currently not at much risk of headwinds in revenue and margins on account of lesser exposure to exports vs. peers on one hand and drawing large revenue from 2W in auto space (30% of automotive segment) on the other, which has shown a volume growth of 9% last year. The same will grow this year as well. Additionally, SKF India has adopted indirect ways to incur capex in the industrial space by extending line of credit to unlisted subsidiary of parent in India, and thereby secured its balance sheet. Hence, we believe SKF India will outperform in the medium term.

We expect SKF India to do better on account of domestic focus, higher localization, very less presence in exports, better revenue mix and growth, margin performance and return ratios vs. peers in the next two fiscals, and hence deserves premium to the current 3-year average of one year forward PE.

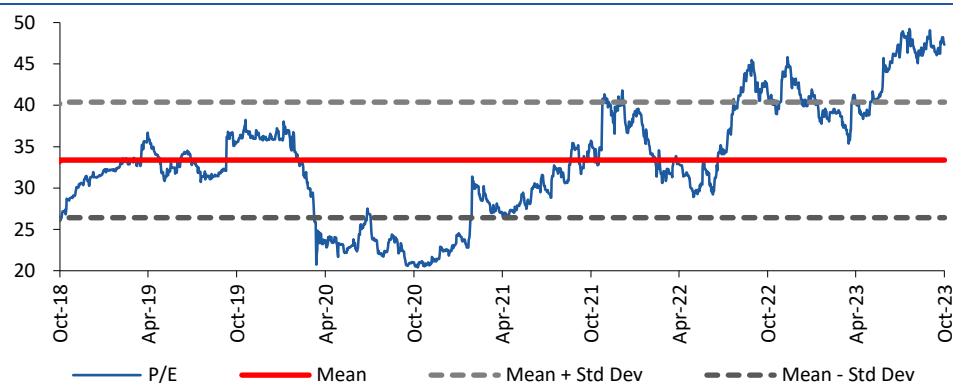
We assign current FY25E earnings multiple of 44x to 1H FY26E EPS of Rs131 to arrive at a Target Price of Rs5,764 and recommend ADD.

Exhibit 98: Average PE

SKF India	3 year	5 year
Average PE (x)	32.9	31.9

Source: Bloomberg

Exhibit 99: SKF India – PE Ratio



Source: Bloomberg

Exhibit 100: Financial Snapshot

Y/E March (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E	FY27E
Revenue	36,659	43,049	47,630	51,933	57,648	64,536
YoY (%)	37.3	17.4	10.6	9.0	11.0	11.9
EBITDA	5,555	7,494	7,995	8,648	9,447	10,890
EBITDA (%)	15.2	17.4	16.8	16.7	16.4	16.9
PAT	3,951	5,248	5,701	6,222	6,731	7,841
YoY (%)	32.7	32.8	6.9	9.1	8.2	16.5
FDEPS (Rs)	79.9	106.1	115.3	125.9	136.1	158.6
RoE (%)	22.9%	24.8%	22.1%	21.2%	20.1%	19.7%
RoIC (%)	28.1%	34.3%	29.3%	28.0%	29.5%	33.4%
P/E (x)	66.7	50.3	46.3	43.5	39.2	33.6
EV/EBITDA (X)	46.2	33.5	31.3	28.9	25.9	21.9
CFO	571	6,902	1,154	3,102	3,199	3,802
Free CF	245	6,453	49	2,263	2,410	3,263
FCF yield (%)	(0.4)	2.5	0.9	1.8	1.9	2.4
EBITDA to CFO conversion (%)	0.3	98.0	41.5	63.2	60.9	62.2
Cash Conversion Cycle (days)	68	75	69	75	77	77

Source: Company Data, Centrum Broking

Risks

- Notably, 50-60% cost of bearings is alloy steel. Inability of SKF India to pass on the rise in raw mat cost will result in margin erosion.
- SKF India faces the highest brunt of spurious product and Chinese imports on account of its presence in the aftermarkets and on non-critical application. Any disproportionate rise in those things will be detrimental for SKF India.
- SKF India is a net importer and it doesn't hedge. Any unfavorable currency movement will impact margins
- Royalty and trademark rates haven't been changed since long. Any large rise in those will put downward pressure on EBIDTA margin.
- Delay in introducing new technology and products may result in loss of market share.
- Prolonged slowdown in the economy.

P&L					
YE Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenues	36,659	43,049	47,630	51,933	57,648
Operating Expense	24,813	28,368	32,096	35,048	38,936
Employee cost	2,857	2,996	3,174	3,491	3,840
Others	3,433	4,191	4,365	4,746	5,425
EBITDA	5,555	7,494	7,995	8,648	9,447
Depreciation & Amortisation	571	668	803	895	966
EBIT	4,984	6,826	7,192	7,753	8,480
Interest expenses	21	15	15	15	15
Other income	162	159	200	200	200
PBT	5,310	7,329	7,864	8,582	9,284
Taxes	1,358	2,081	2,162	2,360	2,553
Effective tax rate (%)	25.6	28.4	27.5	27.5	27.5
PAT	3,951	5,248	5,701	6,222	6,731
Minority/Associates	0	0	0	0	0
Recurring PAT	3,951	5,248	5,701	6,222	6,731
Extraordinary items	0	0	0	0	0
Reported PAT	3,951	5,248	5,701	6,222	6,731
Ratios					
YE Mar	FY22A	FY23A	FY24E	FY25E	FY26E
Growth (%)					
Revenue	37.3	17.4	10.6	9.0	11.0
EBITDA	32.2	34.9	6.7	8.2	9.2
Adj. EPS	32.7	32.8	8.6	9.1	8.2
Margins (%)					
Gross	38.8	40.4	39.1	39.1	39.0
EBITDA	15.2	17.4	16.8	16.7	16.4
EBIT	13.6	15.9	15.1	14.9	14.7
Adjusted PAT	10.8	12.2	12.0	12.0	11.7
Returns (%)					
ROE	22.9	24.8	22.1	21.2	20.1
ROCE	23.0	24.9	22.2	21.2	20.1
ROIC	28.1	34.3	29.3	28.0	29.5
Turnover (days)					
Gross block turnover ratio (x)	4.9	5.2	5.0	5.0	5.1
Debtors	63	58	55	56	55
Inventory	93	97	93	97	98
Creditors	88	79	79	77	77
Net working capital	87	59	74	75	76
Solvency (x)					
Net debt-equity	(0.2)	(0.4)	(0.4)	(0.4)	(0.4)
Interest coverage ratio	267.1	496.3	529.5	572.7	625.6
Net debt/EBITDA	(0.7)	(1.3)	(1.4)	(1.3)	(1.7)
Per share (Rs)					
Adjusted EPS	79.9	106.1	115.3	125.9	136.1
BVPS	381.5	473.6	569.4	618.4	735.1
CEPS	91.5	119.7	131.6	144.0	155.7
DPS	14.5	40.0	20.0	20.0	20.0
Dividend payout (%)	18.1	37.7	17.3	15.9	14.7
Valuation (x)					
P/E	65.6	49.4	45.4	41.6	38.5
P/BV	13.7	11.1	9.2	8.5	7.1
EV/EBITDA	45.9	33.3	31.1	28.7	25.7
Dividend yield (%)	0.3	0.8	0.4	0.4	0.4

Source: Company, Centrum Broking

Balance sheet					
YE Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Equity share capital	494	494	494	494	494
Reserves & surplus	18,365	22,921	27,659	30,080	35,850
Shareholders fund	18,859	23,415	28,153	30,575	36,345
Minority Interest	0	0	0	0	0
Total debt	0	0	0	0	0
Non Current Liabilities	481	404	423	450	480
Def tax liab. (net)	0	0	0	0	0
Total liabilities	19,340	23,819	28,576	31,025	36,824
Gross block	7,544	8,354	9,593	10,432	11,221
Less: acc. Depreciation	(3,519)	(4,113)	(4,917)	(5,811)	(6,778)
Net block	4,025	4,241	4,676	4,620	4,443
Capital WIP	515	634	500	500	500
Net fixed assets	4,540	4,875	5,176	5,120	4,943
Non Current Assets	1,813	2,187	2,711	4,011	3,661
Investments	25	25	25	25	25
Inventories	6,768	6,860	7,921	8,851	10,063
Sundry debtors	6,857	6,787	7,569	8,252	9,161
Cash & Cash Equivalents	4,019	9,580	10,795	10,973	15,958
Loans & advances	400	0	0	0	0
Other current assets	1,503	1,259	1,259	1,259	1,259
Trade payables	5,085	6,079	6,420	7,000	7,771
Other current liab.	1,485	1,512	292	292	292
Provisions	238	371	376	383	391
Net current assets	12,740	16,525	20,456	21,660	27,987
Total assets	19,340	23,819	28,576	31,025	36,824

Cashflow					
YE Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Profit Before Tax	5,310	7,329	5,701	6,222	6,731
Depreciation & Amortisation	571	668	803	895	966
Net Interest	(163)	(345)	(472)	(629)	(603)
Net Change – WC	(3,614)	1,321	(2,716)	(1,026)	(1,342)
Direct taxes	(1,486)	(2,119)	(2,162)	(2,360)	(2,553)
Net cash from operations	571	6,902	1,154	3,102	3,199
Capital expenditure	(916)	(1,067)	(1,105)	(839)	(789)
Acquisitions, net	0	0	0	0	0
Investments	(72)	(17)	0	0	0
Others	662	635	0	0	0
Net cash from investing	(326)	(449)	(1,105)	(839)	(789)
FCF	245	6,453	49	2,263	2,410
Issue of share capital	0	0	0	0	0
Increase/(decrease) in debt	(42)	(51)	0	0	0
Dividend paid	(717)	(719)	(989)	(989)	(989)
Interest paid	(21)	(15)	(15)	(15)	(15)
Others	0	0	2,170	(1,080)	3,579
Net cash from financing	(780)	(786)	1,166	(2,084)	2,575
Net change in Cash	(535)	5,668	1,215	179	4,985

Source: Company, Centrum Broking

Timken India

Medium Term Headwinds

Timken India, the largest player in Tapered Roller Bearing (TRB), commands an overall share of 11% in the organized bearing market in India and ~40% in TRB segment. The company is experiencing decline in exports since past few quarters owing to inventory correction drive in United States (US) and in Europe which is expected to last for few more quarters. US contributes 60% to the exports. Certain sectors like wind, commodities, MHCV, etc. in the domestic market are also subdued; all put together it is 45-50% of the revenue. Hence, the growth and margin outlook till FY25E is estimated to be under cloud. The company took a plant shut down at Jamshedpur to realign its production schedule with falling demand. Taking note of these events, we estimate FY23-25E revenue and PAT CAGR of 9% and -4%, respectively. However, with commercialization of Rs6bn capex (2.5x Asset turn) and thereby entry in new Rs 40 bn SRB/CRB market, FY26E revenue and PAT are likely to report a YoY growth of 18% and 20%, respectively. Hence, despite the medium term turbulence, Timken India can regain its mojo from FY26E. Taking cognizance of the same, we have valued the company based on its last 3-year average earnings multiple to reflect the trust in its capabilities. We recommend Sell with TP of Rs2,222 (42x 1HFY26E EPS of Rs53).

After two excellent years, Timken India likely to face headwinds till FY25E

The company clocked a revenue and PAT CAGR of 41% and 38%, respectively over FY21-23. However, the growth momentum has been slowed down considerably since December 2022 quarter owing to stress in exports and in some pockets of industrial & automotive segments (wind, commodities and MHCV, etc.). The company blamed inventory correction drive for the same. Exports declined 25-34% YoY sequentially since December 2022 quarter. Gross margin compressed by 450-950bps YoY in the last four quarters till June 2023. The company took plant shut down owing to demand slowness. We have factored in these developments and estimate FY23-25E revenue and PAT CAGR of 9% and -4%, respectively.

Higher depreciation and subdued revenue growth to impact PAT growth till FY25E

Timken is doing a huge capex of Rs6bn (current Gross Block: Rs13bn). The gross block is expected to clock CAGR of 23% over FY23-25E resulting in depreciation CAGR of 32%. However, the revenue is estimated to grow at 9% CAGR only. Capex growth also led to rise in operating costs, leading to margins compression and negative PAT CAGR of 4%.

Uptick in performance could be seen from FY26E

Locally manufactured import substitutes new products – SRB and CRB likely to open a large Rs40bn p.a. domestic opportunity from FY26E. Likely end of inventory correction and cyclical uptick in Class 8 truck sales in US along with some revival in the subdued pockets of domestic industrial space could accentuate financial performance from FY26E. We estimate YoY revenue and PAT growth of 18% and 20%, respectively for FY26E.

Financial and valuation summary

YE Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenues	22,032	28,066	30,293	33,049	39,051
EBITDA	5,107	5,604	5,740	6,205	7,385
EBITDA margin (%)	23.2	20.0	18.9	18.8	18.9
Adj. Net profit	3,271	3,907	3,692	3,617	4,343
Adj. EPS (Rs)	43.5	51.9	49.1	48.1	57.7
EPS growth (%)	128.5	19.5	(5.5)	(2.0)	20.1
PE (x)	70.3	58.9	62.3	63.6	53.0
EV/EBITDA (x)	45.1	40.8	39.9	36.6	30.4
PBV (x)	13.9	11.3	9.6	8.4	7.3
RoE (%)	21.8	21.2	16.7	14.1	14.7
RoCE (%)	21.4	20.1	16.5	14.0	14.6

Source: Company, Centrum Broking

Initiating Coverage

India | Indian Bearing Sector

12 October 2023

SELL

Price: Rs3,060

Target Price: Rs2,222

Forecast return: -27%

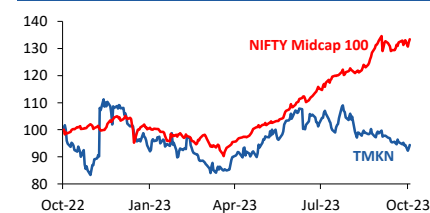
Institutional Research

Market Data

Bloomberg:	TMNK IN
52 week H/L:	3,761/2,626
Market cap:	Rs230.2bn
Shares Outstanding:	75.2mn
Free float:	39.6%
Avg. daily vol. 3mth:	78,764

Source: Bloomberg

TMNK relative to Nifty 50



Source: Bloomberg

Shareholding pattern

	Jun-23	Mar-23	Dec-22	Sep-22
Promoter	57.7	67.8	67.8	67.8
FII	6.6	4.0	4.3	3.9
DII	19.1	12.4	12.1	12.1
Public/other	16.6	15.8	15.8	16.2

Source: BSE

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Thesis Snapshot

Centrum vs. consensus

YE Mar (Rs bn)	Centrum FY24E	Consensus FY24E	Variance (%)	Centrum FY25E	Consensus FY25E	Variance (%)
Revenue	30,293	32,191	-5.9	33,049	37,935	-12.9
EBIDTA	5,740	6,675	-14.0	6,205	8,262	-24.9
PAT	3,692	4,610	-19.9	3,617	5,710	-36.6

Source: Bloomberg, Centrum Broking

TMKN India versus NIFTY Midcap 100

	1m	6m	1 year
TMKN IN	(5.5)	3.0	(6.8)
NIFTY midcap 100	(1.7)	37.8	34.6

Source: Bloomberg, NSE

Key assumptions

YE Mar	FY24E	FY25E	FY26E
YoY growth %			
Rail	19	25	30
Mobile	3	5	10
Distribution	6	7	8
Process	5	8	17
Intercompany /Exports	(15)	0	22

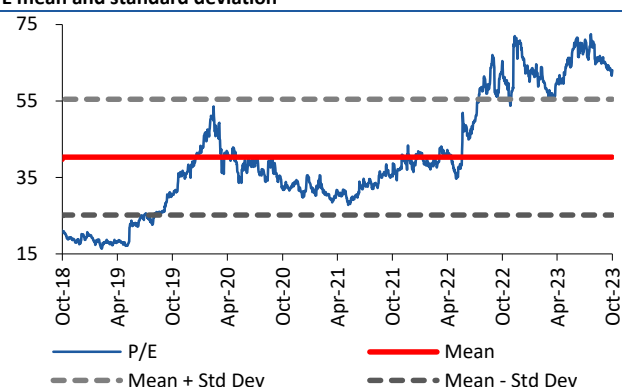
Source: Centrum Broking

Valuations

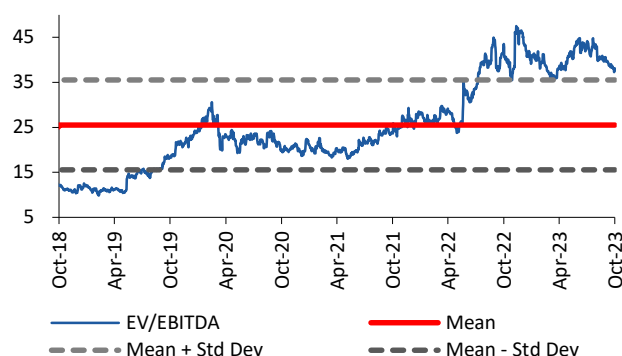
Sustained decline in exports since past few quarters and in industrial space in aftermarkets coupled with headwinds in the cyclical MHCV industry looming, we estimate Timken India to see deceleration in revenue and compression in margin. Ongoing capex will accelerate depreciation at higher rate than revenue growth till FY25E. However, commercialisation of capex will help revenue and PAT to clock ~20% YoY jump in FY26E. Taking cognizance of the same, we have valued the company based on its last 3-year average earning multiple to reflect the trust in its capabilities. We recommend Sell with TP of Rs2,222 (42x 1HFY26E EPS of Rs53).

