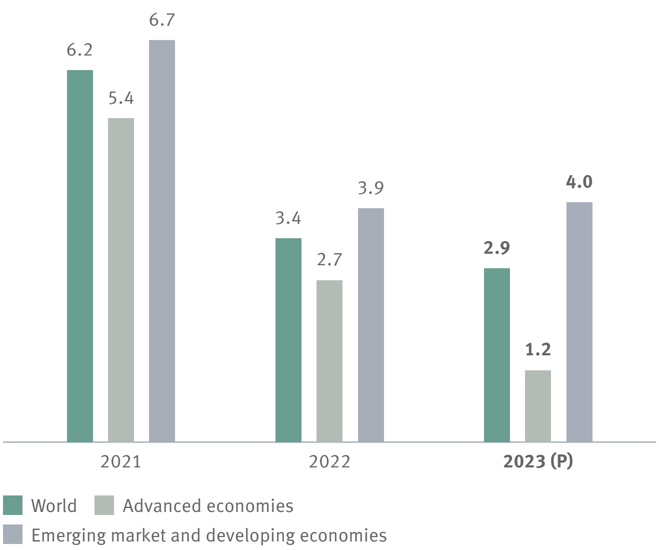
Management Discussion and Analysis

Industry context and performance

Global economy

The year 2022 started out with cautious optimism. Restrictions related to the pandemic were lifted across the globe and economic activities seemed to be on the path to gradual recovery. However, the escalation of Russia-Ukraine conflict led to a sharp increase in commodity prices, further contributing to surging global inflation. China's Zero-COVID Policy resulted in frequent lockdowns, low demand, and disruption in the Asian supply chain. In response to inflationary pressures, central banks in advanced and emerging market economies adopted tools like quantitative tightening, causing demand to slow down further. Despite the challenges, economies across regions started demonstrating signs of resilience from third quarter onwards, including the United States, the Euro area, and major emerging market and developing economies. Resultantly, According to January 2023 edition of the World Economic Outlook, global output is expected to report a growth of 3.4% in 2022, against 6.2% reported in 2021.

Global GDP growth trend



Source: World Economic Outlook – January 2023

Movements in global commodity prices

The year 2022 was an interesting one for the commodities market. Prices of some of the commodities stabilised after skyrocketing in the post-pandemic period. However, it remained largely volatile due to the Russia-Ukraine war, the weakening global economy and lower demand from China. Steel prices softened drastically towards the end of the year after the peak of $1,000 per tonne in April 2022. The escalating geopolitical conflict caused crude prices to reach their highest ever in May 2022, since 2013. Between June and December 2022, the price of crude fell by around 31%.

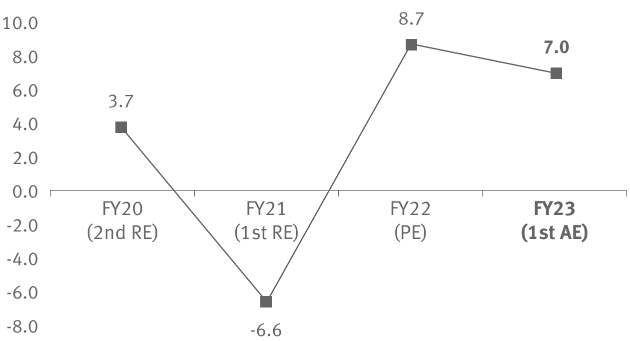
Outlook

The ongoing monetary policy tightening and geopolitical tensions are expected to keep the global economy in a tight spot, with growth estimated at 2.9% in 2023. Growth is expected to pick up in China with complete reopening of the economic and social activities. The pace of growth is likely to recover from 2024, driven by gradual recovery from Ukraine war and waning inflation.

Indian economy

The Indian economy has shown great resilience in the face of adversities and continues to be one of the fastest-growing major economies in the world. The economy is forecasted to grow in the range of 6-6.8% and the growth can be ascribed to strong private consumption and fixed investment growth as well as a strong recovery of demand in the services sector, replacing the export stimuli.

