

Does SKF's high value creation deserve a re-rating?





Valuation Master Class

This information is for learning purposes only.

This is not investment advice or a recommendation.



Does SKF's high value creation deserve a re-rating?





Sector: Industrials



Among the 6 largest manufacturers of bearings and seals worldwide

My estimate: **SEK265**

(Upside 20%)



3 things to know about this company

- Consolidation of manufacturing sites drives margin expansion
- High single-digit industry growth mainly driven by Asia
- ★ Consistent value creation while peers struggle

Key statistics

Analyst consensus (7)

PE ratio

Dividend yield

SEK250

14.2x

2.8%

(**Upside 14%**)

BUY

Revenue breakdown 2020



Sales

Story

FVMR

Value

WCB

Risks

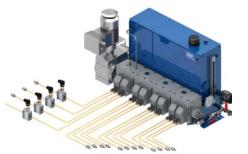
Main product range

Bearings



Seals





Breakdown by customer

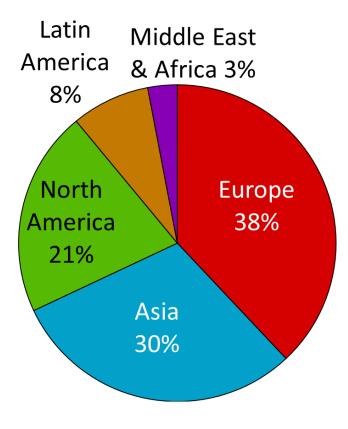
Industrial 73%



Automotive 27%



Breakdown by region



Price could turn bullish soon; but no support from volume



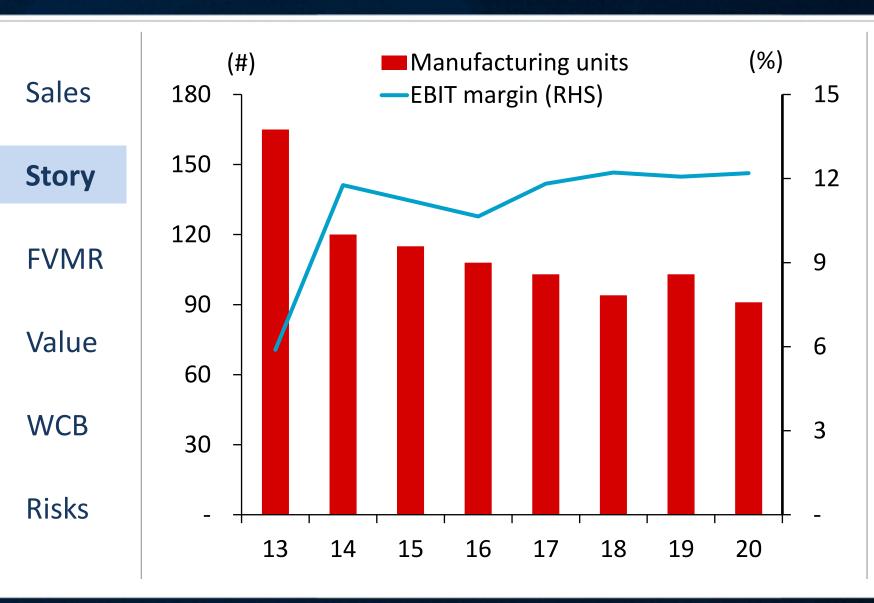


- Overall, the stock price stayed flat over the past year
 - The 50DMA line stayed below the **200DMA since 2H21**
 - However, most recently, the 50DMA moved closer and could cross it soon, which would be a positive signal
- The Volume RSI has been weak recently, which we would interpret as bearish



Consolidation of manufacturing sites drives margin expansion





- Since 2013, SKF has divested 74 of its manufacturing units
 - This equals a reduction of 44% and freed up more than SEK7bn
- The company focused on consolidation and expansion of its primary manufacturing sites