Valuations	Rs/share
1H FY26E EPS	53
Last 3 year average PE (x)	42
Target Multiple (x)	42
Target price (Rs)	2,222

P/E mean and standard deviation



EV/EBITDA mean and standard deviation



Source: Bloomberg, Centrum Broking

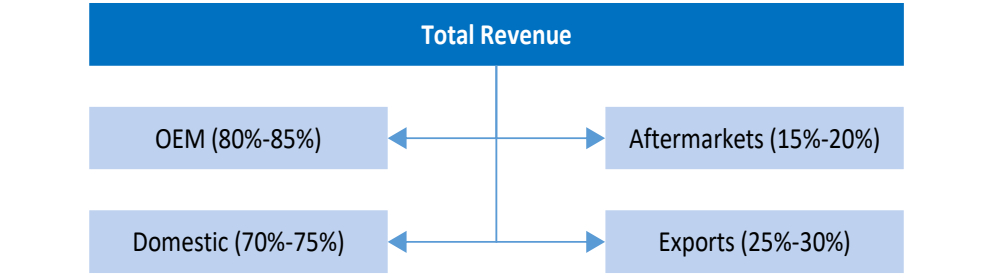
Peer comparison

Company	Mkt Cap	CAGR (CY22/FY23-CY25E/FY26E)				P/E (x)			EV/EBITDA (x)			CY22/FY23	
	(Rs mn)	Sales	EBITDA	EPS	CY23E/FY24E	CY24E/FY25E	CY25E/FY26E	CY23E/FY24E	CY24E/FY25E	CY25E/FY26E	RoE (%)	ROCE (%)	
Schaeffler India	5,04,693	6.0	5.0	1.0	56.9	58.1	53.2	36.3	35.1	31.5	21.8	21.5	
SKF India	2,60,845	10.0	8.0	9.0	45.8	41.9	38.8	31.3	28.9	25.9	24.8	24.9	
Timken India	2,08,046	11.6	9.6	4.0	62.3	63.6	53.0	39.9	36.6	30.4	21.2	20.1	

Source: Company Data, Centrum Broking

Revenue break-up and business structure

Exhibit 101: Timken India is more of a OEM and export player

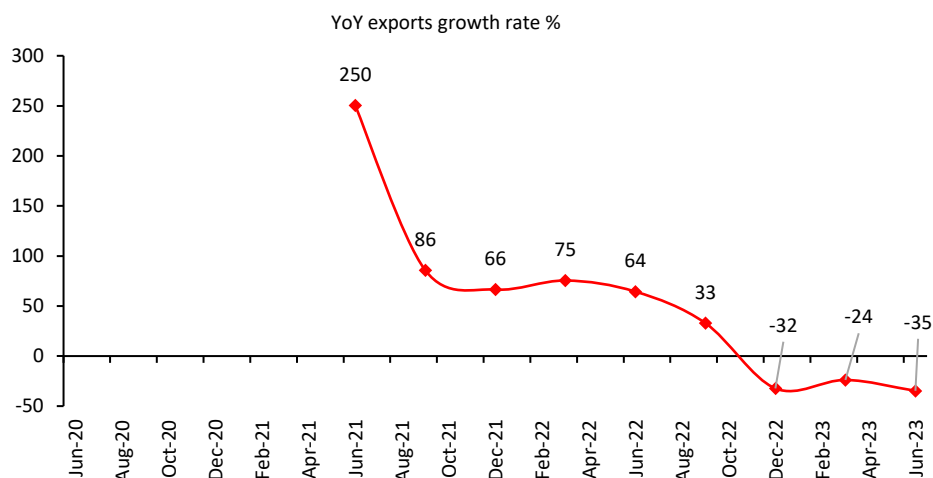


Source: Company Data, Centrum Broking

Export slowdown will persist

US occupies 60% share in exports, which is declining

Exhibit 102: Exports, which occupies 25-30% of revenue is declining since few quarters

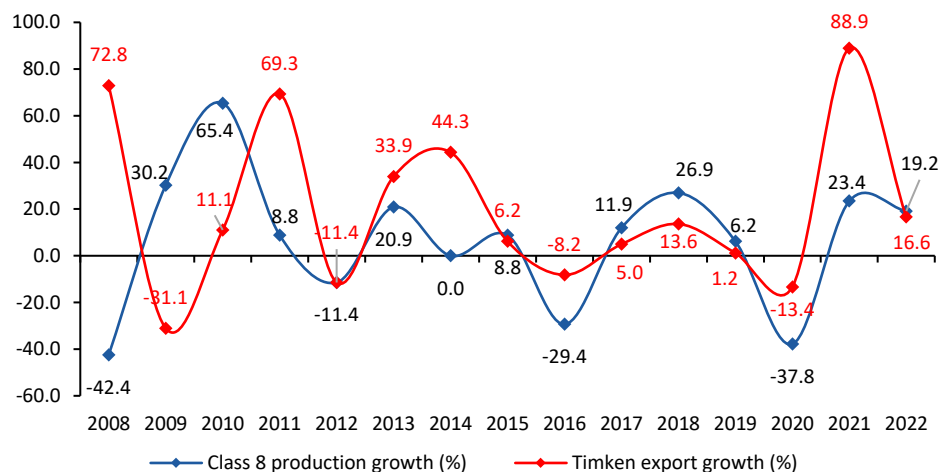


Source: Company, Centrum Broking

Class 8 Trucks are in slow lane. Correlation coefficient of Timken India's exports growth and Class 8 Truck growth is 0.6

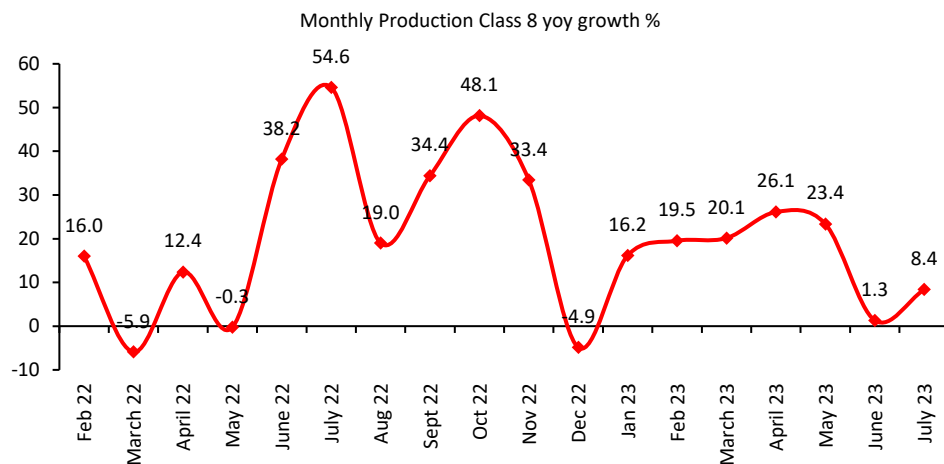
Timken India is the only net exporter amongst leading three players. The company draws 25-30% revenue from exports; 60% of the exports happens to US. Our analysis of Class 8 Truck production and Timken India's export growth rate results in strong correlation of 0.6. Since December 2022 quarter, YoY growth in exports has been negative. This is attributed to slowing down of demand in US on one hand and inventory correction drive on other. One of the reasons, as per management, has been softness in Class 8 Trucks business in the US. On analysing relationship between data on Class 8 trucks and Timken's export growth, we conclude that Timken's export revenue follows Class 8 Truck growth.

Exhibit 103: Long term pattern of YoY growth in Class 8 Trucks and Timken India's exports



Source: Industry, Centrum Broking

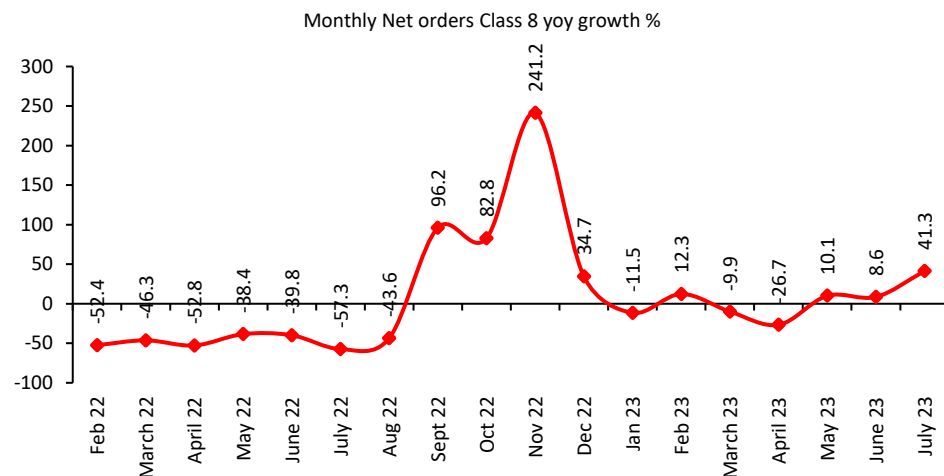
In the past 18 months, a YoY growth rate in monthly production of Class 8 Trucks has been very volatile, and it has come off in the past 3 months very sharply.

Exhibit 104: Monthly production growth rate for Class 8 Truck slowed down

Source: Industry, Centrum Broking

Sentiment indicator Monthly Net orders has come off from the peak and crawling

Another data point which is being monitored by analysts to understand the sentiments in Class 8 Truck segment is Monthly Net Orders. The YoY growth rate has been very volatile here as well and has been in negative zone for few months in the past 18 months.

Exhibit 105: Sentiment indicator data of Monthly Net orders has been crawling

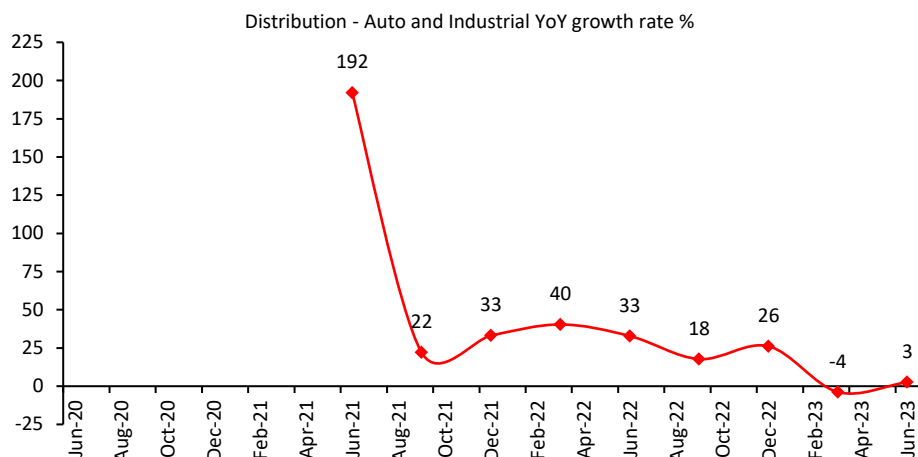
Source: Industry, Centrum Broking

All the above data points pointing towards weak outlook in the medium term.

Industrial and MHCV segment is struggling, mainly in aftermarkets

In addition to negative exports growth, few pockets in the industrial space have also been slowing down, which can be seen from the following chart showing YoY growth rate in quarterly revenue from auto - MHCV and industrial segments in aftermarket space. Timken India is present only in MHCV and off road vehicles in the country.

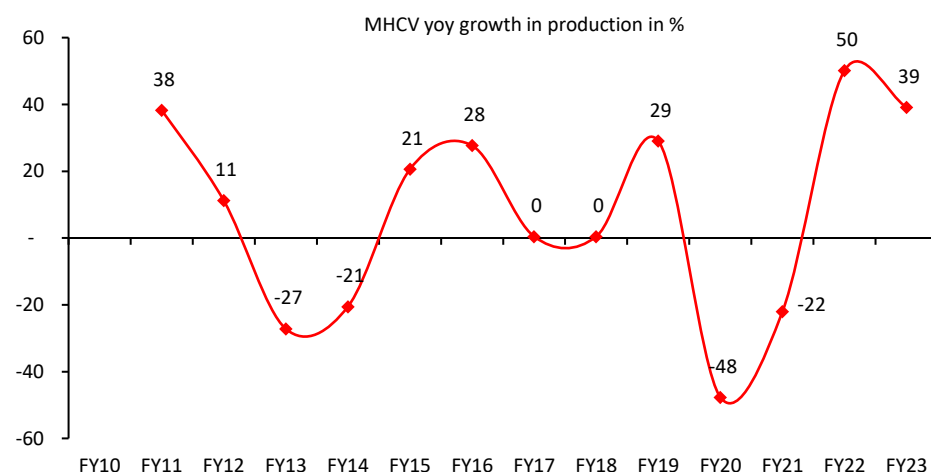
Exhibit 106: YoY revenue growth in quarterly aftermarket for MHCV and industrial segment



Source: Company, Centrum Broking

MHCV and certain pockets in the industrial space are struggling since past few quarters. Historical analysis suggests that MHCV follows cyclical pattern

Exhibit 107: Cyclicity in MHCV production over past 12 years

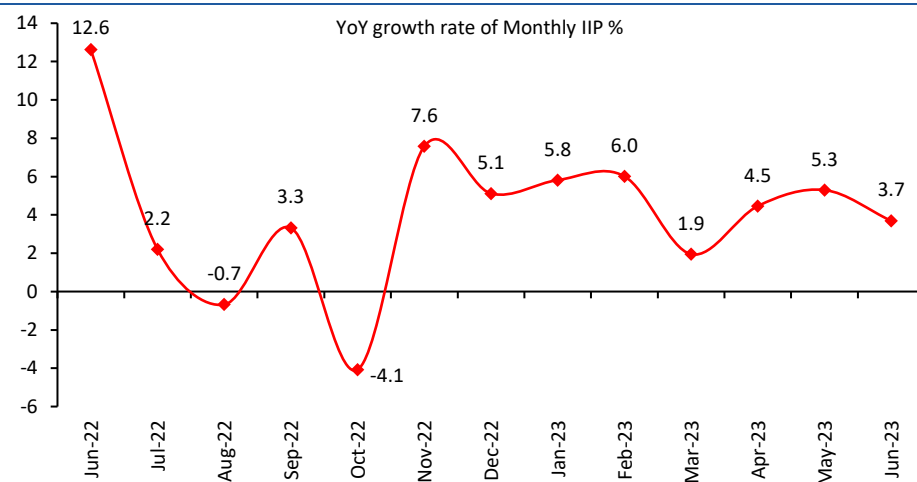


Source: Industry, Centrum Broking

MHCV has cyclical history. The upcycle and down cycle follows each other generally after a span of two years. In the absence of any trigger, there is likely down cycle in the next few months. The commodities sectors like steel and cement in the last few months are subdued. Even monthly IIP data has also been lackluster as depicted from the chart below.

Exhibit 108: Monthly IIP is also range bound with downward bias

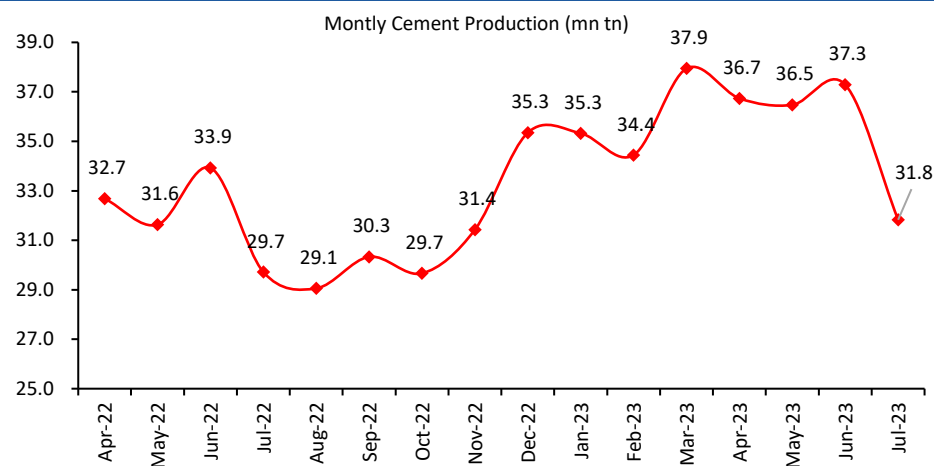
YoY growth in monthly IIP index has been low since past few month



Source: Industry, Centrum Broking

Exhibit 109: Monthly cement production is also range bound

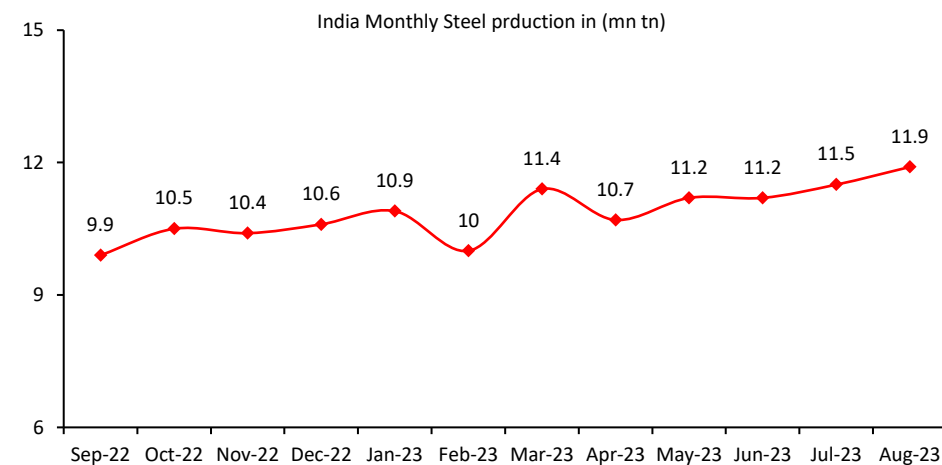
Monthly Cement production has also been range bound and utilization level has declined recently



Source: Industry, Centrum Broking

Exhibit 110: Monthly steel production is hovering around 11mn tonnes

Monthly Steel production hovering around 11 mn tonnes



Source: Industry, Centrum Broking

Plant shut down is a routine phenomenon; but reason for this time around is concerning

Took a plant shut down for 10 days in August sighting slow demand

The company took a plant shut down for ten days in the last week of August. Historically, it has taken such plant shut downs to realign its production schedule with OEM demand and implement cost management. However, the company has explicitly mentioned the reason as slowing down in demand. The management subsequently highlighted that shut down was also because of this weakness in export. However, the company has another objective of utilizing this lean period by finishing monthly production target in 20 days and close down the plant for maintenance work and save on various variable costs including power cost.