Economic growth



Source: Economic Survey 2022-23

Outlook

While the growth projection remains on the lower side, India can withstand the global economic shocks and continue as one of the fast-growing major economies in the world. On the other hand, considering the risks of a slowing global economy and increasing borrowing costs, the country's growth for FY23-24 has been pegged at 6.5%.

Automotive industry

India is the world's largest producer of two and three-wheelers, the second-largest manufacturer of buses, and the largest producer of heavy vehicles like tractors. The automotive industry in India is valued at over $222 billion, and it makes up 8% of the country's total exports and accounts for 7.1% of the GDP.

The pandemic's impact on the industry was severe. In addition to affecting demand, there were numerous supply challenges due to rising costs, semiconductor shortages, and other supply chain bottlenecks. With several industries dependant on the auto sector, the slowdown triggered a ripple effect.

However, in the current scenario, the industry has witnessed recovery, recording growth and increasing demand, and improvements in semiconductor supply.

The first half of FY23 saw the passenger vehicle segment report its highest-ever sales, while the second quarter saw domestic passenger vehicle sales surpass the one million mark for the first time. The surging demand for individual vehicles and greater disposable incomes will contribute to the growth of the Indian automotive industry.

Category	**2019-20**	**2020-21**	**2021-22**	**2022-23***
Passenger vehicles	27,73,519	27,11,457	30,69,499	28,71,695
Commercial vehicles	7,17,593	5,68,559	7,16,566	6,83,310
Three wheelers	6,37,065	2,19,446	2,60,995	3,35,123
Two wheelers	1,74,16,432	1,51,20,783	1,34,66,412	1,22,57,494
Grand total	**2,15,45,551**	**1,86,20,233**	**1,75,13,596**	**1,61,47,622**

* These figures are for 9M - 2022-23 and are thus strictly not comparable with the figures for previous year.

Source: SIAM - https://www.siam.in/statistics.aspx?mpgid=8&pgidtrail=14

Growth drivers in the automotive industry

Autonomous vehicles

The interest and R&D activities around autonomous vehicles have been on the rise. Indian automakers are keen on exploring new arenas to enhance the commuting experience of their customers.

Change in emission standards

The ongoing megatrend of electrification will help in increasing the content per vehicle for OEMs. With stringent safety norms and emission restrictions being imposed on automakers, auto component manufacturers stand to gain from increased business.

Government initiatives

The Government of India has introduced various initiatives like the PLI Scheme to encourage growth in the sector. This will help in promoting domestic manufacturing of Advanced Automotive Products (AAT) and attract investments in the manufacturing value chain.

Connected Cars

The Internet of Things (IoT) has transformed the automotive industry and its widespread usage will allow customers to stay connected even when on road. Automotive IoT allows cars to communicate with other systems and share internet access and data devices. It can also share information at regular intervals, and update software over the air. Cutting-edge technologies such as this drive massive investments into the auto sector.

Electric Vehicle Penetration

Climate change awareness and an attempt to reduce the carbon footprint has bolstered the popularity of electric vehicles. EVs will witness exponential growth with large capex commitment and execution underway by industry players. Global capex committed in this space (including battery) is approximately $500 billion by 2030.

According to the Automobile Mission Plan 2016-26, the Indian automotive sectors' contribution to the nation's GDP is predicted to be more than 12%, and is currently at 7.1%. It also aims to account for at least 40% of the manufacturing sector by 2026. The Government of India has allowed 100% FDI under the automatic route. Some of the recent initiatives taken by Indian Government are:

- Bharat New Vehicle Safety Assessment Program (Bharat NCAP) to award safety ratings to cars to promote safer cars and increase the export-worthiness of Indian cars.
- Under the Production Linked Incentive (PLI) scheme, incentives of up to 18% are extended to encourage the industry to make fresh investments in the indigenous supply chain of AAT products. The PLI Scheme for Automobile and Auto Component has been successful in attracting a proposed investment of ₹74,850 crores against the target estimate of investment ₹42,500 crores for five years.

