Management Discussion and Analysis

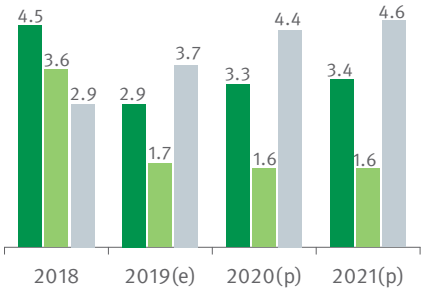
1. Economic overview

1.1 Global

According to the International Monetary Fund (IMF), global economies are estimated to have grown by 2.9% in 2019, down from 3.6% in 2018 and 3.8% in 2017. Weakening economic activity in a few emerging markets such as India, continued uncertainty around trade policy of leading economies and geopolitical tensions were some of the prominent reasons for this slowdown.

Global growth

(%)



p: projections, e: estimate

- World
- Advanced market economies
- Emerging market and developing economies

Source: IMF - World Economic Outlook, January 2020

Most advanced economies witnessed further decrease in economic activity during the year. Even as job creation started to pick up from record lows, consumer price inflation remained muted across most advanced economies amid lower demand for prominent metals as well as oil. The government and central banks around the world continued to announce measures to boost consumption growth. Easing of monetary policy across most economies provided support and is likely to aid world economy over the next few months.

Outlook

The IMF expects global growth to improve and reach levels of 3.3% in 2020 and 3.4% in 2021. Notably, these projections were lowered by 0.1 percentage point and 0.2 percentage points in January 2020, respectively, as compared to those made in October 2019, after considering aggravating stress points in select emerging and advanced economies and rising social unrest. Benefits from easing monetary policy could provide significant tailwinds to economic growth in 2020. Stronger cross-border cooperation and implementation of supportive fiscal policies aimed at boosting demand could also aid global activity.

1.2 India

In FY20, growth in India's GDP is estimated to touch 11-year lows of 5.0% (Source: National Statistical Office). This slowdown is a combined outcome of factors such as deceleration in consumption (~60% of GDP), subdued investments (~30% of GDP), sluggish growth in the manufacturing sector and declining credit growth, to name a few. Amid subdued demand, inflation as measured by the consumer price index remained largely benign for most part of 2019. However, in sync with the surge in vegetable prices, this metric moved up in the last 2-3 months of the year and crossed the 7% mark for the first time in the past 2-3 years. In view of these pressures, the government has relaxed the targeted fiscal deficit for FY20 to 3.8%.

Outlook

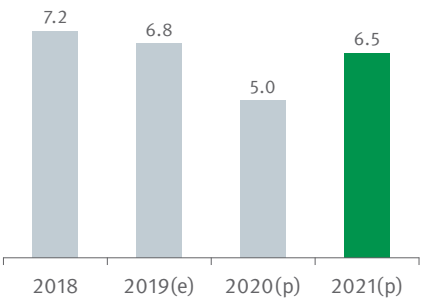
The IMF estimates India's GDP to grow by 6.5% in FY21 on the back of monetary and fiscal reforms, subdued oil prices and the improving health of corporates. Measures such as lower corporate taxes for new manufacturing units will be key to making India a preferred manufacturing destination in Asia. A large domestic market, improving ease of doing business, reasonable labour costs and availability of skilled resources are other enablers for such a shift. Thus, India's manufacturing sector could witness sustainable recovery, going forward. With most companies coming to terms with the Insolvency and Bankruptcy Code, 2016 (IBC) due to takeover by larger, more capable corporates, private capex is likely to get a boost over the medium term.