Recent stake sale by promoter won't have any impact on Timken India's commitment

Promoter recently offloaded ~10% stake

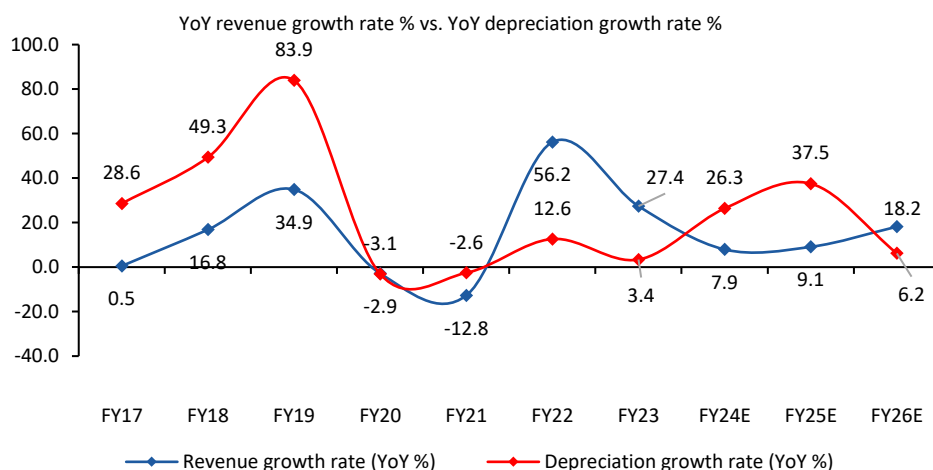
The reason given by the management for the stake sale by parent company is strategic in nature and nothing else. The promoter has offloaded ~10% stake and now holds 57.7% at a price of Rs3,000 per share in June 2023. The current promoter still has majority shareholding and will remain focused on Indian market.

Ongoing capex at Baruch would lead to a 32% CAGR for depreciation between FY23-25E

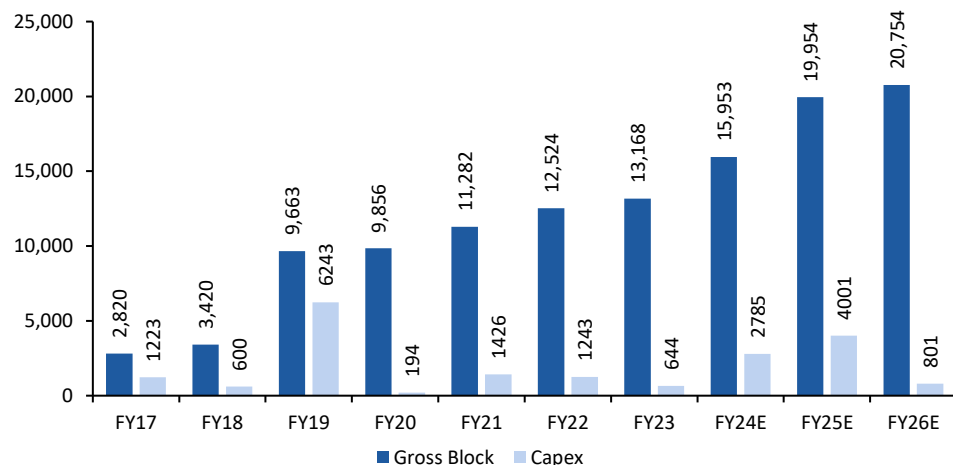
Ongoing capex of Rs6bn, for SRB and CRB, on the existing Gross block of Rs13bn is huge and will accelerate depreciation charge

The company made an announcement of setting up a new channel to localize the manufacturing of SRB and CRB of size 0-400 millimetre which otherwise were getting imported by Timken India. The total capex envisaged is Rs6bn with asset turn of 2.5x. The plant will get commercialised in Q4FY25 and first full year of operation would be FY26E. However, in FY24E and FY25E, we estimate tepid revenue growth in higher single digit; however, the depreciation would go up in excess of 30%. This will result in compression of margin at PAT level. The delta in the revenue on account of capex would start trickling in from FY26E and thereby in bottom line as well. The Indian market size for SRB and CRB put together is ~Rs40bn. Localization of the manufacturing will put Timken India at much advantageous position. SRB and CRB find applications in almost all industries. Timken India will have to pay royalty for sourcing the technology for SRB and CRB to parent. The supply chain for the new products has been in place.

Exhibit 111: For FY24E and FY25E revenue growth will lag behind depreciation growth



Source: Company, Centrum Broking

Exhibit 112: Capex will peak out in FY25E as per the current plans

Source: Company, Centrum broking

Slowdown in revenue growth would allow Timken India to meet demand in FY24E and FY25E

Timken India can cater to demand upswing on the basis of existing capacity by making changes in the production planning

Timken India can import from Timken group plants outside India and a lot of capacity is available. On the other hand there is scope left to increase manpower and add extra shift to cater to sudden spike in demand. It can tweak manufacturing process. Besides, that level of automation provides opportunity to optimize production without resorting to immediate capex.

After achieving a certain level of localization, the company is focusing on minimization

The company is a first mover to localize the supply of steel alloy grades. Now the focus of the company is to reduce the delays and wastage of resources in the manufacturing process

The company has localized the manufacturing of TRBs in India. But more commendable achievement for the company is localizing the supply chain. The company is a first mover to localize supply for most of steel alloy grades. And today majority of the steel alloy consumption is sourced locally. The share of local manufacturing is now in the range of 65-70%. However, it cannot reach to 100% as volume for bigger size bearings is not large enough and tooling costs are also prohibitive to localize those. So it makes economic sense to import those bearings. Besides the various grades of alloy steel, the company has local supply chains for child parts, cages, rolling elements, forging, etc. It allows the company to reduce lead time to the market, save on logistic cost and working capital.

Now the focus of the company is to reduce the delays and wastage of resources in the manufacturing process. Jamshedpur plant of the company has been ideally located as it allows company to accommodate entire manufacturing process right from raw material sourcing to dispatching finished product within 20 km. It saves logistic cost and shorten time to market.

In the process of localization few things will remain inside the company while rest is outsourced. The application in the product technology, intricate grinding and related aspects of assembly design remains in-house. Heat treatment and rolling elements making will be a combination. While steel making, forging, green turning, cages, etc., will always be outsourced.

Timken is the leader in railway business in India amongst listed peers. It has 60% share in freight application bearings. Despite the price led tender business, railway segment is clocking double digit margin for Timken India

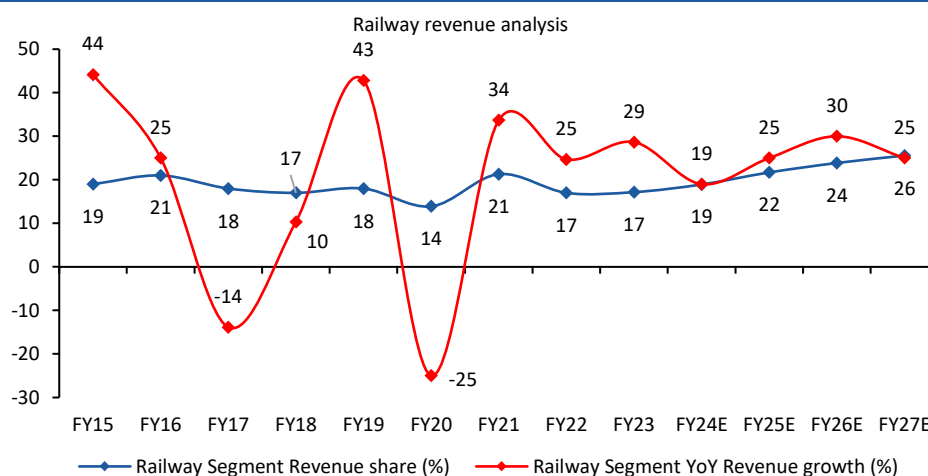
Railway is the silver lining in otherwise subdued performance estimated till FY25

The company is the largest player on freight applications in the Railway segment. However, it has limited presence on passenger coaches and locomotive applications. As per our estimate, the company commands upwards of 50% volume market share in the freight application bearings. It provides grease seals and other components to the railways as well.

We have seen that railway occupies second largest share in the revenue at 17-18% after exports and has grown at a CAGR of ~20% over FY18-23. With the continuous availability of budgets for wagon addition and periodical requirement to refurbish existing bearings along with Dedicated Freight Corridor (DFC) opportunity on the horizon, we estimate railway segment will continue to do well for Timken India.

Railway business is tender based business wherein the bidder quoting the least price wins the bid. Hence, the lowest one, L1, will win the majority of the tendered quantity. Railway few times missed out on issuing tenders at regular interval and that has impact on YoY growth rate of railway segment revenue for Timken India.

Exhibit 113: Railway is the second largest revenue earner after exports



Source: Company, Centrum broking

Now planning to improve presence on passenger coaches and locomotive applications. Adding SRB/CRB localization would help in capturing larger pie in the railway segment

Timken India manufactures E Class, G Class and K Class CTRB (Cartridge Tapered Roller Bearings) used by Indian Railways for LHB passenger coaches, locomotives, freight wagon and DFC wagon applications

With localization of SRB and CRB, Timken India now can focus on passenger coaches and locomotive applications as well. The estimated market size of railway bearings including freight wagons, passenger coaches, locomotives, metro, refurbishment of bearings is Rs15bn which is nearly 10% of the size of total organized bearing market in India.

With capex of Rs6bn (2.5x asset turn) for SRB and CRB getting commercialized fully in FY26E, Timken is expected to expand its market in passenger coach and locomotives applications with these newly added products.

Timken India manufacture E Class, G Class and K Class CTRB (Cartridge Tapered Roller Bearings) used by Indian Railways for LHB passenger coaches, locomotives, freight wagon and DFC wagon applications. Now with SRB and CRB facility coming up in January 2025, the company would supply those bearings to railways mainly for non-LHB coaches.

Timken India is the largest player in the railway segment in India

We have analyzed the data published by the Indian Railways to understand the exact position of freight application bearing demand and Timken's position in this segment. Timken India enjoys Numero Uno position with the volume market share in the range of 50-60%.

Exhibit 114: Annual freight bearing order details CTRB E Class and K Class

Particulars	Product	Unit	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Freight Bearings Ordered	CTRB - all types	No	0	95,466	124,080	0	218,125	336,355	83,188	128,556	71,003	0	179,659	75,210	147,726
YoY growth		%			30.0			54.2	-75.3	54.5	-44.8			-58.1	96.4
Total Order Size		Rs mn	0	961	1293	0	2345	3724	932	1487	959	0	2295	1018	1885
YoY growth		%			34.5			58.8	-75.0	59.6	-35.5			-55.6	85.1
Avg Rate		Rs per unit		10,070	10,424		10,750	11,072	11,199	11,568	13,507		12,773	13,538	12,757
YoY growth		%			3.5			3.0	1.1	3.3	16.8			6.0	-5.8
DFC Bearings Ordered	K Class	No						25,200							
Total Order Size		Rs mn						516.88							
Avg Rate		Rs per unit						20,511							

Source: Indian Railways, Centrum Broking

Exhibit 115: Timken is the largest CTRB and Class K player in freight application bearings for railways in India

Particulars	Product	Unit	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Timken India's share	CTRB	No	0	95,466	76,811	0	130,875	134,541	39,930	42,852	42,602	0	71,864	30,084	88,636
		%		100.0	61.9		60.0	40.0	48.0	33.3	60.0		40.0	40.0	60.0

Particulars	Product	Unit	2016
		Nos	11,760
Bearings	CLASS K	Rs per unit	19,930
		Rs mn	234

Source: Indian Railways, Centrum Broking

Exhibit 116: Grease Seals opportunity is small in size

Particulars	Product	Unit	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Grease Seal	Grease Seal	Nos	4,99,000	3,99,352	5,32,911	4,10,403	4,30,825	12,74,455	6,82,223	8,33,538	8,90,755	2,68,624	4,36,598	7,73,274	5,86,890
YoY growth		%		-20.0	33.4	-23.0	5.0	195.8	-46.5	22.2	6.9	-69.8	62.5	77.1	-24.1
Order Size	Grease Seal	Rs mn	120.90	61	73	45	43	146	79	99	270	6815	39	242	148
YoY growth		%		-49.9	20.9	-38.4	-4.1	238.1	-45.8	24.3	173.4	2427.8	-99.4	520.8	-38.7
Realisation	Grease Seal	Rs per unit	242	152	138	110	100	115	116	118	303	25370	89	313	253
YoY growth		%		-37.4	-9.4	-20.0	-8.7	14.3	1.3	1.7	155.8	8282.1	-99.6	250.5	-19.2

Source: Indian Railways, Centrum Broking

Exhibit 117: Timken India's share in Grease Seals

Particulars	Product	Unit	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Timken India's share	Grease Seal	No	1,99,600	1,07,835	2,79,735	1,64,161	1,50,789	5,09,781	2,72,889	3,33,415	2,45,652	1,98,232	1,22,248	3,09,309	50,936
		%	40%	20%	52%	40%	35%	40%	40%	40%	35%	30%	28%	40%	7%

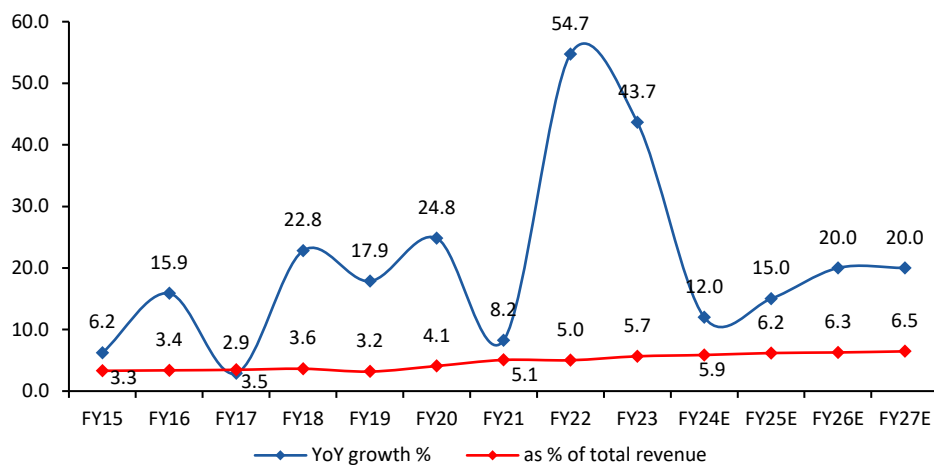
Source: Indian Railways, Centrum Broking

Timken India is the largest player in refurbishment of railway bearings. It has developed new bearing for railways which can last for 10 years without refurbishment

In addition to the above opportunities, Timken India is the largest player on the refurbishment of freight application bearings. Every bearing which goes into wagons and coaches are required to undergo condition monitoring once in every four years. Timken has recently developed a freight application bearing with a technology wherein those bearings once fitted will last for 10 years. Obviously cost is higher. Railway department is working on it at present.

Industrial motion revenue will take long to constitute double digit share in the revenue

Exhibit 118: Services revenue share is moving up at lower rate



Source: Company, Centrum Broking

Industrial motion revenue segment includes the sales of products other than bearings and related services which Timken India's parent offers. It draws around 30% revenue from these products and services (as against 5.5% by Timken India)

Industrial motion revenue segment includes the sales of products other than bearings and related services which Timken India's parent offers. It draws around 30% revenue from these products and services (as against 5.5% by Timken India). The parent has made series of acquisitions of the companies that are manufacturing components required in a machine or engine apart from bearings.

For example, a power train industry require bearings, motors, split bearings, gear boxes, couplings, brakes, chain, belt, mounting bearing, lubrication system, clutch. All these components are part of the drivetrain. Timken is offering only bearing while other components have to be bought out. Timken has taken over these companies and now offers entire system.

Timken India recently supplied lubrication system to Pune Metro

Most of the companies acquired by Timken India's parent are situated in US or in Europe. These are high cost destinations. Hence, these products could be outsourced to low cost destination like India (which also has advantage of China+1 thought movement).

Very recently Timken India supplied a lubrication system to Pune Metro which was imported and assembled in India and running well at present.

Timken India has set up a combined gear box and bearing refurbishment facility at Raipur catering to 2tn and 16tn mission critical gear boxes in the industrial belt of Chhattisgarh

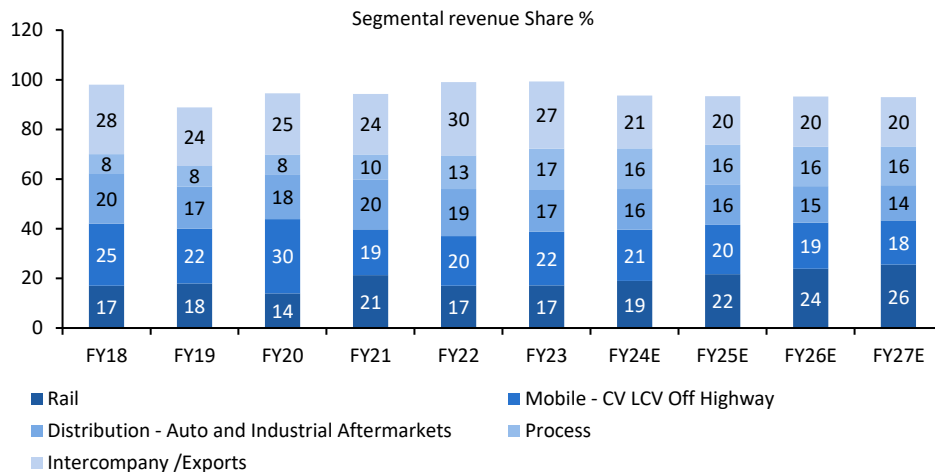
Timken India has set up a combined gear box and bearing refurbishment facility at Raipur. The Raipur facility is capable of refurbishment of mission critical 2tn and 16tn gear boxes. Timken India has high-technology machines for the first time in India to decode some bearings which can be sold or refurbished for oil and gas sector. The company has also exported a few gearboxes for cooling tower applications in the US. The plant is strategically located in the hub of metal, cement; coal-fired power generation and mining industries and will support in growing its after-market penetration in these industries.

Onsite MILLTEC® programme provides round-the-clock management of a steel and aluminum mills' roll shops to minimize operational problems and downtime

Onsite MILLTEC® programme provides round-the-clock management of a steel and aluminum mills' roll shops to minimise operational problems and downtime. This service includes assembling, disassembling, maintenance, repair, overhauling and other related activities in rolling mills at customer sites. Currently, this market is served by few small players or the metal companies manage themselves in-house. However, the trend is moving towards third-party leading players for maintenance of roll shops. Its clients include Tata Steel, JSW Steel, and Essar Steel, to name a few.