Stable and growing margin shows its resiliency

Sources: A. Stotz Investment Research, company data



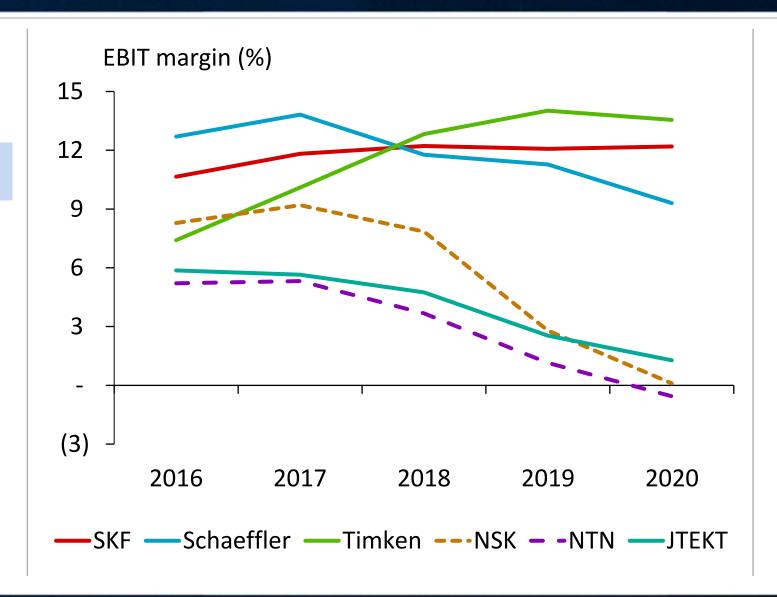


Story

FVMR

Value

WCB



- The consolidation strategy paid off as SKF has now the second-highest operating margin among the 6 biggest manufacturers of bearings
 - Overall, the 6 players make up more than 70% of global output
- It's also worth noting that SKF's margin has been the most stable among all peers



High single-digit industry growth mainly driven by Asia



Sales

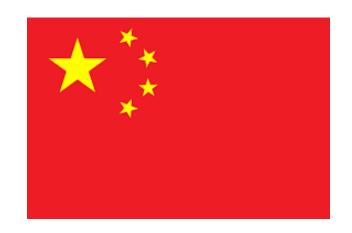
Story

FVMR

Value

WCB

- ★ In 2020, the global bearings market was about SEK390bn
 - Asia makes up around 50% of it (China 30%)
- ★ In 6 years, the market value could reach SEK690bn, a 77% increase from 2020
 - Rapid urbanization in Asia drives demand for bearings that are used in infrastructure, industrials, and automobile industries
- ★ SKF expanded its presence in China which makes me optimistic that it can reach 5%+ EPS growth over the next 5 years





Consistent value creation while peers struggle



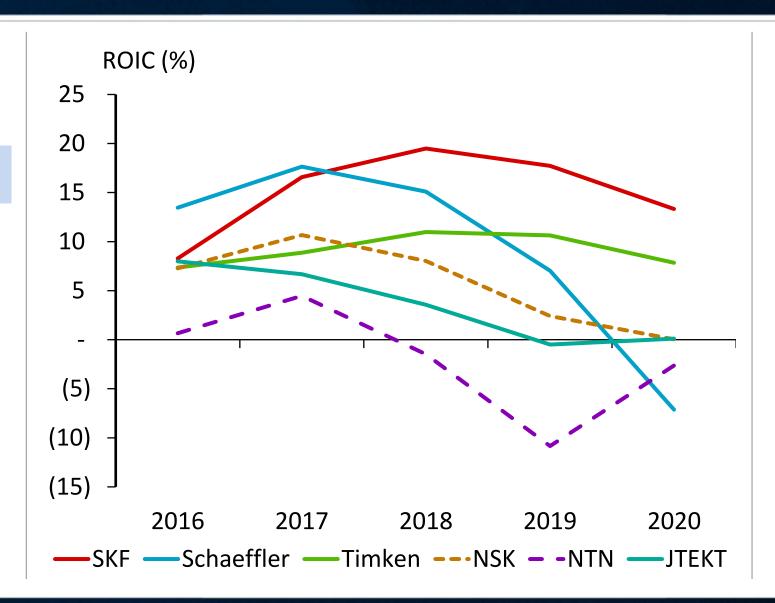


Story

FVMR

Value

WCB



- ★ SKF has shown an impressive ROIC over the past years that has led to value creation
- It generates the highest return among all its closest competitors
- Management's objective is to return to an ROIC of 15%
 - I believe it could exceed this target by 2-3ppts in 22E



Home

Student login

FAQ

5

Resources

Testimonials



What Is Going to Happen with Inflation?