Government measures to boost growth

- Reduction in basic corporate tax rate to 15% for all new manufacturing units commencing production before March 2023
- Reduction in basic corporate tax rate from 30% to 22% for existing companies
- Provision of special funds for stalled housing projects
- Extension of time limit for interest on affordable housing loans
- Reduction in income tax rates for individuals
- Focus on improving the ease of doing business

India's GDP growth

(%)



p: projections, ae: advanced estimate

Source: National Statistical Office, IMF - World Economic Outlook, January 2020

2. Industry overview

2.1 Automotive sector review

Automotive sales witnessed a severe slowdown (worst in the past two decades) across all segments in the year gone by. Structural factors such as growing congestion in bigger cities, increasing share of ride-hailing apps such as Ola and Uber, moderating economic growth, financing issues and subdued consumption contributed to this weakness. Migration to BSVI emission norms also added pressure on auto manufacturers in terms of the investment entailed and the time needed to replace the older inventory.

Auto sales

(In '000s)	**2019**	2018	% change
Two-and three-wheelers	**24,170**	26,546	(9)
Commercial vehicles	**893**	1,109	(19)
Passenger vehicles	**3,623**	4,062	(11)
Agriculture tractors	**773**	926	(17)

The Government of India announced some measures to provide relief to the sector over the medium to long term.

Union Budget 2020: Positive announcements for the domestic automobile sector

- Increase in customs duty on imported EV to aid their production indigenously
- A ₹ 1,000-crore scheme for mid-sized auto and auto component makers to push exports, R&D and technology upgradation

However, more needs to be done to revive demand. Some of the enablers for demand would be to introduce incentive-based vehicle scrappage scheme, provide budget allocation for procurement of diesel buses by state road transport undertakings and initiate zero customs duty for lithium ion batteries.

Outlook

Industry experts believe recovery in the automobile sector will be a gradual one. The sector (which forms 3-4% of India's GDP) is likely to witness normalisation of inventories in 2020, which could help arrest the decline in volumes. Easing of interest rates and expectations of improving demand in rural areas are other enablers for the sector. Segments such as passenger vehicles, which are under-penetrated as compared to other countries, could also see some revival, especially in the compact segment. Rising adoption of EVs (particularly those used for public transport) in the country is a long-term, fundamental driver of growth.

2.2 Industrial sector review

Industrial activity in India as measured by the Index of Industrial Production (IIP) witnessed mixed trend in 2019 owing to a broad-based slowdown in the economy. For the first three months of the year, this metric remained muted with y-o-y growth staying between 0.1% and 1.6%. It hovered largely around the 4.3-4.6% range between April and July (2% growth in June) and continued to decline for the three months ending October 2019. It witnessed an uptick of 1.8% in the month of November, which can be attributed to some rebound in construction activity as well as a lower base of the previous year. Core sector output too remained subdued for a large part of the year led by a steep fall in consumer durables output and weakness in the steel, refinery, fertilisers, electricity and cement sectors.

Outlook

The Government of India continues to provide higher thrust to the manufacturing sector in India. Besides improving the overall environment for doing business, various measures have been announced to boost investment in the sector. Multiple nation-wide projects and initiatives such as development of industrial corridors, smart cities and 'Make in India', among others, are likely to aid performance of the industrial sector over the next few years. Additionally, a host of measures are underway to strengthen India's railway infrastructure. This includes upgradation of railway stations, building and expanding metro stations and replacing older coaches.

Union Budget 2020: Positive announcements for the infrastructure and engineering sectors

- Total capital outlay for railways of ₹ 1.6 trillion
- Proposed a pipeline of ₹ 1 trillion by infusing ₹ 220 billion equity in infrastructure finance companies (such as IIFCL and NIIF)
- 100% tax exemption proposed on the interest, dividend and capital gains income of Sovereign Wealth Fund's investments in the infrastructure sector

3. Business overview

Schaeffler India operates in two businesses, namely automotive and industrial, providing a diverse product portfolio. Your Company also provides best-in-class training services to important groups such as garages and fleet workshops under the automotive aftermarket and industrial distribution segments. Your Company enjoys a prominent position in all its business segments. It has a balanced revenue mix between its automotive and industrial businesses.