Exhibit 119: Revenue break-up suggests total share of exports and railways at ~40%

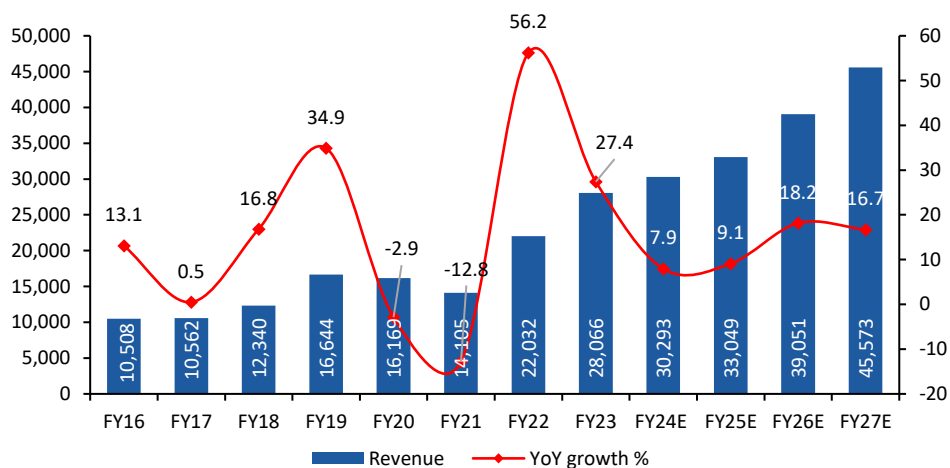
Timken India's revenues will remain dominated by railways and exports



Source: Company Data, Centrum Broking

Exhibit 120: Revenue and revenue growth

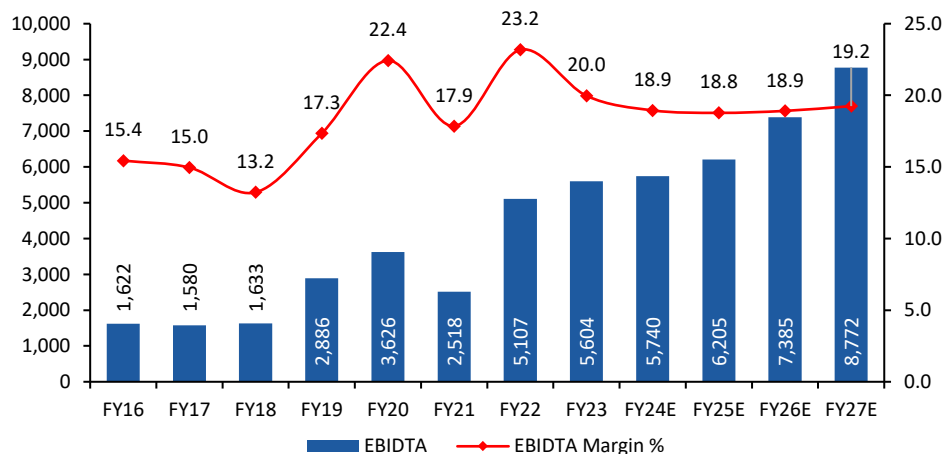
FY24E and FY25E to witness YoY revenue growth coming off from double digit to single digit



Source: Company Data, Centrum Broking

Exhibit 121: EBITDA and EBITDA margin

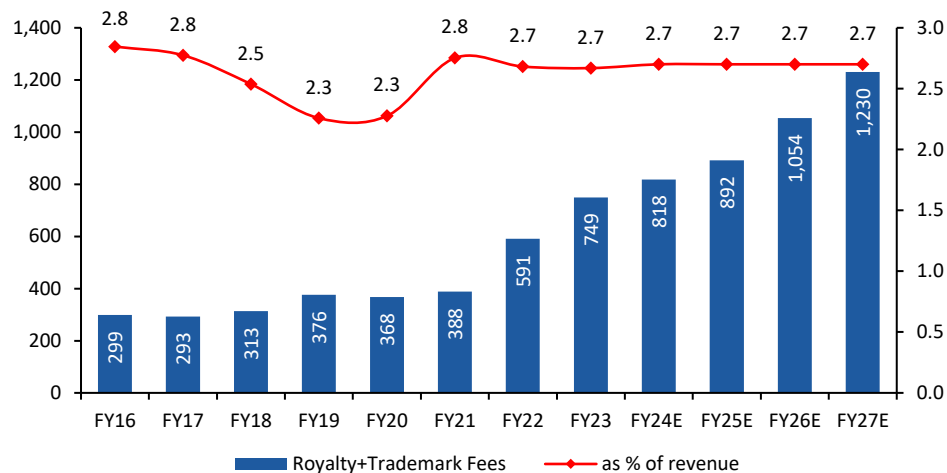
EBITDA margin would witness a fall in FY24E and then expected to remain in the narrow range



Source: Company Data, Centrum Broking

Exhibit 122: Royalty and Trademark fees

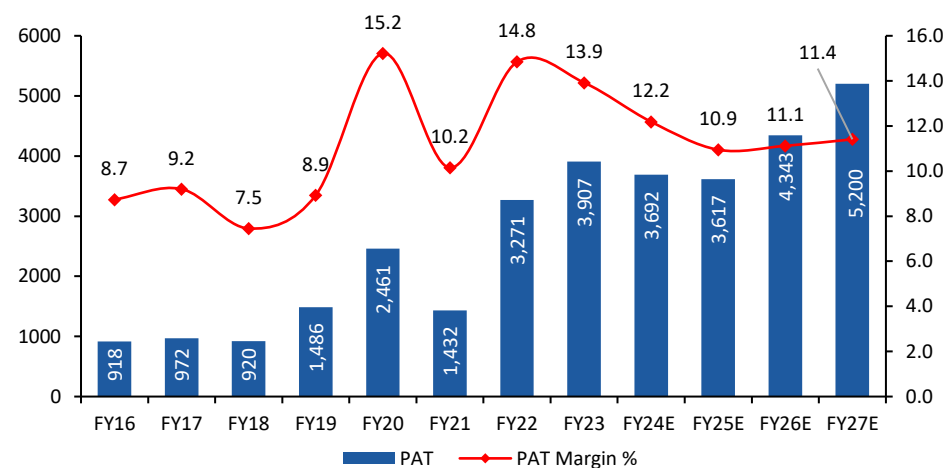
New plant for SRB and CRB is being set up would source technology from parent and it will keep Royalty and Trademark fees at steady level of 2.7%



Source: Company Data, Centrum Broking

Exhibit 123: PAT to decline YoY in FY24E and FY25E

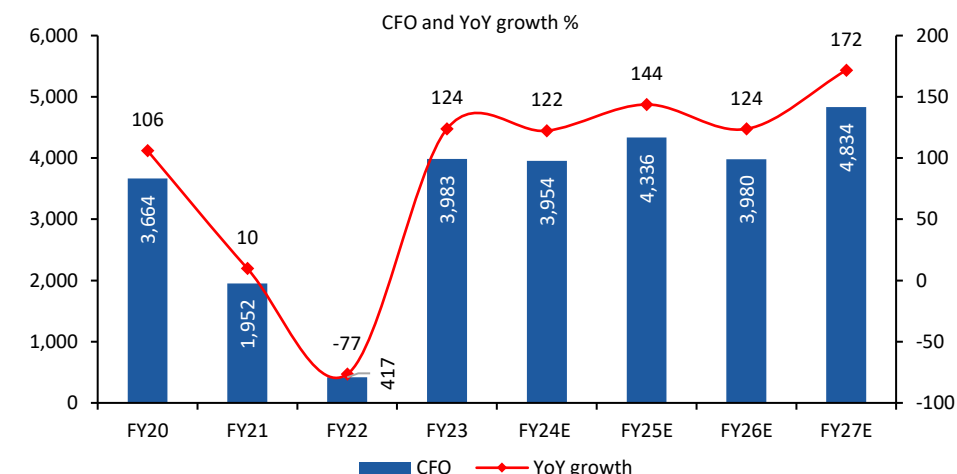
Lower revenue growth, compression in margin and higher depreciation will result in decline in PAT YoY for both FY24E and FY25E



Source: Company Data, Centrum Broking

Exhibit 124: Higher depreciation would help in augmenting CFO in FY25E

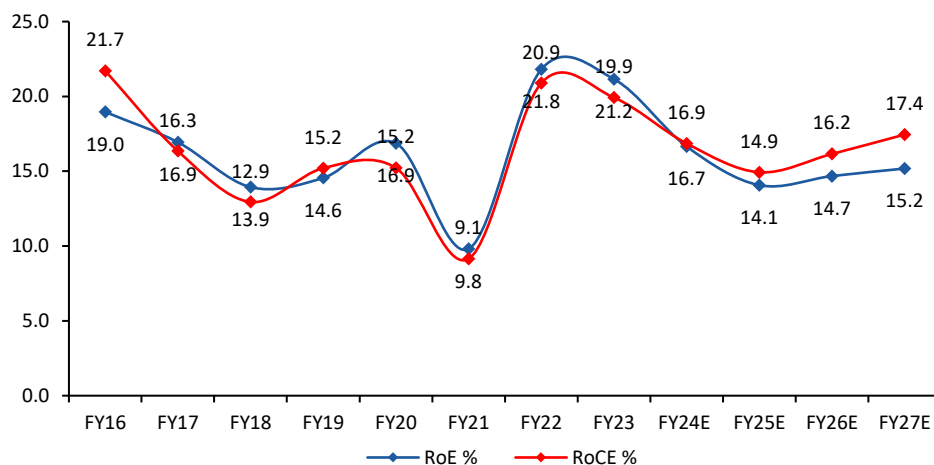
Higher depreciation charge would help CFO



Source: Company Data, Centrum Broking

Exhibit 125: Capex, slow revenue growth, lowering of margin to pressure return ratios

Return ratios to go down till FY25E



Source: Company Data, Centrum Broking

Higher depreciation and low revenue growth estimated to reduce PAT in FY25E

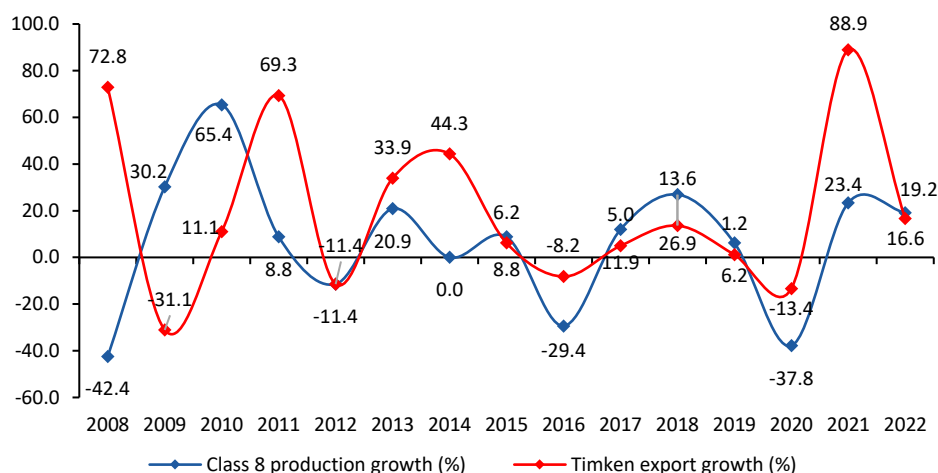
Gross margin erosion since past four sequential quarters will get steadied at 40%. Gross margin will be range bound as it depends upon revenue mix, realisations/pricing (competition is now in railways and higher margin exports are slowing) and SRB/CRB will be at low margin initially.

Valuation n outlook

Pain in exports and in industrial & MHCV aftermarket segments put ~45% of higher margin business under cloud for FY24E and FY25E

Last three sequential quarters (Q3FY23, Q4FY23, Q1FY24) reported a huge YoY decline of 34%, 24% and 32% respectively in exports revenue which historically occupied 30% share in the revenue. The management has cautioned about the stress in exports; albeit with some delay and initiated action of taking plant shut down putting forth reason of demand slowdown in the month of August to realign the production with low demand. The largest revenue segment- exports (with highest margin) coupled with few segments in the aftermarkets namely industrial space (wind, commodities, etc.) including MHCV segment (combined revenue share 45%), are showing signs of slowdown. We estimate an average YoY revenue growth of mid-single digit for these segments for FY24E and FY25E, while YoY decline in mid-teens for exports in FY24E and flat growth in FY25E. Around 60% of the exports happened to the US both for auto and industrial segment. Our analysis of Class 8 Truck production and Timken India's export growth rate results in strong correlation of 0.6. The chart below shows how Timken's exports revenue mimic Class 8 production graph with certain lag.

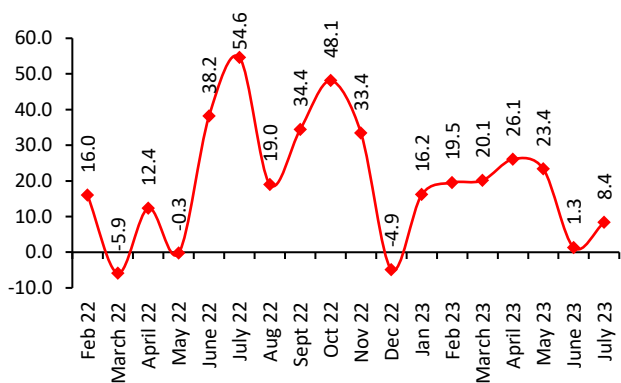
Exhibit 126: Long term pattern of YoY growth in Class 8 Trucks and Timken India's export



Source: Industry, Centrum Broking

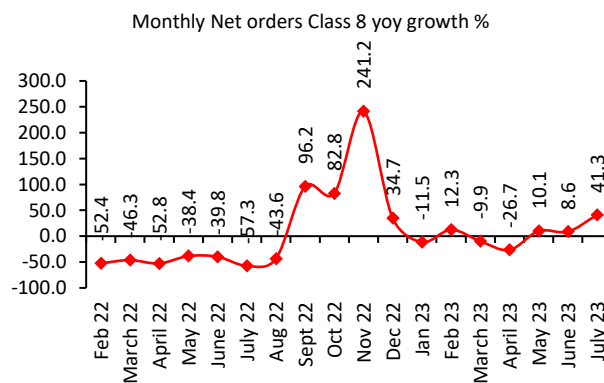
Furthermore, sentiment indicator data point of Monthly Net Orders and YoY growth in monthly production for the past 18 months for Class 8 in US also shows weak sentiments as reflected in charts.

Exhibit 127: Production of Class 8 trucks is in slow lane (%)



Source: Industry, Centrum broking

Exhibit 128: Sentiment indicator has also been volatile

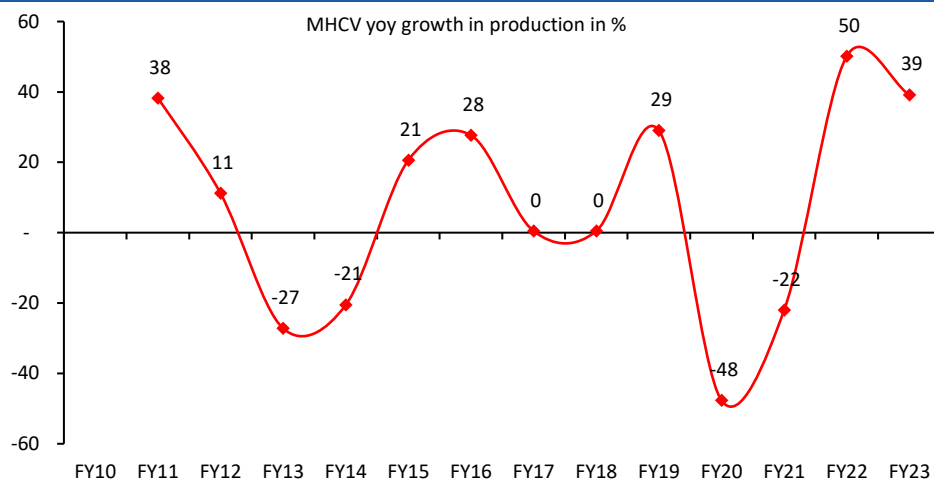


Source: Industry, Centrum broking

MHCV in automotive space is expected to undergo cyclical slowdown in the coming quarters as per the historical performance.

Exhibit 129: Cyclicity in MHCV production since past 12 years

Historical analysis suggests that MHCV follows cyclical pattern



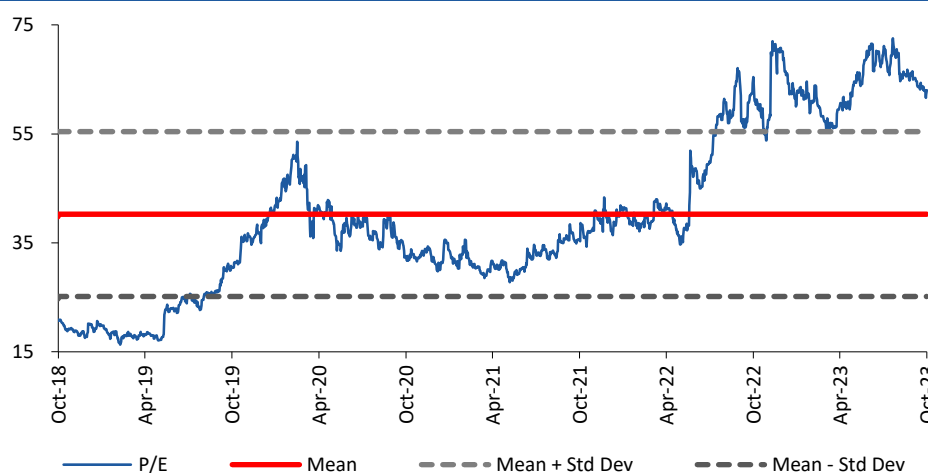
Source: Industry, Centrum Broking

Estimated MHCV, commodities in industrial segment and exports decline put Timken India at the risk of single digit revenue growth for FY24E and FY25E with compressions in margin resulting in marginal YoY decline in PAT for FY24E and FY25E. We believe that current valuations (53x FY26E earnings) are not adequately reflecting the tough period ahead. However, strong bounce back on account of new capacity coming on stream for SRB and CRB, which otherwise Timken India didn't have in its quiver, would allow the company to expand its own manufactured product range and thereby capture additional revenue both in domestic and export markets. Hence, despite the medium term turbulence, Timken India can regain its mojo from FY26E. Taking note of the same, we have valued the company based on its last 3-year average earning multiple to reflect the trust in its capabilities. We recommend Sell with TP of Rs2,222 (42x 1HFY26E EPS of Rs53)

Exhibit 130: Average PE ratio

Timken India	3 year	5 year	10 year
Average PE (x)	42	37.1	36.6

Source: Bloomberg

Exhibit 131: Timken India – PE Ratio

Source: Bloomberg

Exhibit 132: Financial Performance snapshots

Y/E March (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E	FY27E
Revenue	22,032	28,066	30,293	33,049	39,051	45,573
YoY (%)	56.2	27.4	7.9	9.1	18.2	16.7
EBITDA	5,107	5,604	5,740	6,205	7,385	8,772
EBITDA (%)	23.2	20.0	18.9	18.8	18.9	19.2
PAT	3,271	3,907	3,692	3,617	4,343	5,200
YoY (%)	128.5	19.5	(5.5)	(2.0)	20.1	19.7
FDEPS (Rs)	43.5	51.9	49.1	48.1	57.7	69.1
RoE (%)	21.8%	21.2%	16.7%	14.1%	14.7%	15.2%
RoIC (%)	21.4%	20.1%	16.5%	14.0%	14.6%	15.1%
P/E (x)	70.4	58.9	62.3	63.6	53.0	44.3
EV/EBITDA (X)	45.1	40.8	39.9	36.6	30.4	25.1
CFO	329	3,412	3,900	4,277	4,074	4,755
Free CF	(432)	2,940	(350)	1,776	3,274	3,855
FCF yield (%)	(0.2)	1.3	(0.2)	0.8	1.4	1.7
EBIDTA to CFO conversion (%)	6.4	60.9	67.9	68.9	55.2	54.2
Cash Conversion Cycle (days)	116	123	121	121	118	121

Source: Company Data, Centrum Broking

Risks

- There is risk of underutilization of new capex of Rs6bn if exports and domestic user industry dwindles.
- The company pays royalty and trademark charges in USD. Any steep depreciation in Indian Rupee against USD will put strain on financials.
- Company has to face more competition from global leading players in its strong turf of Railway segment on freight application side.
- The current combined royalty and trademark rate is around 2.7%. Any large increase will be strenuous.
- General economic condition in US and SEA along with India matters a lot for company's export growth prospects along with domestic growth.
- Any unusual movement in raw material cost will stress working capital.