Electric Vehicles in India

India is the second-largest EV market in Asia, after China. With rising oil prices and environmental factors like pollution and climate change, there is a strong case for the adoption of EVs. India's EV ecosystem is thriving due to the support it gets from government initiatives, increasing sector investments, and widespread adoption by organisations. According to CRISIL, EVs present an opportunity of almost ₹3 lakh crore for various stakeholders in India in the five years through fiscal 2026, and is likely to create five crore jobs by 2030. This will also necessitate huge investments in charging infrastructure to sustain the electric vehicles.

In the April-September 2022 period, India recorded sales of 277,910 electric two-wheelers – a 404% increase over the same period last year. In H1 FY22-23, 18,142 electric cars were sold, registering a 268% growth. In Q2 FY23 (July-September 2022), sales were at 10,015 units, which is a 23% increase over Q1's 8,127 units*. At COP-26 (the 26th Conference of Parties), Prime Minister Narendra Modi announced that India is set to achieve 50% of its installed electrical capacity from non-fossil sources by 2030. The government is working to improve upon both demand and supply of EV ecosystem by providing tax rebates and simplifying loan processes.

Initiatives by the Indian Government to promote electric mobility:

- Setting up EV Charging stations under FAME India Scheme I and II.
- Battery-Swapping Policy introduced In Union Budget 2022-23, allowing drained batteries to be swapped with charged batteries at designated charging stations.

E-AMRIT (Accelerated e-Mobility Revolution for India's Transportation) has been set up to act as a one-stop portal for any information on electric vehicles in India.

* Source: India Briefing

PESTLE analysis on the auto industry

Political

- Governments are favouring low emission vehicles and undertaking initiatives like tax subsidy.
- Government policies on import and export tax impact the industry.
- Govt. Initiatives like PLI and Gati Shakti to promote the industry.

Economic

- Demand and Sales depend on global economic conditions.
- India is a developing economy with good purchasing power and disposable income, which is profitable for auto industry.

Sociocultural

- Cars have been considered an extension of individual's personality.
- Need for new models keeping people's preferences in mind.
- Need to keep up with changing social trends.
- There is a shift towards demand for SUVs.

Technological

- Technology and innovation are important, and it is important to keep upgrading.
- People are looking for efficient, safe, and high-mileage vehicles.
- Tesla's self-driving cars are gaining popularity.
- Lithium Battery technology is improving.

Legal

- Demand and Sales depend on global economic conditions.
- India is a developing economy with good purchasing power and disposable income, which is profitable for auto industry.

Environmental

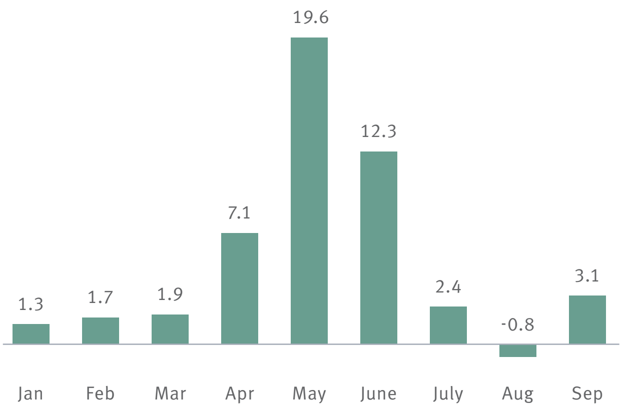
- Demand for EVs is growing, there are cost savings for e-cars.
- Rising fuel prices and carbon emissions.

Industrial sector

The Index of Industrial Production (IIP) grew by 3.1% to 133.5 in September 2022, as against the 2% forecast by the Ministry of Statistics & Programme Implementation (MoSPI). This growth was achieved on the back of rising manufacturing and mining output. There has been a significant increase in capital and infrastructure spending which is a strong indicator of the confidence the industry has in the changing tides of the Indian economy and its growing demand. In September 2022, the manufacturing sector grew by 1.8% to 134.3, mining output increased by 4.6% to 99.5, and power generation was up 11.6% to 187.5.