By Valuation Master Class Student

Many forces at work impact inflation.
There are current trends that cause both inflationary and deflationary measures.
Whether we'll see inflation or deflation in the future depends on which of these forces dominate.

Read More



How to Value a Startup

By Andrew Stotz

This story started when Dan, a podcast listener, replied to my recent weekly email with this question, "How do you value a startup, especially if there is no revenue?"

Read More



How to Fight Back When Your Dreams Are Crushed

By Andrew Stotz

The trouble you face is not your fault, and I'm gonna show you how you can fight back. I challenge you to recommit to your dreams today!

Read More

ValuationMasterClass.com



What Does It Mean to Be

Financially World Class?





Scan this QR code to go to the ValuationMasterClass.com blog to download all full Case Study reports for free.

*It's usually up within 24h.



FVMR Scorecard

- Measures a stock's
 attractiveness relative to all
 other companies
- * Attractiveness is based on four elements
 - Fundamentals, Valuation,
 Momentum, and Risk
- *Scale from 1 (Best) to 10 (Worst)



Average on fundamentals, but attractive on valuation



Sales

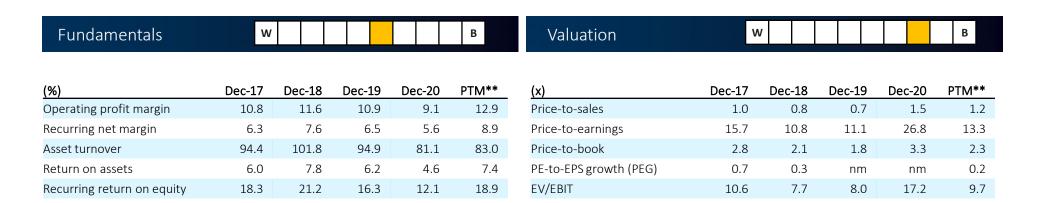
Story

FVMR

Value

WCB

Risks



Momentum	W				В	Risk	W				В
(%)	Dec-17	Dec-18	Dec-19	Dec-20	PTM**	(x)	Dec-17	Dec-18	Dec-19	Dec-20	PTM**
Revenue growth	7.4	10.0	0.4	(13.0)	5.0	Current ratio	2.1	2.3	2.1	2.2	2.4
Recurring EPS growth	21.4	32.1	(14.1)	(24.9)	88.0	Net debt-to-equity (%)	42.6	19.3	36.7	14.7	13.4
Operating profit margin chg. (bps)	40	83	(76)	(175)	407	Times-interest-earned	12.5	16.7	12.5	23.7	nm
	6mth	3mth	1mth	3wk	1wk		5yr	3yr	1yr	6mth	3mth
Price change	(8.9)	(4.9)	(0.7)	(3.1)	1.3	Beta	1.2	1.1	1.0	0.9	1.0

Note: Benchmarking against 190 non-financial companies in Sweden.

Recently, I created a short online course explaining my FVMR investing approach

I usually sell it for \$97 but for a limited time I am offering it for FREE





Consensus sees small upside



Sales

Story

FVMR

Value

WCB

Risks

Analyst consensus valuation						
Recommendation	Oct-21	Nov-21	Dec-21	Current		
Strong buy	3	3	2	3		
Buy	9	9	9	10		
Hold	6	7	8	8		
Sell	5	5	5	4		
Strong sell	-	-	-	-		
Average score	2.6	2.6	2.7	2.5		
Price target	Oct-21	Nov-21	Dec-21	Current		
Median	243	235	230	250		
Mean	255	245	243	251		

25 analysts



Upside: 14%

- Majority of analysts issued a BUY recommendation while 4 have a SELL
- Consensus expects two strong years in terms of revenue that make up for the decline in 2020
 - 23E onward, analysts assume rather slow but steady growth