P&L					
YE Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenues	22,032	28,066	30,293	33,049	39,051
Operating Expense	13,431	18,443	20,135	21,973	26,073
Employee cost	1,406	1,591	1,782	1,996	2,195
Others	2,089	2,429	2,635	2,875	3,397
EBITDA	5,107	5,604	5,740	6,205	7,385
Depreciation & Amortisation	843	872	1,102	1,515	1,608
EBIT	4,263	4,732	4,638	4,690	5,777
Interest expenses	24	28	28	29	26
Other income	143	532	335	184	66
PBT	4,382	5,235	4,945	4,846	5,817
Taxes	1,111	1,328	1,254	1,228	1,475
Effective tax rate (%)	25.3	25.4	25.4	25.4	25.4
PAT	3,271	3,907	3,692	3,617	4,343
Minority/Associates	0	0	0	0	0
Recurring PAT	3,271	3,907	3,692	3,617	4,343
Extraordinary items	0	0	0	0	0
Reported PAT	3,271	3,907	3,692	3,617	4,343
Ratios					
YE Mar	FY22A	FY23A	FY24E	FY25E	FY26E
Growth (%)					
Revenue	56.2	27.4	7.9	9.1	18.2
EBITDA	102.8	9.7	2.4	8.1	19.0
Adj. EPS	128.5	19.5	(5.5)	(2.0)	20.1
Margins (%)					
Gross	45.8	40.9	40.3	40.3	40.1
EBITDA	23.2	20.0	18.9	18.8	18.9
EBIT	19.4	16.9	15.3	14.2	14.8
Adjusted PAT	14.8	13.9	12.2	10.9	11.1
Returns (%)					
ROE	21.8	21.2	16.7	14.1	14.7
ROCE	21.4	20.1	16.5	14.0	14.6
ROIC	18.0	17.7	14.5	13.6	16.1
Turnover (days)					
Gross block turnover ratio (x)	1.8	2.1	1.9	1.7	1.9
Debtors	75	72	72	72	69
Inventory	142	124	121	122	117
Creditors	101	74	72	72	68
Net working capital	138	137	136	133	131
Solvency (x)					
Net debt-equity	0.0	(0.1)	0.0	(0.1)	(0.2)
Interest coverage ratio	208.7	199.2	203.3	217.7	289.6
Net debt/EBITDA	0.0	(0.2)	(0.2)	(0.4)	(0.8)
Per share (Rs)					
Adjusted EPS	43.5	51.9	49.1	48.1	57.7
BVPS	220.3	270.8	318.5	365.2	421.6
CEPS	54.7	63.5	63.7	68.2	79.1
DPS	1.5	1.5	1.5	1.5	1.5
Dividend payout (%)	3.4	2.9	3.1	3.1	2.6
Valuation (x)					
P/E	70.3	58.9	62.3	63.6	53.0
P/BV	13.9	11.3	9.6	8.4	7.3
EV/EBITDA	45.1	40.8	39.9	36.6	30.4
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0

Source: Company, Centrum Broking

Balance sheet					
YE Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Equity share capital	752	752	752	752	752
Reserves & surplus	15,817	19,620	23,207	26,720	30,959
Shareholders fund	16,569	20,372	23,959	27,472	31,711
Minority Interest	0	0	0	0	0
Total debt	298	294	300	300	300
Non Current Liabilities	731	657	676	694	716
Def tax liab. (net)	280	264	264	264	264
Total liabilities	17,878	21,586	25,199	28,730	32,991
Gross block	12,524	13,168	15,953	19,954	20,754
Less: acc. Depreciation	(3,923)	(4,735)	(5,837)	(7,352)	(8,960)
Net block	8,602	8,433	10,116	12,602	11,794
Capital WIP	495	535	2,000	500	500
Net fixed assets	9,097	8,968	12,116	13,102	12,294
Non Current Assets	241	481	481	481	481
Investments	0	0	0	0	0
Inventories	5,585	5,695	6,290	6,868	8,154
Sundry debtors	5,388	5,757	6,224	6,791	8,024
Cash & Cash Equivalents	182	1,617	1,314	3,067	6,172
Loans & advances	31	39	39	39	39
Other current assets	1,414	3,009	3,009	3,009	3,009
Trade payables	3,285	3,444	3,735	4,081	4,630
Other current liab.	697	490	490	490	490
Provisions	77	45	49	55	60
Net current assets	8,540	12,138	12,602	15,147	20,216
Total assets	17,878	21,586	25,199	28,730	32,991
Cashflow					
YE Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Profit Before Tax	4,382	5,235	4,945	4,846	5,817
Depreciation & Amortisation	843	872	1,102	1,515	1,608
Net Interest	(3)	(6)	(36)	(37)	(159)
Net Change – WC	(3,681)	(960)	(766)	(793)	(1,965)
Direct taxes	(1,140)	(1,539)	(1,344)	(1,254)	(1,228)
Net cash from operations	329	3,412	3,900	4,277	4,074
Capital expenditure	(803)	(620)	(4,251)	(2,501)	(801)
Acquisitions, net	0	0	0	0	0
Investments	0	0	0	0	0
Others	42	149	0	0	0
Net cash from investing	(761)	(472)	(4,251)	(2,501)	(801)
FCF	(432)	2,940	(350)	1,776	3,274
Issue of share capital	0	0	0	0	0
Increase/(decrease) in debt	(10)	(12)	6	0	0
Dividend paid	(113)	(113)	(113)	(113)	(113)
Interest paid	(24)	(28)	(28)	(29)	(26)
Others	0	0	183	118	(31)
Net cash from financing	(147)	(153)	47	(23)	(169)
Net change in Cash	(579)	2,787	(303)	1,753	3,105

Source: Company, Centrum Broking

Schaeffler India

Interim tough times

Schaeffler India, post amalgamation with LUK and INA in 2017, became the largest bearing player in India with revenue market share of 33%. The company is the leading Spherical Roller Bearing (SRB) and Cylindrical Roller Bearing (CRB) manufacturer with ~47% share in Rs40bn SRB/CRB market. After posting 2-year revenue and PAT CAGR of 35% and 74% respectively, exports (16% revenue share) and industrial segment revenue (32% revenue share) have started reporting YoY decline since past few quarters. Recognizing the trend, management has guided for the subdued outlook for the coming quarters. The company, however, continued with its localization drive by incurring huge capex and investments. The company has recently acquired Koovers, an online auto component retailer to strengthen its position in the aftermarkets. However, this acquisition would be EPS dilutive for the next few quarters and will require further investments. We have factored in these headwinds in the medium term while estimating a tepid YoY average revenue growth of 3.9% and average YoY PAT decline of 2.4% for CY23E and CY24E. However, improved localization led by commercialization of capex by CY25 will make the company more competitive in exports and in the domestic industrial space. Hence, we have valued the company based on its last 3-year average PE to reflect the trust in its long term capabilities. We recommend SELL with TP of Rs1,681 (30x 1HCY25E EPS of Rs56).

Dependence on Europe in general and Germany in particular impacting export performance

Europe (including Germany) is facing sluggish economic conditions; around 50% of exports happens to Europe (40% to Germany alone). Growth in exports (16% revenue share, 2-year CAGR 63%) is now under cloud led by demand decline in the region. The market is in inventory correction mode. A YoY growth in the exports since last three sequential quarters has started coming off and registered a decline of 3.5% in the latest quarter. The situation is likely to remain same for the next few quarters.

Industrial segment reported YoY revenue decline in three quarters out of the latest four

Industrial segment (35% revenue share, 2-year CAGR of 25%) reported a YoY decline in quarterly revenue in three out of latest four quarters. This has come after an average 30% YoY growth for six consecutive quarters. Few pockets like wind, commodities, etc. are witnessing slowdown in the domestic market.

Is it too much too fast for Schaeffler India?

Huge capital outlay (Rs10bn on existing Gross Block of Rs21.7bn) for localization of products & supply chains, capacity expansion, plant relocation, investments in adjacencies and inorganic growth made Schaeffler India spreading too much too fast. It enjoys strong financial position aided by last couple of years of accelerated performance. All these are structural steps with long term benefits. However, in the interim period of next 4-6 quarters, the company could face challenging or testing times owing to slower revenue growth and accelerated depreciation impacting its financials.

Financial and valuation summary

YE Dec (Rs mn)	CY21A	CY22A	CY23E	CY24E	CY25E
Revenues	55,605	68,674	70,516	74,056	81,824
EBITDA	9,715	12,944	12,952	13,363	14,780
EBITDA margin (%)	17.5	18.8	18.4	18.0	18.1
Adj. Net profit	6,291	8,642	8,552	8,375	9,146
Adj. EPS (Rs)	201.3	55.3	54.7	53.6	58.5
EPS growth (%)	116.2	(72.5)	(1.0)	(2.1)	9.2
PE (x)	15.6	56.6	57.2	58.4	53.5
EV/EBITDA (x)	48.9	36.6	36.5	35.3	31.7
PBV (x)	2.7	11.4	10.3	9.3	8.5
RoE (%)	18.5	21.8	18.9	16.7	16.6
RoCE (%)	18.0	21.5	18.5	16.6	16.4

Source: Company, Centrum Broking

Initiating Coverage

India | Indian Bearing Sector

12 October, 2023

SELL

Price: Rs3,131
Target Price: Rs1,681
Forecast return: -46%

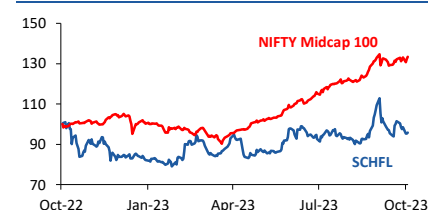
Institutional Research

Market Data

Bloomberg:	SCHFL IN
52 week H/L:	3,726/2,555
Market cap:	Rs489.4bn
Shares Outstanding:	156.3mn
Free float:	25.9%
Avg. daily vol. 3mth:	99,812

Source: Bloomberg

SCHFL relative to Nifty Midcap 100



Source: Bloomberg

Shareholding pattern

	Jun-23	Mar-23	Dec-22	Sep-22
Promoter	74.1	74.1	74.1	74.1
FII	4.0	4.4	4.8	5.7
DII	15.9	15.6	15.1	14.2
Public/other	6.0	5.9	6.0	5.9

Source: BSE

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Thesis Snapshot

Centrum vs consensus

YE Mar (Rs mn)	Centrum CY23E	Consensus CY23E	Variance (%)	Centrum CY24E	Consensus CY24E	Variance (%)
Revenue	70,516	75,210	-6.2	74,056	87,038	-14.9
EBIDTA	12,952	11,789	9.9	13,363	16,977	-21.3
PAT	8,552	9,684	-11.7	8,375	11,365	-26.3

Source: Bloomberg, Centrum Broking

SCHFL India versus NIFTY Midcap 100

	1m	6m	1 year
SCHFL IN	(12.9)	0.5	(4.7)
NIFTY Midcap 100	(1.7)	37.8	34.6

Source: Bloomberg, NSE

Key assumptions

YE Dec	CY23E	CY24E	CY25E
YoY Growth %			
Total Automotive	12	10	10
Automotive Technologies	11	8	8
Automotive Aftermarket	15	20	20
Total Industrial	(6)	(1)	7
Total exports and others	(5)	0	18

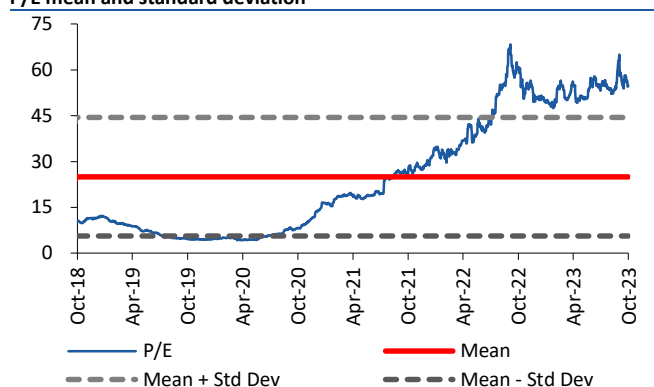
Source: Centrum Broking

Valuations

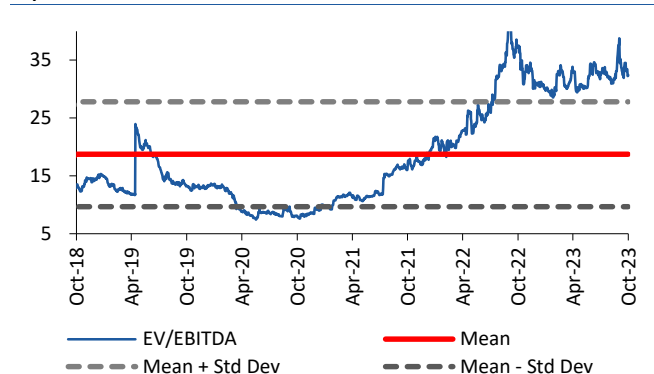
We have factored in decline in exports and stress industrial segment in the medium term. However, improved localization led by commercialization of capex by CY25 will make the company more competitive in exports and in the domestic industrial space. Hence, we have valued the company based on its last 3 year average PE to reflect the trust in its long term capabilities. We recommend Sell with TP of Rs 1,681 (30x 1HCY25E EPS of Rs 56)

Valuations	Rs/Share
1H CY25E EPS	56
Last 3 year average PE (x)	30
Target Multiple (x)	30
Target price (Rs)	1,681

P/E mean and standard deviation



EV/EBITDA mean and standard deviation



Source: Bloomberg, Centrum Broking

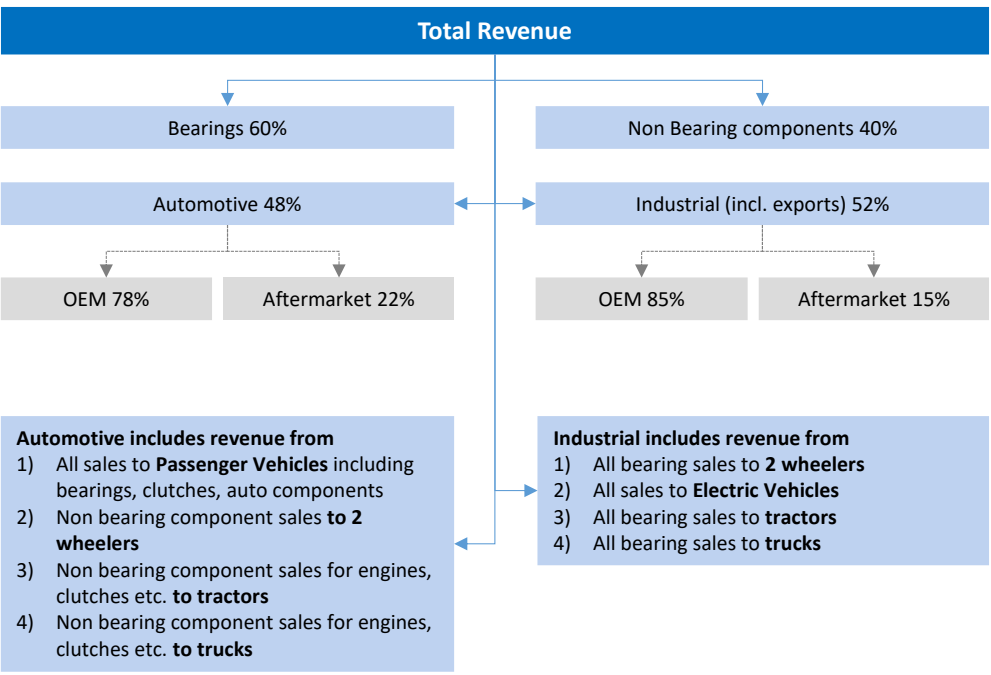
Peer comparison

Company	Mkt Cap	CAGR (CY22/FY23-CY25E/FY26E)				P/E (x)			EV/EBITDA (x)			CY22/FY23	
	(Rs mn)	Sales	EBITDA	EPS		CY23E/FY24E	CY24E/FY25E	CY25E/FY26E	CY23E/FY24E	CY24E/FY25E	CY25E/FY26E	RoE (%)	ROCE (%)
Schaeffler India	5,04,693	6.0	5.0	1.0		56.9	58.1	53.2	36.3	35.1	31.5	21.8	21.5
SKF India	2,60,845	10.0	8.0	9.0		45.8	41.9	38.8	31.3	28.9	25.9	24.8	24.9
Timken India	2,08,046	11.6	9.6	4.0		62.3	63.6	53.0	39.9	36.6	30.4	21.2	20.1

Source: Company Data, Centrum Broking

Revenue break-up and business structure

Exhibit 133: Schaeffler India generates only 60% revenue from bearings



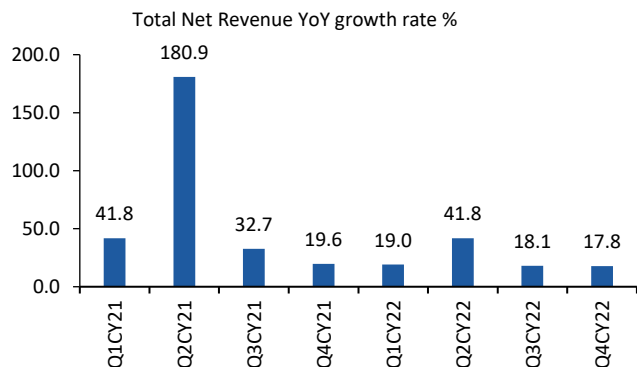
Source: Company Data, Centrum Broking

Subdued performance expected till CY24

We estimate stress in exports and industrial segment for CY23E and CY24E, which will result in marginal YoY decline in PAT for these years.