3.1 Schaeffler India: SCOT analysis

Strengths	Challenges	Opportunities	Threats
• Strong parentage that provides decades of experience, a strong ecosystem and multi-faceted capabilities • A culture of innovation that enables your Company to offer superior products and gain competitive advantage • Wide range of products across automotive as well as industrial business segments • A scalable, agile and robust business model • Strong capabilities and an expert team of professionals	• Rapid changes in the technology landscape • Scaling up of digitalisation capabilities	• Realise full potential of the three brands to drive top line growth • Optimise our R&D capabilities to offer distinct, game-changing solutions for both the local and global markets • Embrace digitalisation across all functions • Immense potential to grow products catering to the EVs and other technologically advanced product segments • Potential to move up the value chain — from providing products to providing systems and end-to-end solutions	• Prolonged stress in the macro economy, automotive and industrial sectors • Unforeseen and sudden currency volatility and raw material prices

3.2 Operational performance review

Your Company posted a fitting performance in 2019, even under the adverse market conditions. The team's all-round focus on becoming a leaner, more cost-efficient entity offset some of the pressures arising from weak demand. Your Company responded swiftly to the market trends and improved inventory across all locations. By keeping a firm eye on ensuring availability of healthy free cashflows, your Company mitigated a large part of the stress on its working capital needs. As a consequence of these efforts, your Company managed to register relatively better (than industry) operating profit in the year. Reduction in corporate taxes provided additional support to your Company's profitability during the year.

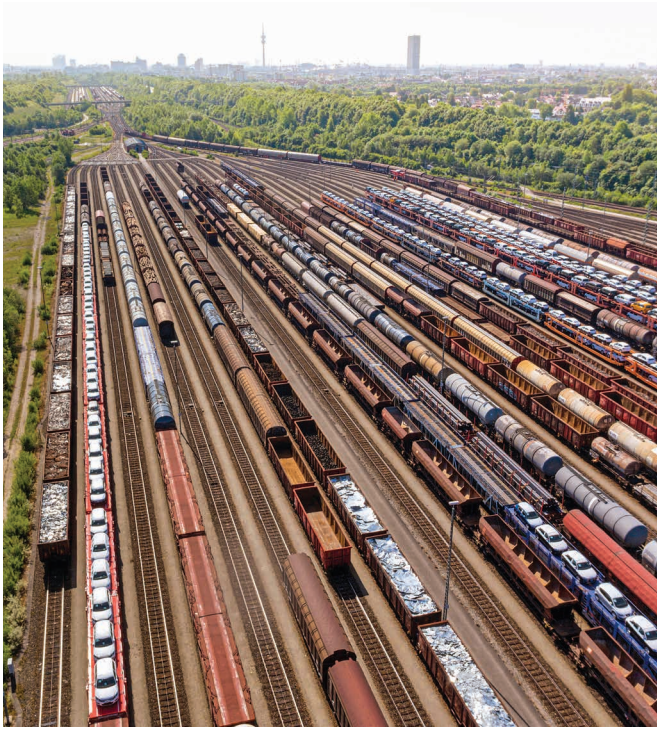
Automotive

Improving sales mix and a sharp focus on driving cost rationalisation enabled your Company to balance some of the pressure on revenues as well as profitability during the year. Schaeffler India's strong association with a wide array of automotive OEM manufacturers – both existing and new – was a key enabler to this segment's performance in 2019. Your Company continued to launch distinct, innovative products during the year and hence was able to protect its market share across most products, such as heavy-duty bearings (load bearing capacity of 32.5 tonnes) for dedicated freight corridors.

Revenues from this business declined for the first three quarters of 2019 (witnessing some improvement in the last quarter), owing to a sharp fall in the production volumes of commercial and passenger vehicles.