Analyst consensu	ıs 3-year fo	recast			348	
(%)	18	19	20	21 E	22 E	23E
Revenue growth	2.5	0.4	(13.0)	7.8	7.2	3.2
Gross margin	24.4	24.4	22.7	25.7	26.1	26.3
EBIT margin	12.2	12.1	12.2	13.3	13.7	14.3
Net margin	8.5	6.5	5.7	9.1	9.2	9.7

Profit & loss statement



Sales

Story

FVMR

Value

WCB

(YE Dec, kr m)	2019A	2020A	2021E	2022E
Revenue	86,013	74,852	80,840	86,499
Cost of goods & services	(64,991)	(57,843)	(58,609)	(63,577)
Gross profit	21,022	17,009	22,231	22,922
SG&A	(11,741)	(10,242)	(13,500)	(13,407)
Other operating (exp)/inc	1,100	2,358	2,429	2,502
EBIT	10,381	9,125	11,159	12,016
Interest expense (net)	(626)	(221)	(461)	(516)
Other non-operating inc/(exp)	(472)	(159)	(0)	-
Earnings before taxes (EBT)	9,283	8,745	10,699	11,501
Income tax	(2,677)	(1,826)	(2,996)	(3,220)
Earnings after taxes (EAT)	6,606	6,919	7,703	8,281
Equity income/Minority interest	(223)	(160)	(294)	(317)
Earnings from cont. operations	6,383	6,759	7,409	7,964
Forex/Exceptionals before tax	(826)	(2,461)	(0)	-
Net profit	5,557	4,298	7,409	7,964

- Revenue could return to the pre-pandemic level in 22E
 - Especially, demand from China contributes to a strong rebound

Balance sheet - assets



Sales

Story

FVMR

Value

WCB

(YE Dec, kr m)	2019A	2020A	2021E	2022E
Cash & short-term investments	6,790	14,192	11,151	15,429
Accounts receivable	15,477	13,094	14,147	15,137
Inventories	18,051	15,733	19,536	19,426
Other current assets	7,526	3,879	5,659	6,055
Total current assets	47,844	46,898	50,493	56,048
Long-term investments	-	-	-	-
Net fixed assets	21,411	20,678	21,473	22,319
Intangible assets	7,146	6,125	6,309	6,503
Goodwill	11,251	10,117	10,218	10,320
Other long-term assets	6,456	6,739	7,076	7,430
Total assets	94,108	90,557	95,570	102,620

- ★ SKF recognized a larger inventory in 21E
 - Inventory days have increased to 120 days in 3Q21, which is a 20% increase to the previous year

Balance sheet - liabilities



Sales

Story

FVMR

Value

WCB

(YE Dec, kr m)	2019A	2020A	2021E	2022E
Overdrafts & short-term loans	3,062	2,735	2,225	2,336
Accounts payable	14,989	13,431	13,610	14,764
Other current liabilities	5,089	5,478	4,042	4,325
Total current liabilities	23,140	21,644	19,877	21,425
Long-term debt	14,920	15,089	16,313	17,129
Other long-term liabilities	18,682	18,112	18,474	18,844
Total liabilities	56,742	54,845	54,664	57,397
Minority interest	1,854	1,403	1,712	2,044
Paid-up capital - Common shares	1,702	1,702	1,702	1,702
Paid-up capital - Preferred shares	-	-	-	-
Retained earnings	31,443	33,785	37,492	41,477
Revaluation/Forex/Others	2,367	(1,178)	_	-
Total equity	35,512	34,309	39,194	43,179
Total liab & shareholders' equity	94,108	90,557	95,570	102,620

- The company did not significantly increase its LTdebt during the pandemic
 - Net debt-to-equity is likely to stay around 0.2x in the near future