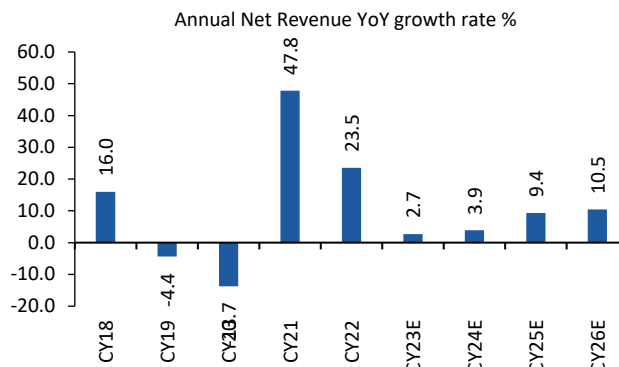
Over CY20-22, the company reported revenue CAGR of 35% led by growth in all segments. However, it has started tapering off as witnessed from the charts below.

Exhibit 134: Quarterly YoY growth rate in net revenue



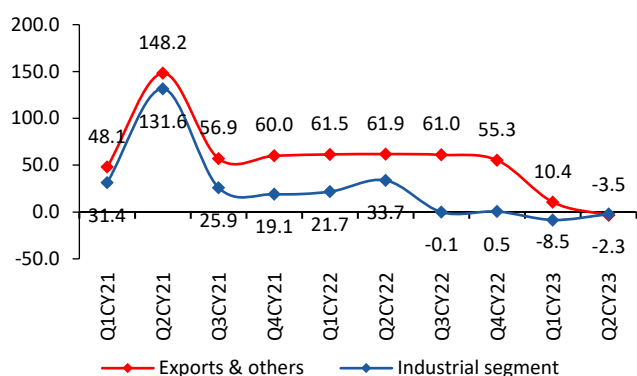
Source: Company Data, Centrum Broking

Exhibit 135: Annual YoY growth rate in net revenue



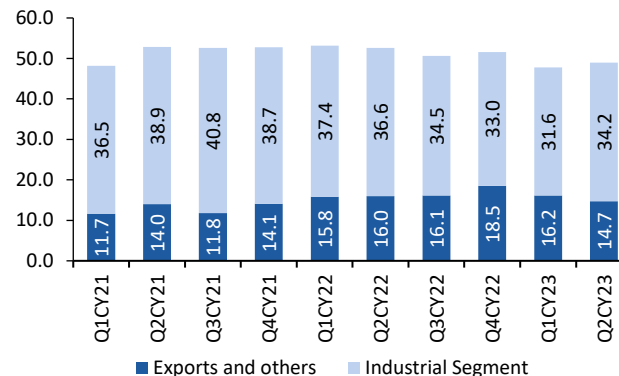
Source: Company Data, Centrum Broking

Exhibit 136: Export and Industrial YoY growth rates %



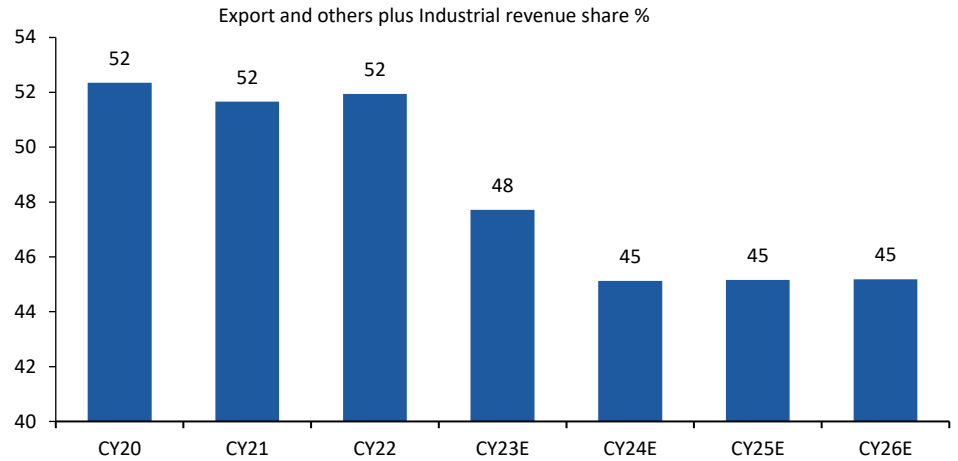
Source: Company Data, Centrum Broking

Exhibit 137: Revenue share of exports and industrial %

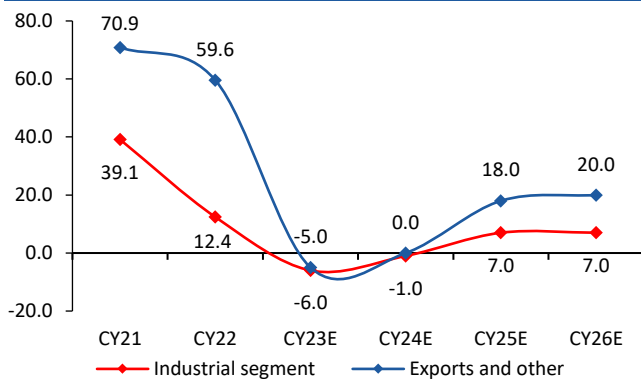


Source: Company Data, Centrum Broking

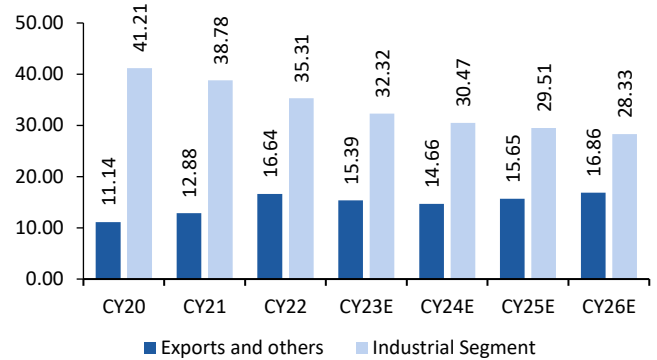
Growth across segments started tapering off since past four quarters and has entered into negative territory for exports (~16% revenue share) and industrial segment (~32% revenue share).

Exhibit 138: Around 48% of the revenue is facing challenging outlook till CY24

Source: Company Data, Centrum Broking

Exhibit 139: Export to revive from CY25

Source: Company Data, Centrum Broking

Exhibit 140: Share of exports and industrial revenue

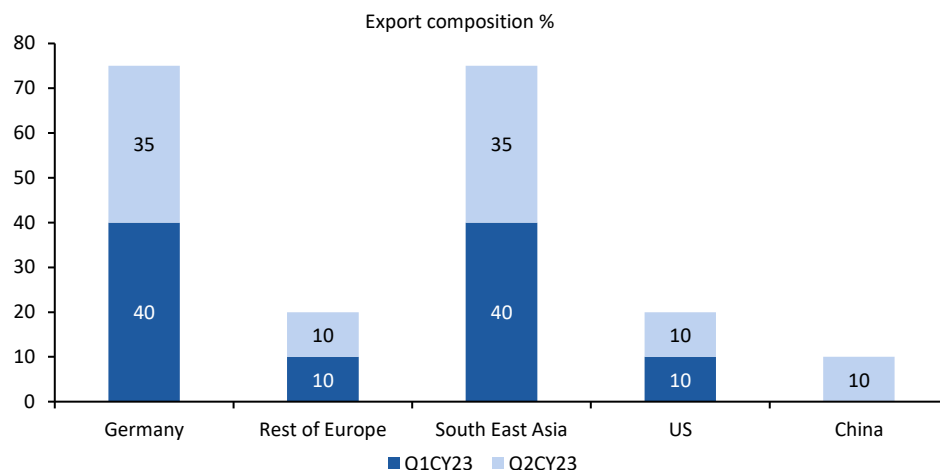
Source: Company Data, Centrum Broking

Exports closely linked to the state of German economy

Focus on exports in the past three years resulted in – (1) increase in share of exports by ~500bps to ~16% between CY20 and CY22; (2) CY20-22 export CAGR at 63% has been substantially higher than total net revenue CAGR of 35%. The latest export composition is heavily tilted towards Europe (including Germany) in general (~50% share) and Germany in particular (40% point share in Europe). Hence, it would be inevitable to get some health check of German economy.

Exhibit 141: Europe dominates export composition

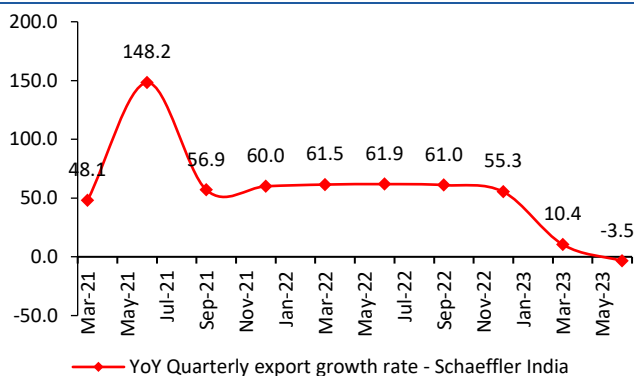
Germany, which occupy 40% share in exports, is facing down turn in the economy



Source: Company Data, Centrum Broking

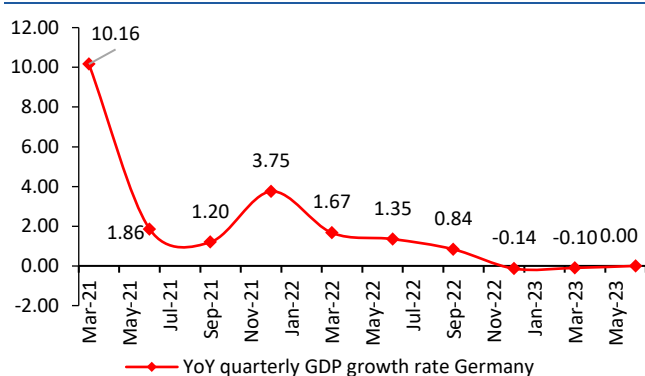
German economy is not doing fine and has been reporting contraction in economy since December 2022 quarter. The health of German economy matters a lot for Schaeffler India's export performance, at least for the next few quarters. In general, entire Europe's economic growth is important for Schaeffler India's exports. The statistical correlation between export growth rate and Germany's GDP growth rate is 0.12. However, we believe it will get stronger over the next few quarters. **It can be witnessed from the below charts that the slope of Schaeffler's export growth follows Germany's GDP growth with a lag of two quarters.**

Exhibit 142: Exports are on declining trend



Source: Company Data, Centrum Broking

Exhibit 143: German economy is in contraction phase



Source: Industry, Centrum Broking

Exhibit 144: Schaeffler India's exports follows German economy with some lag

Particulars	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23
YoY Quarterly export growth rate - Schaeffler India %	48.1	148.2	56.9	60.0	61.5	61.9	61.0	55.3	10.4	(3.5)
YoY quarterly GDP growth rate Germany %	10.16	1.86	1.20	3.75	1.67	1.35	0.84	(0.14)	(0.10)	0.00

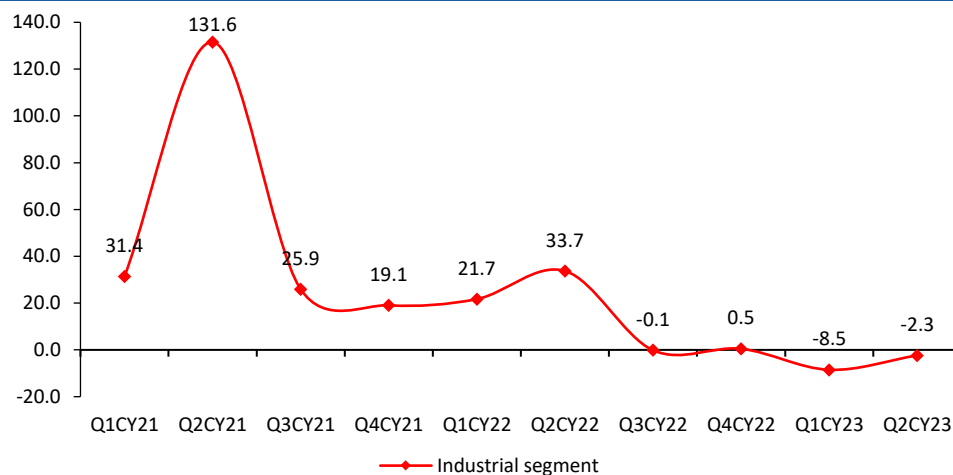
Source: Company Data, Industry, Centrum Broking

Industrial segment is facing headwinds

Industrial segment (~32% revenue share) is witnessing stress since past four sequential quarters. The deceleration in the YoY revenue growth rate has been on the back of six sequential quarters of high-octane growth. Decline in revenue growth rate attributed to sluggish demand from the sectors like wind energy and commodities. The data suggests some softness in steel and cement production in the past few months. Further, YoY growth in monthly IIP and Manufacturing IIP numbers have also been range bound, hence, no tailwinds on that front for the company in the next few quarters.

Exhibit 145: YoY growth rates (%) of quarterly industrial revenue entered negative territory

Certain sectors like wind, commodities, 2W are in slow lane



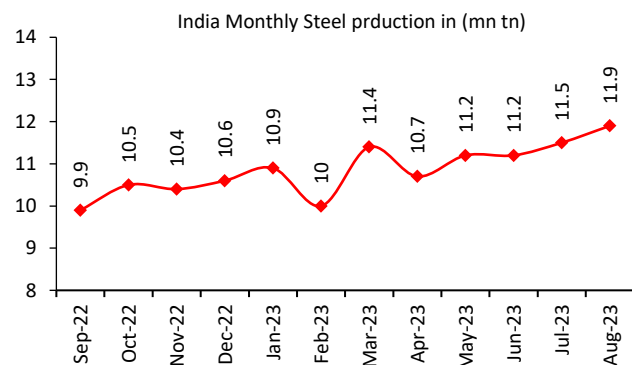
Source: Company Data, Centrum Broking

Exhibit 146: Industrial segment declined YoY in three quarters

YoY Growth rate %	Q1CY21	Q2CY21	Q3CY21	Q4CY21	Q1CY22	Q2CY22	Q3CY22	Q4CY22	Q1CY23	Q2CY23
Industrial segment	31.4	131.6	25.9	19.1	21.7	33.7	(0.1)	0.5	(8.5)	(2.3)

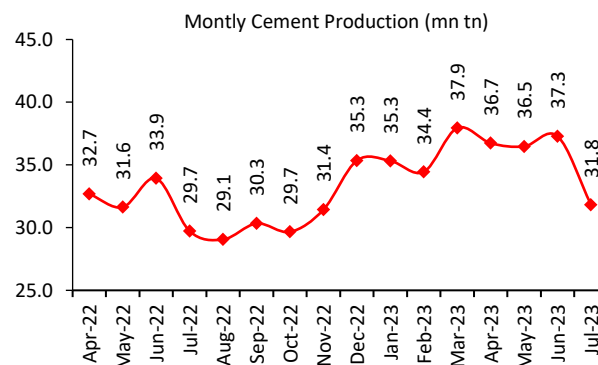
Source: Centrum Broking, Company Data

Exhibit 147: Range bound volume

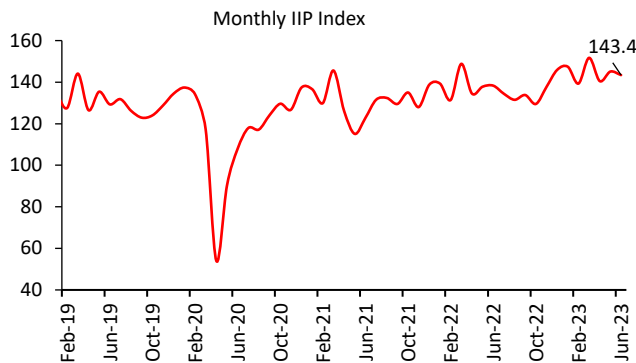


Source: Industry, Centrum Broking

Exhibit 148: Stagnation in cement volume production

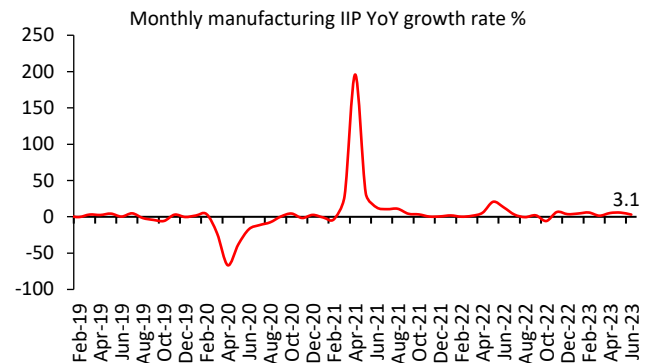


Source: Industry, Centrum Broking

Exhibit 149: IIP growth is in the narrow range

Source: Industry, Centrum Broking

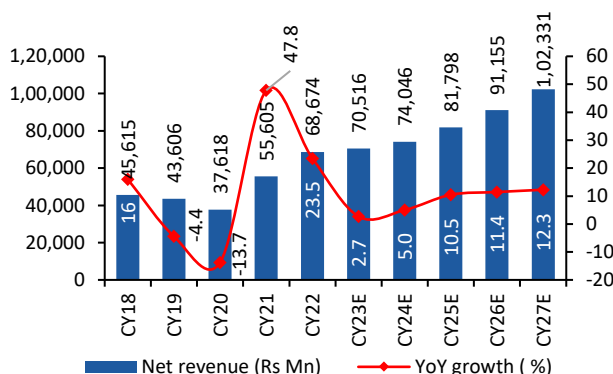
We have taken note of decline in exports and industrial segment and estimating tepid growth in CY23E and CY24E

Exhibit 150: Manufacturing IIP growth rate also flatish

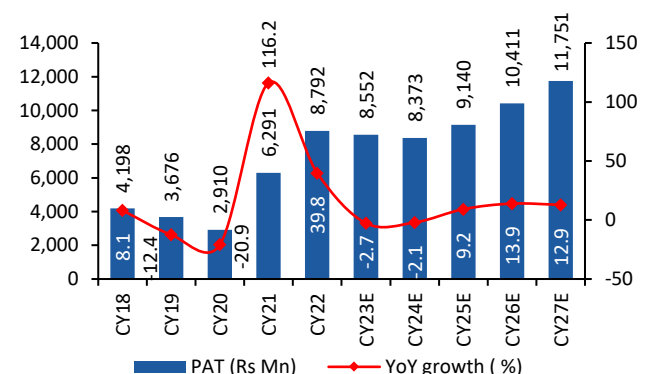
Source: Industry, Centrum Broking

The management has admitted the sluggish performance in exports and in industrial segment, and attributed it to inventory correction drive in Europe and demand contraction in few sectors in the domestic economy. They have further guided for weaker performance in H2CY23 and expect that it may continue for few more quarters beyond CY23.