Industrial

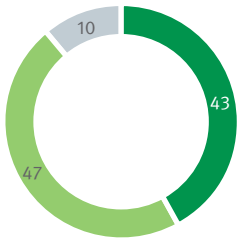
This business continued to perform well for most part of the year. Strong growth in industrial revenues helped reduce the impact of falling revenues in the automotive business. Though it started softening a bit in the last quarter, this development is likely to be short-lived. Your Company's expertise and rich experience in this segment has empowered it to build solid, long-lasting and trustworthy relationships with its customers. Schaeffler India has demonstrated its ability to create value for its customers by partnering them to enhance the quality, productivity and reliability of their processes and plants. While most segments are witnessing a healthy momentum, demand from wind energy and railways (including metros) grew at robust levels in 2019 as compared to 2018. The industrial aftermarket segment registered double-digit growth.



3.3 Financial performance review

In 2019, there was a degrowth of 4.4% in net revenues to ₹ 43,606.3 million as compared to ₹ 45,615.1 million in 2018. Owing to the balanced revenue model of your Company, decline in the top line was restricted and was better compared to the industry. Growth in the industrial segment compensated for the fall in automotive volumes and lower proportion of diesel vehicles in the passenger segment. Exports sales were similar to those recorded in 2018. While there were some pressures witnessed on the operating profit owing to lower capacity utilisation, lower outgo towards corporate taxes aided profit after tax. This metric stood at ₹ 3,676.4 million in 2019 as compared to ₹ 4,198.0 million in 2018, and decreased by 12.4% on a y-o-y basis.

Revenue mix (%): 2019



- Automotive and automotive aftermarket
- Industrial and industrial aftermarket
- Exports

(₹ in million)

Particulars	2019	2018
REVENUES	**43,606.3**	45,615.1
EBITDA*	**6,460.8**	7,585.4
Less: Depreciation	**1,587.1**	1,485.0
Less: Finance cost	**34.7**	70.4
Add: Interest income	**507.2**	719.0
PROFIT BEFORE TAX (before exceptional items)	**5,346.2**	6,749.0
Provision for Tax	**1,666.4**	2,119.0
PROFIT AFTER TAX	**3,676.4**	4,198.0

Your Company managed to reduce its inventory days from 73 in 2018 to 60 in 2019. Working capital days in 2019 were in line with last year at 72 days of sales versus 70 days of sales in 2018. Your Company continues to make strategic investments and incurred capex of ₹ 3,200 million in 2019.

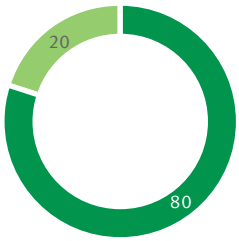
3.3.1 Revenue

Revenue stood at ₹ 43,606.3 million in 2019 versus ₹ 45,615.1 million in 2018. Weak demand in the automotive and ancillary sectors had an impact on revenues from mobility components and related solutions, which declined by 7%, while revenues from other segments grew by 9% compared to 2018.

(₹ in million)

Particulars	2019	2018
Segment revenue		
Mobility components and related solutions	**35,015.9**	37,732.9
Others	**8,590.4**	7,882.2

Revenue mix (%): 2019



- Mobility components and related solutions
- Others

3.3.2 EBITDA

EBITDA stood at ₹ 6,460.8 million in 2019 versus ₹ 7,585.4 million in 2018, down 14.8%. Favourable sales mix and focus on achieving higher cost efficiencies aided this metric during the year.

(₹ in million)

Particulars	2019	2018
EBITDA*	**6,460.8**	7,585.4
Less: Depreciation	**1,587.1**	1,485.0
Less: Finance cost	**34.7**	70.4
Add: Interest income	**507.2**	719.0
PROFIT BEFORE TAX (before exceptional items)	**5,346.2**	6,749.0

* Earnings before Interest, Tax, Depreciation and Amortization

3.3.3 Profit before tax

Profit before tax in 2019 was at ₹ 5,346.2 million compared to ₹ 6,749.0 million in 2018, down 21%. This decline was partly on account of a one-time interest income in 2018.