Sales

Story

FVMR

Value

WCB

Risks

(YE Dec)	2019A	2020A	2021E	2022E
General growth (YoY, %)				
Revenue	0.4	(13.0)	8.0	7.0
Assets	8.0	(3.8)	5.5	7.4
Gross profit	0.5	(19.1)	30.7	3.1
Operating profit	(0.9)	(12.1)	22.3	7.7
Attributable profit	(23.7)	(22.7)	72.4	7.5
EPS	(23.7)	(22.7)	72.4	7.5
Recurring EPS	(13.0)	(1.2)	22.6	7.5
Du Pont analysis (%)				
Net profit margin	6.5	5.7	9.2	9.2
Revenue per kr100 of assets	94.9	81.1	86.9	87.3
Assets/equity (x)	4.5	4.3	3.0	2.4
Return on equity	27.6	19.9	23.8	19.3
Others (%)				
Effective tax rate	31.7	29.1	28.0	28.0
Dividend payout ratio	22.4	48.9	49.9	49.9

Record margin in 21E and 22E expected due to strong demand from the Industrials sector, where SKF makes a higher margin than from its automobile customers

Ratios (cont.)



Sales

Story

FVMR

Value

WCB

(YE Dec)	2019A	2020A	2021E	2022E
Internal liquidity (x)				
Current ratio	2.1	2.2	2.5	2.6
Quick, or acid test ratio	1.3	1.4	1.6	1.7
Working cap. mgmt (Days)				
Inventory conversion period	99	105	108	110
Receivables collection period	64	69	61	61
Days from raw mat to coll	163	174	169	171
Payables deferral period	85	88	83	80
Cash conversion cycle	78	85	86	91
Profitability ratios (%)				
Gross profit margin	24.4	22.7	27.5	26.5
EBIT margin	12.1	12.2	13.8	13.9
EBIT return on avg assets	11.5	9.9	12.0	12.1
Return on average assets	6.1	4.7	8.0	8.0
Financial risk (x)				
Liabilities-to-assets (%)	60.3	60.6	57.2	55.9
Debt-to-equity	0.9	0.8	0.5	0.5
Net debt-to-equity	0.6	0.2	0.2	0.1
Times-interest-earned	18.3	43.2	23.5	24.3
Effective interest rate (%)	4.4	1.6	3.3	3.3

- Increased working cap requirements lengthen the cash conversion cycle
 - Bottlenecks in logistics and customer shutdowns have increased inventories

A. Stotz Investment Research Stock Picking Checklist

- ★ Inspired by Peter Lynch's tenbaggers (when the share price 10x)
- * Based on extensive research
- *9 factors that drive longterm share price performance



Long-term share price performance potential



Sales

Story

FVMR

WCB

Ratios

Value

A. Stotz Investment Research			Good
Stock Picking Checklist		Comment	
 Management – Management has a proven commitment to growth 	Weak	No aggressive expansion or M&A planned	
2. Growth – Product and industry can support a decade of 10%+ annual growth	Moderate	Industry could see high-single digit growth	
3. Sustainable – Competitive strategy creates sustainably high gross margin	Good	Second-highest and most stable margin relative largest players in the market	e to the
1. Quality – Good earnings quality, non- core items are small or non-existent	Moderate	Stable operating profit, but extraordinary expedragged net profit in 2019 and 2020	enses
aster than assets	Moderate	Sales are likely to grow in line with assets	
6. Tight – Relatively low cash conversion cycle, negative is best	Weak	Cash conversion cycle stood at 85 days in 2020 could see an increase due to higher inventory	and
7. Cash flow – Operating cash flow is consistently positive	Good	Stable cash flow generation in the past and the reason to assume differently for the future	ere is no
3. Capacity – Company has access to capital to fund growth	Good	Net debt-to-equity stood at 0.2x in 2020	
9. Inexpensive – Valuation is reasonable, avoid very expensive stocks	Good	Cheap on both PE and PB compared to Swedish Industrials	h