We have taken note of these developments and estimating tepid YoY revenue growth for CY23E and CY24E. Lower revenue growth, compression in EBIDTA margin YoY along with higher rate of growth in depreciation than revenue growth is likely to result in YoY decline in PAT for CY23E and CY24E.

Exhibit 151: YoY revenue growth down to single digit

Source: Company Data, Centrum Broking

Exhibit 152: PAT to witness marginal decline in CY23/CH24

Source: Company Data, Centrum Broking

Exhibit 153: Exports and Industrial segment to remain subdued till CY24E

YoY growth rate %	CY21	CY22	CY23E	CY24E	CY25E	CY26E
Automotive Segment	49.9	22.8	11.7	10.2	10.4	11.4
Industrial Segment	39.1	12.4	-6.0	-1.0	7.0	7.0
Exports and others	70.9	59.6	-5.0	0.0	18.0	20.0

Source: Company data, Centrum broking

Is it too much too fast for Schaeffler India?

Schaeffler India is doing too many things at the same time which includes plant relocation, acquisition, capacity expansion, etc.

Capex of Rs10bn is huge on the existing Gross Block of Rs21bn, it is around 50% addition in the next 12 to 15 months

Huge capital outlay (Rs10bn on existing Gross Block of Rs21.7bn) for localization of products & supply chains, capacity expansion, plant relocation, investments in adjacencies and inorganic growth made Schaeffler India spreading too much too fast. It enjoys strong financial position aided by last couple of years of accelerated performance. All these are structural steps with long term benefits. However, in the interim period of next 4-6 quarters, the company could face challenging or testing times impacting its financials.

Huge capex of Rs10bn lined up for capacity expansion, plant relocation and for localization

Schaeffler India has always been following the strategy of local for local globally. In India also, the company is following it for automotive segment. Almost all the bearings required for automotive segment are locally produced. However, bearings for industrial applications are imported. Exports was not its focus area. However, post pandemic the group has changed its strategy and the concept of the best cost country came up. The region or the country which possesses necessary technical and cost competency would get an opportunity to start making that product. Based on this strategy, Schaeffler India got selected to manufacture Tapered Roller bearings. The Schaeffler group is relocating its plant from Europe to Savali, Gujarat. Total estimated relocation cost is Rs3bn. This plant will be utilised to boost the exports.

Besides plant relocation, the company has undertaken capex to enhance SRB and CRB capacity by 10% for wind, heavy industries and railways. The company is setting up heat treatment plant, grinding unit, etc. The construction at Hossur plant has started.

The company has chalked out a plan to spend 5-7% of quarterly revenue on capex. The construction at Hossur plant in Tamil Nadu has also started.

The company outlined the total capex of Rs10bn for CY23 and CY24 on the existing Gross Block of Rs21bn, out of that Rs2.50bn is already spent in 1HCY23. This is a huge capex.

Muted top line growth, compression in EBIDTA margin and higher depreciation growth rate to result in YoY decline in PAT

Exhibit 154: CFO growth would lag capex growth

Particulars (Rs mn)	CY17	CY18	CY19	CY20	CY21	CY22	CY23E	CY24E	CY25E	CY26E	CAGR CY19-CY22	CAGR CY22-CY25E
Gross block	9,429	10,777	14,000	17,045	19,541	21,699	26,409	31,619	35,970	40,790	16%	18%
Capex	4,927	1,348	3,224	3,044	2,496	2,158	4,710	5,210	4,351	4,820	-13%	26%
CFO	4,010	2,382	7,446	6,492	4,647	7,505	9,916	10,048	10,422	11,857	0%	12%

Source: Centrum Broking, Company Data

Exhibit 155: Depreciation to grow at higher CAGR than revenue

Particulars (Rs mn)	CY18	CY19	CY20	CY21	CY22	CY23E	CY24E	CY25E	CY26E	CY27E	CAGR CY19-CY22	CAGR CY22-CY25E
Net revenue	45,615	43,606	37,618	55,605	68,674	70,516	74,056	81,824	91,195	1,02,391	23%	9%
Depreciation	1,485	1,587	1,940	1,971	2,065	2,437	2,874	3,301	3,750	4,249	8%	15%

Source: Centrum Broking, Company Data

Exhibit 156: Annual depreciation growth rate would be higher than revenue growth rate

Particulars (%)	CY18	CY19	CY20	CY21	CY22	CY23E	CY24E	CY25E	CY26E
Revenue growth rate	16.0	-4.4	-13.7	47.8	23.5	2.7	5.0	10.5	11.5
Depreciation growth rate	7.5	6.9	22.2	1.6	4.7	18.0	17.9	14.9	13.6

Source: Centrum Broking, Company Data

Exhibit 157: CFO annual growth rate would be lower than Gross block growth rate

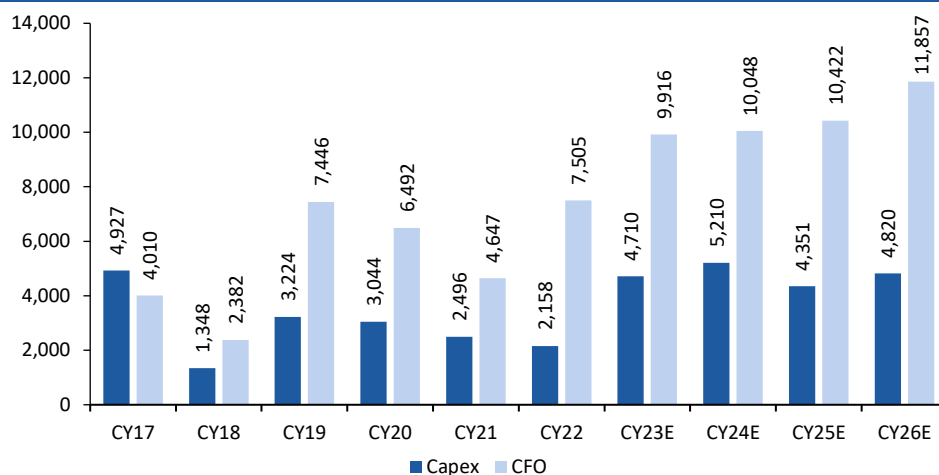
Particulars	CY18	CY19	CY20	CY21	CY22	CY23E	CY24E	CY25E	CY26E
Gross block growth rate %	14.3	29.9	21.7	14.6	11.0	21.7	19.7	13.8	13.4
CFO growth rate %	-40.6	212.6	-12.8	-28.4	61.5	32.1	1.3	3.7	13.8

Source: Centrum Broking, Company Data

From above tables following inferences can be drawn

Lower revenue growth rate coupled with compression in margin and accelerated depreciation would result in marginal decline in PAT till CY24E

- The capex each year from CY23E would be lower than CFO generated in the respective year. Hence, there won't be any requirement to borrow in future. However, YoY growth rate of CFO would be lower than YoY Gross Block growth rate.
- Revenue estimated to clock a CAGR of 6% between CY22-25E. However, during the same period, depreciation to clock a higher CAGR of 13%. For the medium term till CY24E, revenue will grow at an average rate of 3.9% while depreciation to grow at an average rate of 18%. This along with compression in EBITDA margin would result in YoY decline in PAT for each of CY23E and CY24E at an average rate of 2.4%.

Exhibit 158: Capex to remain lower than CFO (Rs mn)

Source: Company Data, Centrum Broking

Current localization level, share of traded goods in revenue indicates capex for localization to continue

The company aims to increase localization level gradually to 80% over a period of next few years from the current 75%

Since the company doesn't have any unlisted associate entity or any unlisted subsidiary of parent in India, we can take traded goods share as proxy to get the share of localization. Share of traded goods in the revenue has been stuck in the range of 25-30% since past few years. Hence, rest of the portion 70-75% represents localization level. The management during quarterly earnings discussions shared the same range. The company is planning to increase localisation level to 79-80%. The company has guided for the capex of 6% of the quarterly revenue to achieve the targeted level of localization.

Exhibit 159: Gradual decline in the share of traded revenue is expected

Particulars	CY17	CY18	CY19	CY20	CY21	CY22	CY23E	CY24E	CY25E	CY26E
Share of traded revenue %	26.0	31.3	27.6	24.1	25.8	24.6	24.0	22.8	22.0	21.5

Source: Company Data, Centrum Broking

Exhibit 160: Localisation level has been around 75% since past few years

Particulars	CY2018	CY2019	CY2020	CY2021	CY2022
Localisation Level %	69.1	70	75.5	74.2	75

Source: Company Data, Centrum Broking

Koovers acquisition is a good strategic move; but would be margin and EPS dilutive in the interim

Schaeffler India is targeting automotive aftermarkets through e-commerce platform

Schaeffler India will acquire 100% stake in KRSV Innovative Auto Solutions (KRSV) at an equity value of Rs1.42bn in an all-cash deal (implied valuation of 1.8X FY2023 EV/sales). The transaction expected to get completed by Q3CY23. KRSV offers B2B e-commerce spare parts solutions to the Indian automotive aftermarket workshops through their app 'Koovers DMS'. The platform will continue to operate under Koovers brand and operate as a wholly owned subsidiary of Schaeffler India.

With the acquisition, the company targets to tap on the automotive aftermarket segment through e-commerce platform to improve market penetration, which will drive revenue growth over the medium term. The acquisition will also help the company become an omni channel player with all of their products getting listed on the platform and utilizing the distributors network to fulfil the requirement of the customers.

Schaeffler India is further required to invest in logistics backbone and technology in Koovers

The management shared that Koovers has become positive only at gross level. The platform requires further investments to make it technologically more advanced. It's back-end operations and logistics support need to be strengthened as Schaeffler wants to make it a Pan India platform, which is currently focussing on part of South India. Hence, we believe this acquisition will remain margin dilutive and thereby earnings dilutive for the next few quarters.

Above KRSV: KSRV offers passenger vehicle spare parts solutions to more than 7,000 workshops and has a listed portfolio of 1.8mn SKUs in the Koovers app through which the company sells the products to both retail and commercial customers. Koovers revenues grew at 112% CAGR over FY21-23 from Rs168mn to Rs777mn, albeit on a low base.

Exhibit 161: Automotive aftermarkets revenue share to grow into double digit

Particulars	CY20	CY21	CY22	CY23E	CY24E	CY25E	CY26E
Revenue Share of automotive aftermarket (%)	8.9	9.0	8.6	9.7	11.1	12.0	12.9
YoY growth in aftermarket revenue (%)		50	18	15	20	20	20

Source: Company Data, Centrum Broking

Bearing forms only 60% of the revenue; rest comes from selling other components

Amalgamation with LUK and INA makes Schaeffler India more diverse auto component player. Non-bearing revenue has now touched 40%

Before amalgamation with INA and LUK, FAG was a bearing player with most of the revenue coming from selling bearings. Post amalgamation, Schaeffler in its new version has more products which includes transmission components like clutches, chassis precision components, damper, flywheel, engine components like timing drive, variable valve train, etc. The company has over the last few years added more products which are either manufactured by itself or bought out for trading purpose. These products primarily serve

OPTIME is condition monitoring service of the company. It uses algorithms and machine learning for the remote diagnosis of the problem

aftermarkets. It includes own manufactured products like shock absorbers, centre joint support, etc. Traded products include wiper blades, lubrication system, batteries, etc. The reason for adding these products is to widen and deepen aftermarket presence. It aids in growing core business and brings additional revenue as well. Distributors also demand more products to increase customer engagement.

The company also offers condition monitoring services through its flagship product called OPTIME. Through this the company help clients to improve plant reliability, efficiency, and uptime needs. What company offers here are the services to make root cause analysis about the health of machine or equipment with the support of algorithms and machine learning software. This is an industry agnostic solution but is mainly useful in continuous process industry wherein cost of downtime is far more than the cost of hiring these services.

Exhibit 162: Services segment revenue

Particulars	CY19	CY20	CY21	CY22	CY23E	CY24E	CY25E	CY26E
Services revenue as % of total revenue	0.17	0.23	0.22	0.66	0.70	0.70	0.69	0.71
YoY growth in Services revenue (%)	23	18	44	265	8	5	10	15

Source: Company Data, Centrum Broking

Not a significant player in railway segment though qualified to supply for all applications

Schaeffler has localized CTRB manufacturing for railways

While the revenue share from railways ranges between 3 -4%, Scaheffler India has made a lot of investments in localizing all bearings and other components required for passenger coaches, metro coaches, locomotives and freight applications. The company never had any significant presence in freight applications but has sizable market share in metro, passenger coaches (Non LHB coaches) and locomotives. The company has also localised manufacturing of TRB knowing fully that Indian Railways is moving towards TRBs even for passenger coaches and locomotives applications.

It won a contract to supply CTRBs for LHB coaches of Vande Bharat for suspension rod bearing and traction motor bearings. These are CTRBs UIC 130. In metro, the company not only supplies bearings but entire subassembly with axle boxes. It is also supplying traction motors wherein specially coated bearings are required. Schaeffler India is pioneer in manufacturing it in India. As of February 2023, the field trials for bearings for LHB coaches has been completed, and the company is manufacturing it in India.

Company won the contract to supply bearings to LHB coaches of Vande Bharat train

The company admitted that they do not have good products to offer in freight application segment given that it is a cost driven market. It has launched a bearing for electric locomotive in 2019 and also launched Class K bearing TAROL for DFC in 2019. The company won a small order of 1,200 bearings in 2016 to supply TAROL to railways. The company manufactures railway bearings at Maneja which has got AAR (American Association of Railroad) Certification both for product as well for plant. This will allow Schaeffler India to export railway application bearings to US. The company also provides refurbishment of bearing services to railways from its Maneja plant.

Very low presence on freight application business

Exhibit 163: CTRB order

Particulars	Product	Unit	2013	2017	2018
Schaeffler India					
Bearings	CTRB	Nos	5,909	10,815	21,426
Rate		Rs per unit	10,050	10,140	10,400
Order Size		Rs mn	59.39	109.66	222.83

Source: Indian Railways, Centrum Broking

Exhibit 164: K Class bearings for DFC

Particulars	Product	Unit	2016
Bearings	CLASS K	Nos	1200
		Rs per unit	19140
		Rs mn	22.97

Source: Indian Railways, Centrum Broking

We have sourced this data for freight application bearings from Railways and it can be seen that the company has very less presence on freight application side of railway business.

Range of products to offer in the Electric Vehicle (EV) space; but it's a long haul

Started acquiring EV business in 2W segment

Schaeffler group is globally present on transmission, engine and chassis applications in EV space. They are present in leading names like Tesla. The parent will share EV technology with Indian subsidiary. Schaeffler India has started acquiring Electric 2-wheeler business in India. The company is working with an electric passenger vehicle manufacturer for 2-in-1 clutch for e-axle which offers Euro 300mn opportunity spread over 7-years. The manufacturing will start in CY24. It would be an electric motor coupled with gear box along with power electronics that go with it. Schaeffler India will have motor and gearbox of its own while power electronics would be bought out. The sample production is under way. It's an import substitute product. The company might go for Production Linked Incentive Scheme (PLI scheme) for this product. The company expects to improve content per vehicle from Euro 50 to Euro 70 from this product over a period of time. EV contributes less than 3% to the top line.

Schaeffler group is globally working on following products and technologies in EV space

Developing 2-in-1 e-axle for EV in passenger vehicle segment. It's a Euro 300mn opportunity for 7-years. Expected to start from 2025

- High power density motor for e-axle
- Series production of motors
- Controller that goes with motors
- Robotics products like planetary gear box
- Digitalisation support system
- Lubrication system
- Condition monitoring system
- Thermal management system
- 2 speed transmission system to integrate with motor – it is being developed in India
- Hydraulic Lash Adjuster

Content per vehicle likely to go up with addition of components from current Euro 50

Content per vehicle reached Euro 50 for gasoline vehicles

The content per vehicle has moved up from Euro 37 as of March 2020 to Euro 50 as of June 2023. However, it has been a roller coaster ride for the company over the quarters. But largely it was steady around Euro 40. With foray into EV and addition of new products in its quiver, the company aims to take it to euro 70 over a period of time.

Exhibit 165: Content per vehicle

Particulars	CY2018	CY2019	CY2020	CY2021	CY2022
Content per vehicle (Euro per unit)	33	37.5	38	40	50

Source: Company Data, Centrum Broking

Performance of wind sector with contribution of 7-10% to the revenue has been volatile

Largest player in the wind energy space globally

In the June quarter earnings communication, the management portrayed some optimistic picture for the sector after a sluggish performance for more than four sequential quarters in terms of equipment produced in the country. The company said that they have witnessed 16% growth in wind equipment produced in the country on sequential basis in June 2023 quarter. Schaeffler India's June 2023 quarterly revenue from wind sector is up 31%.