(₹ in million)

Particulars	2019	2018
Profit before tax (before exceptional items)	**5,346.2**	6,749.0

3.3.4 Taxes

Tax expense was at ₹ 1,666.4 million in 2019 against ₹ 2,119.0 million in 2018, down 21%. Corporate tax rate reduced from 34.94% in 2018 to 25.17% in 2019.

(₹ in million)

Particulars	2019	2018
Tax expense	**1,666.4**	2,119.0

3.3.5 Profit/(loss) after tax

Profit after tax in 2019 was at ₹ 3,676.4 million compared to ₹ 4,198.0 million in 2018, down 12%.

(₹ in million)

Particulars	2019	2018
Profit after tax	**3,676.4**	4,198.0

3.3.6 Cashflow

Cash from operations stands at ₹ 5,097.7 million in 2019 versus ₹ 2,382.0 million in 2018.

(₹ in million)

Particulars	2019	2018
EBITDA*	**6,460.8**	7,585.4
Income tax	**(1,633.3)**	(2,287.2)
Change in working capital and others	**270.2**	(2,916.2)
Capital expenditure**	**(3,198.6)**	(2,438.5)
Interest Income**	**536.0**	546.6
Free cash flow	**2,435.1**	490.1

* Earnings before Interest, Tax, Depreciation and Amortization

** Figures are net

4. Business outlook

Schaeffler India is progressing well on most of its strategic objectives and will continue to make requisite investments to take its growth to the next level. Your Company is looking to strengthen its local R&D capabilities and expand its edge. Focus on localisation is likely to continue and the proportion of products sourced locally is targeted to improve over the years.

In the automotive business, your Company will continue to focus on providing innovative products and solutions with superior technology. It will play a proactive role in bringing environment-friendly products to India. Your Company plans to capture the opportunity presented by the implementation of the BSVI norms and increase its content per vehicle by 30%. Launch of new products across categories such as clutches, damping systems and engine parts with higher customer value proposition will enable your Company to grow this business. Implementation of Corporate Average Fuel Efficiency/Economy (CAFÉ) norms to reduce CO_2 emissions will aid the proportion of diesel content per vehicle and is likely to benefit your Company.

In the industrial business, Schaeffler India will continue to focus on deepening its relationships with existing customers on one hand and growing the overall client base on the other. It is looking to expand and improve the value chain and offer complete solutions (rather than only products) to cater to their multi-faceted needs.

5. Internal control systems

Your Company has a system of Internal Financial Controls (IFC) that ensures the accuracy of the accounting system and the related financial reporting. The internal control system provides for well-documented policies and procedures that are aligned with Schaeffler Group's standards and processes. It adheres to local statutory requirements for orderly and efficient conduct of business, safeguarding of assets, the detection and prevention of frauds and errors, adequacy and completeness of accounting records, and timely preparation of reliable financial information. The efficacy of the internal checks and control systems are validated by internal auditors.

Your Company's IFC is conceptually based on regulatory framework, as applicable. The controls defined in the framework are applied at all levels — entity level, process level and IT systems level. The management assesses the appropriateness and effectiveness of the controls in place on a yearly basis. To this end, your Company uses a standardised methodology to identify the processes relevant to IFC, define the required controls and document them in accordance with uniform requirements. This is then followed up with a review of the defined controls that is performed using a risk-based approach. The process controls are self-evaluated and audited by the internal and statutory auditors. The measurement plans are laid out and monitored regularly to overcome the deficiencies as detected during self-evaluation, and confirmed by the auditors.

The Audit Committee reviews the adequacy and effectiveness of the internal control systems, makes significant audit observations and monitors the sustainability of remedial measures.

Cautionary statement

Statement made in the 'Management discussion and analysis' describing the Company's objectives, projections, estimates and expectations may be 'forward-looking statements' within the meaning of applicable securities, laws and regulations. Actual results could differ from those expressed or implied. Important factors that could make a difference to your Company's operations include economic conditions affecting demand supply and price conditions in the domestic and overseas markets in which your Company operates, changes in the government regulations, tax laws, other statutes and other incidental factors.