Free cash flow



Sales

Story

FVMR

Value

WCB

(YE Dec, kr m)	2019A	2020A	2021E	2022E
EBIT	10,381	9,125	11,159	12,016
Est tax rate (%)	32	29	28	28
NOPAT	7,095	6,473	8,035	8,652
Add: Depre & amort	3,338	3,370	3,013	3,203
Less: CAPEX	(3,413)	(2,978)	(3,411)	(3,631)
Chg in A/R	(347)	2,383	(1,053)	(990)
Chg in inventory	(225)	2,318	(3,803)	110
Chg in oth curr assets	(4,829)	3,647	(1,780)	(396)
Chg in A/P	(734)	(1,558)	179	1,154
Chg in oth curr liabs	2,100	389	(1,436)	283
Less: Chg in working cap	(4,035)	7,179	(7,893)	160
Less: Chg in invest cap				
Free cash flow to firm	2,985	14,044	(255)	8,385

- ★ SKF likely to record a negative FCFF in 21E due to an increase in inventory
 - The company should be able to return to positive FCFF in 22E and maintain it over time

Value estimate



Sales

Story

FVMR

Value

WCB

Forecast assumptions		
3-year average	Consensus	My assumptions
Revenue growth (CAGR)	6.1	6.7
Gross margin	26.0	26.3
EBIT margin	13.7	13.9
Net margin	9.3	9.3

My valuation method		
Market: Sweden		
Market risk-free rate	1.0	
Market equity risk premium	7.0	
Market return	8.0	Valuation Method:
Company beta (x)	1.0	FCFF
COE	8.0	TCIT
WACC	6.8	
Terminal growth rate	2.0	

- ★ I am a bit more optimistic about the growth outlook than consensus
 - SKF should benefit from strong global demand for bearings over the next 5 years

Value estimate



Sales

Story

FVMR

WCB

Ratios

Value

Risks

Bear **SEK249**



Base **SEK265** (Upside 20%)



Bull **SEK284**

(Upside 29%)



World Class Benchmarking Scorecard

- We identify a company's competitive position relative to global peers
- * We use a composite rank of profitability and growth, called "Profitable Growth"
- Scale from 1 (Best) to 10 (Worst)



Strong profitability and growth



Sales

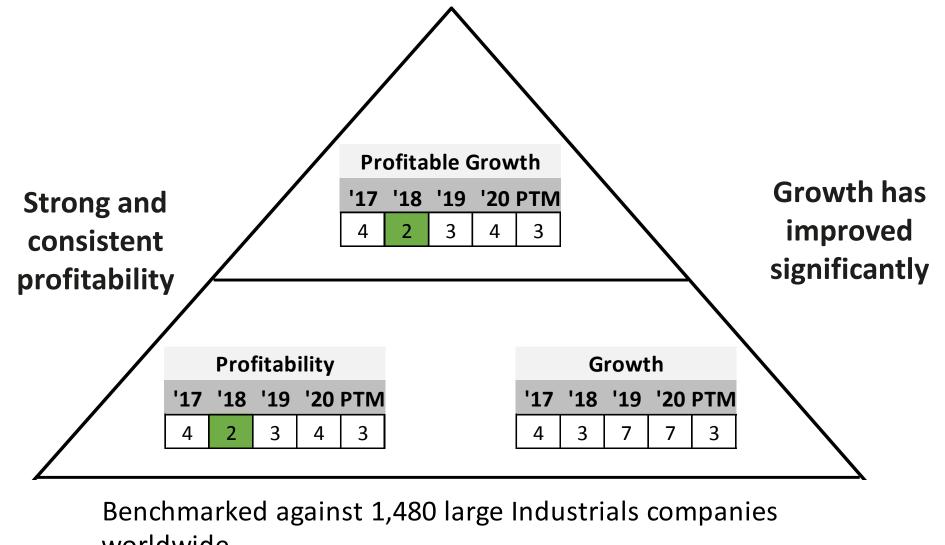
Story

FVMR

Value

WCB

Risks



worldwide.

Key risk is intensifying competition



Sales

Story

FVMR

Value

WCB

- ★ Market could become more fragmented with rising local manufacturers (e.g., China)
- ★ Failure to adapt to changing product requirements by customers
- ★ Fluctuating input prices and inflation could pressure margins

CONCLUSION

- Sector-leading margin results in ongoing value creation
- Industry faces good and stable growth prospects
- Valuation appears cheap; could be a good opportunity to buy