However, there are still lot of headwinds globally for the wind business on account of Ukraine war and suspension of order book for gearbox manufacturers.

Other income led PAT growth in 1HCY23

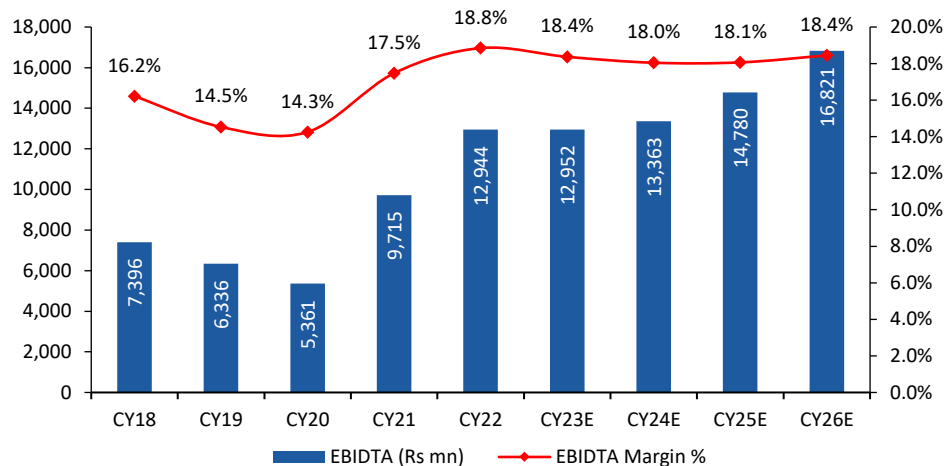
A 75% YoY jump in other income in 1HCY23 allowed Schaeffler to report 6% jump in the PAT

The company has reported lower revenue and PAT growth rates and EBIDTA margin compression for 1HCY23 vs. 1HCY22. Slowdown in exports and industrial segment has resulted in lower revenue growth rate. The company has reported 75% YoY jump in other income which led to 5.5% growth in PAT despite the erosion of EBIDTA margin by 35bps YoY. However, the company has exceptional gains of Rs149.8mn in 1HCY22 when it sold its Chain drive business to CATENSYS.

Financial performance

Exhibit 166: EBITDA margin to decline till CY24E

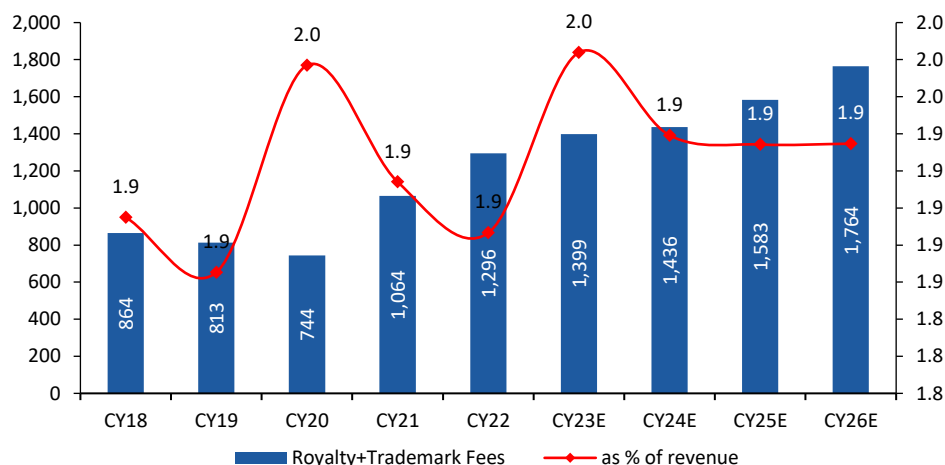
Gross margin in 1HCY23 expanded by 55 bps which would arrest huge fall in EBITDA margin despite lower revenue growth in CY23E



Source: Company Data, Centrum Broking

Exhibit 167: Royalty and trademark fees

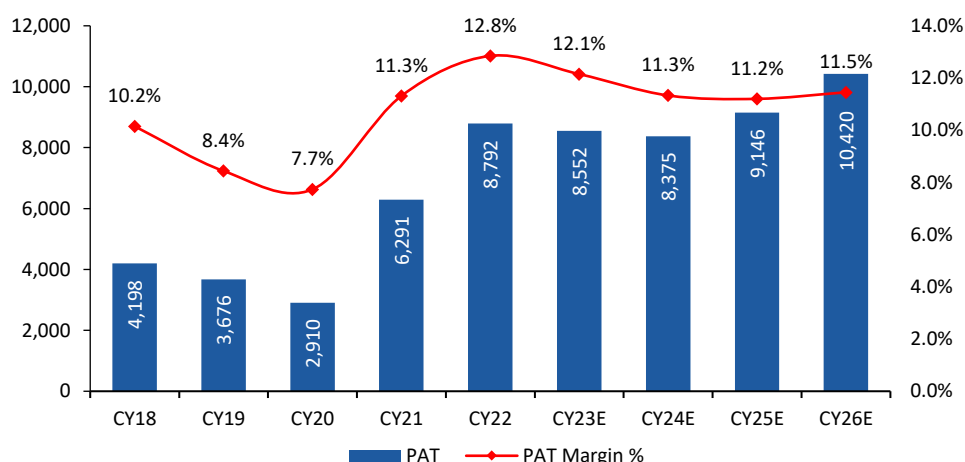
Royalty and trademark fees to remain around 2%



Source: Company Data, Centrum Broking

Exhibit 168: PAT and PAT margin

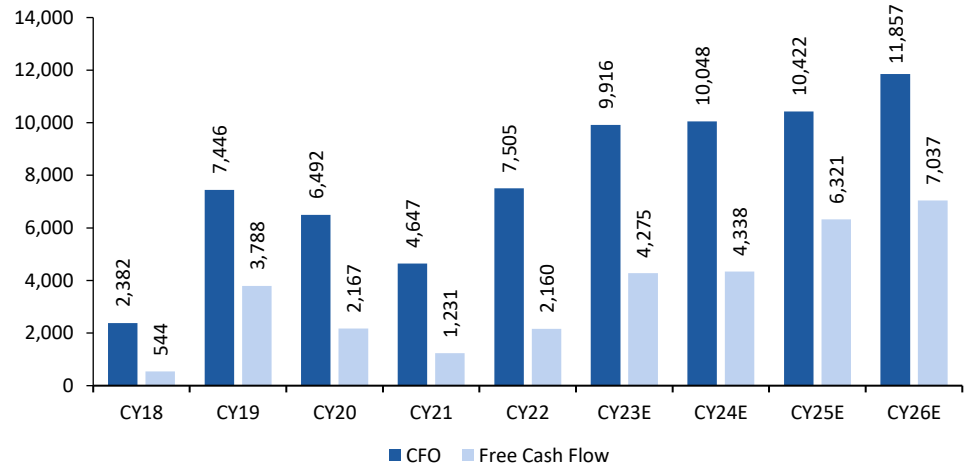
PAT margin to decline owing to lower revenue growth, higher depreciation and decline in EBITDA margin



Source: Company Data, Centrum Broking

Exhibit 169: CFO and Free Cash Flow to go down

The CFO would be higher than capex per annum which led to Free Cash Flow growth



Source: Company Data, Centrum Broking

Valuations and outlook

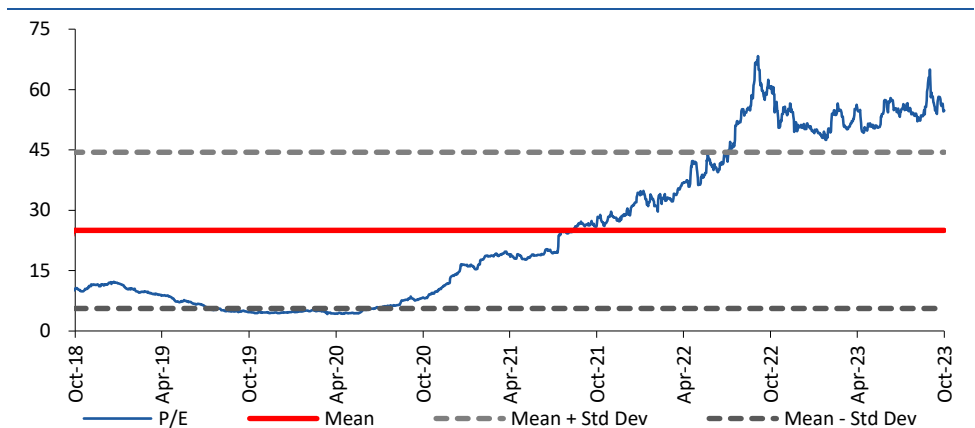
Schaeffler India: We have witnessed YoY revenue decline in industrial segment and exports (together 47% of the revenue) in the latest two sequential quarters of CY23 which has resulted in muted 6% YoY revenue growth in 1HCY23. Schaeffler India draws most of the automotive revenue from critical and higher margin engine, chassis and transmission applications. The company commands higher EBITDA margin than its nearest competitor SKF India despite the comparatively lower gross margin and higher share of OEMs in the automotive revenue. Higher margin exports have also reached to 17% share in the revenue. The company has shown improvement in localization level from less than 65% to 75% over past few years. The market perceived amalgamation with LUK and INA as a sign of better corporate governance. All these have put Schaeffler India at a premium valuation than SKF India. However, taking clue from the last few consecutive quarterly results and the sound bites from the management expressing caution on H2CY23 performance and likely medium term stress in exports as well as in industrial space (both put together 47% of the revenue), we estimate decline in revenue growth rate and in margin resulting in marginal decline in PAT for the next two fiscals. However, ongoing capex will improve exports and industrial business in domestic market from CY25 onwards. And hence, we have valued the company based on its last 3-year average earnings multiple to reflect the trust in its capabilities. We recommend Sell with TP of Rs1,681 (30x 1HCY25E EPS of Rs 56).

Exhibit 170: Average PE

Schaeffler India	3 year	5 year	10 year
Average PE (x)	29.3	30.1	31.2

Source: Bloomberg

Exhibit 171: Schaeffler India - PE Ratio



Source: Bloomberg

Exhibit 172: Company Financials

Y/E March (Rs mn)	CY21	CY22	CY23E	CY24E	CY25E	CY26E	CY27E
Revenue	55,605	68,674	70,516	74,056	81,824	91,195	1,02,391
YoY (%)		23.5	2.7	5.0	10.5	11.5	12.3
EBITDA	9,715	12,944	12,952	13,363	14,780	16,821	18,977
EBITDA (%)	17.5	18.8	18.4	18.0	18.1	18.4	18.5
PAT	6,291	8,792	8,552	8,375	9,146	10,420	11,763
YoY (%)		39.8	(2.7)	(2.1)	9.2	13.9	12.9
FDEPS (Rs)	201.3	56.3	54.7	53.6	58.5	66.7	75.3
RoE (%)	18.5%	21.8%	18.9%	16.7%	16.6%	17.0%	17.2%
RoIC (%)	27.1%	29.0%	24.9%	22.4%	23.1%	24.5%	25.7%
P/E (x)	80.2	57.4	59.0	60.3	55.2	48.4	42.9
EV/EBITDA (X)	50.5	37.8	37.7	36.4	32.7	28.5	25.0
CFO	4,647	7,505	9,916	10,048	10,422	11,857	13,205
Free CF	1,231	2,160	4,275	4,338	6,321	7,037	7,825
FCF yield (%)	1.2	0.4	0.8	0.9	1.3	1.4	1.6
EBITDA to CFO conversion (%)	47.8	58.0	76.6	75.2	70.5	70.5	69.6
Cash Conversion Cycle (days)	54	61	66	65	64	64	63

Source: Company data, Centrum Broking

Risks

- Over-dependence on Germany and in turn on Europe for exports.
- Huge capex undertaken at present. If revenue doesn't register at least high teens growth rate, the bottom line growth would be negative
- Auto components and products other than bearings are margin dilutive.
- Prolonged sluggish economic activities in the company's export destinations.

P&L					
YE Dec (Rs mn)	CY21A	CY22A	CY23E	CY24E	CY25E
Revenues	55,605	68,674	70,516	74,056	81,824
Operating Expense	37,355	45,923	47,389	49,721	55,192
Employee cost	3,952	4,306	4,736	5,209	5,730
Others	4,582	5,502	5,439	5,763	6,121
EBITDA	9,715	12,944	12,952	13,363	14,780
Depreciation & Amortisation	1,971	2,065	2,437	2,874	3,301
EBIT	7,744	10,879	10,515	10,489	11,479
Interest expenses	37	36	36	36	36
Other income	0	0	0	0	0
PBT	8,431	11,621	11,449	11,211	12,243
Taxes	2,140	2,978	2,897	2,836	3,097
Effective tax rate (%)	25.4	25.6	25.3	25.3	25.3
PAT	6,291	8,642	8,552	8,375	9,146
Minority/Associates	0	0	0	0	0
Recurring PAT	6,291	8,642	8,552	8,375	9,146
Extraordinary items	0	150	0	0	0
Reported PAT	6,291	8,792	8,552	8,375	9,146
Ratios					
YE Dec	CY21A	CY22A	CY23E	CY24E	CY25E
Growth (%)					
Revenue	47.8	23.5	2.7	5.0	10.5
EBITDA	81.2	33.2	0.1	3.2	10.6
Adj. EPS	116.2	(72.5)	(1.0)	(2.1)	9.2
Margins (%)					
Gross	37.7	38.1	38.2	38.0	37.8
EBITDA	17.5	18.8	18.4	18.0	18.1
EBIT	13.9	15.8	14.9	14.2	14.0
Adjusted PAT	11.3	12.8	12.1	11.3	11.2
Returns (%)					
ROE	18.5	21.8	18.9	16.7	16.6
ROCE	18.0	21.5	18.5	16.6	16.4
ROIC	27.1	29.0	24.9	22.4	23.1
Turnover (days)					
Gross block turnover ratio (x)	2.8	3.2	2.7	2.3	2.3
Debtors	50	50	54	54	52
Inventory	95	100	106	104	101
Creditors	91	89	94	93	90
Net working capital	54	54	55	55	56
Solvency (x)					
Net debt-equity	(0.4)	(0.4)	(0.3)	(0.3)	(0.4)
Interest coverage ratio	264.7	364.6	363.6	375.1	414.9
Net debt/EBITDA	(1.4)	(1.2)	(1.3)	(1.3)	(1.4)
Per share (Rs)					
Adjusted EPS	201.3	55.3	54.7	53.6	58.5
BVPS	1,168.8	274.2	305.1	334.9	369.6
CEPS	264.3	68.5	70.3	72.0	79.6
DPS	16.0	24.0	24.0	24.0	24.0
Dividend payout (%)	8.0	42.7	43.9	44.8	41.0
Valuation (x)					
P/E	15.6	56.6	57.2	58.4	53.5
P/BV	2.7	11.4	10.3	9.3	8.5
EV/EBITDA	48.9	36.6	36.5	35.3	31.7
Dividend yield (%)	0.5	0.8	0.8	0.8	0.8

Source: Company, Centrum Broking

Balance sheet					
YE Dec (Rs mn)	CY21A	CY22A	CY23E	CY24E	CY25E
Equity share capital	313	313	313	313	313
Reserves & surplus	36,224	42,546	47,378	52,033	57,458
Shareholders fund	36,537	42,859	47,691	52,345	57,771
Minority Interest	0	0	0	0	0
Total debt	88	100	100	100	100
Non Current Liabilities	554	506	506	506	506
Def tax liab. (net)	0	0	0	0	0
Total liabilities	37,179	43,465	48,297	52,951	58,376
Gross block	19,541	21,699	26,409	31,619	35,970
Less: acc. Depreciation	(8,844)	(10,472)	(12,909)	(15,783)	(19,084)
Net block	10,697	11,227	13,500	15,836	16,886
Capital WIP	892	2,493	2,000	2,000	2,000
Net fixed assets	11,589	13,721	15,500	17,836	18,886
Non Current Assets	2,815	3,603	3,603	3,603	3,603
Investments	0	0	1,424	1,924	1,674
Inventories	10,865	12,434	12,785	13,415	14,867
Sundry debtors	8,463	10,324	10,626	11,159	12,330
Cash & Cash Equivalents	14,157	15,545	16,771	17,978	21,211
Loans & advances	162	309	309	309	309
Other current assets	512	948	948	948	948
Trade payables	9,645	11,117	11,368	11,920	13,149
Other current liab.	1,473	2,058	2,058	2,058	2,058
Provisions	666	627	627	627	627
Net current assets	22,374	25,757	27,385	29,204	33,829
Total assets	37,179	43,465	48,297	52,951	58,376
Cashflow					
YE Dec (Rs mn)	CY21A	CY22A	CY23E	CY24E	CY25E
Profit Before Tax	8,431	11,770	11,449	11,211	12,243
Depreciation & Amortisation	1,971	2,065	2,437	2,874	3,301
Net Interest	(453)	(609)	(671)	(589)	(632)
Net Change – WC	5,796	(822)	(402)	(611)	(1,393)
Direct taxes	(1,895)	(3,136)	(2,897)	(2,836)	(3,097)
Net cash from operations	4,647	7,505	9,916	10,048	10,422
Capital expenditure	(1,842)	(4,830)	(4,217)	(5,210)	(4,351)
Acquisitions, net	0	0	0	0	0
Investments	0	0	(1,424)	(500)	250
Others	(1,574)	(515)	0	0	0
Net cash from investing	(3,416)	(5,345)	(5,641)	(5,710)	(4,101)
FCF	1,231	2,160	4,275	4,338	6,321
Issue of share capital	0	0	0	0	0
Increase/(decrease) in debt	0	0	0	0	0
Dividend paid	(1,188)	(2,501)	(3,751)	(3,751)	(3,751)
Interest paid	(3)	(5)	(36)	(36)	(36)
Others	(77)	(64)	738	656	698
Net cash from financing	(1,269)	(2,570)	(3,049)	(3,131)	(3,089)
Net change in Cash	(38)	(410)	1,226	1,207	3,232

Source: Company, Centrum Broking

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