The performance of the core industries is key to industrial growth as they make up around 40% of the IIP. These are electricity, steel, refinery products, crude oil, coal, cement, natural gas, and fertilizers. Government data revealed that the combined index of eight core industries grew 7.9% in September 2022, compared to the 4.1% rise in August 2022 and 5.4% in the year-ago period. Core output during the April-September of FY23 rose 9.6% against 16.9% a year ago.

India Industrial Production for CY2022 (%)



High-technology infrastructure and skilled manpower are necessary to strengthen competitiveness in India's industrial sector. Government initiatives aided by the rising global demand are factors that will propel the growth of this sector in the coming years.

Initiatives by the Indian Government to promote the industrial sector:

Production Linked Incentive (PLI) Scheme

Since its launch in 2020, PLI has rolled out 14 schemes, all of which received a favourable response. The government has about 7-8 more such schemes underway to cover more critical manufacturing sectors to boost economic growth. It is expected to lead to incremental manufacturing of more than $500 million over five years. PLI schemes are crucial to the country's ambition to expand the share of manufacturing in the country's GDP to 25%.

SAMARTH Udyog Bharat 4.0

Launched by the Ministry of Heavy Industries, the initiative aims to facilitate and create an ecosystem for the propagation of the Industry 4.0 set of technologies in every Indian manufacturing unit by 2025. It is expected to increase India's competitiveness in industrial sector.

PM Gati Shakti

It is a multi-modal infrastructure connectivity endeavour. The building of industrial corridors is an important step towards India's industrial development, as establishing a link between infrastructure and industry boosts economic activity. There are 11 Industrial Corridors Projects set for development, with 30 projects to be developed by 2024-25.

Automotive Aftermarket industry

The Indian Automotive Aftermarket industry is forecasted to grow at a CAGR of 3.8% and reach $19.05 billion by 2025. It is gaining traction after two years of slow growth due to the pandemic, and with an increase in auto sales, the industry is on its way to revival. Post-pandemic, there has been an upswing in the demand for personal cars as well. With the average life of cars seeing an increase from 9.78 years to 11.33 years, people are now willing to spend on auto components like wheels, tyres, gears, suspension modifications, etc. Servicing needs have also increased, and there has been more demand for AV accessories and interior accessories, all of which drive growth in the industry.

The automotive sector has kept the pace when it comes to adopting digitalisation and providing maintenance and technical support with improved quality and efficiency. Since the automotive sector is an unorganised one, garages are an important link in providing quality assurances and one-stop solutions for maintenance needs.

Going forward, companies need to invest in training, conducting workshops and imparting knowledge to mechanics to boost the development of the aftermarket industry.

Operational performance review

We faced a challenging and uncertain business environment owing to the geopolitical situation in Europe and record inflation in key international markets. Despite these challenges, we sustained our performance both in terms of revenue and profitability growth on the back of our balanced business mix. Notably, our margin performance was consistent and sustained and our PAT margins stood at 12.8% in 2022.

Our strategic initiatives allowed us to consolidate and sustain our performance. We focused our production on the domestic market and launched new projects.

We sustained our trajectory for business wins in our Automotive Aftermarket and Industrial business. A notable highlight in our Automotive Aftermarket division was the deepened penetration of REPXPERT, which covered 8800 KMs in 2022. This is a testament to the focus on customer-centricity at Schaeffler India. Furthermore, we continued to remain leaders in governance as indicated in the corporate governance scorecard published by IiAS.

Automotive Technologies segment

Our Automotive Technologies segment achieved significant growth despite the uncertainties in the automotive sector. Our consistent focus on innovation paid dividends as our product portfolio helped us drive growth.

In 2022, we won significant business order wins in CVs for double-clutch systems, in PVs for needle bearings, DGBBs, and light vehicle clutch systems. In terms of the opportunities in emerging technologies such as EVs, hybrids etc, we fared well in 2022. We won business order wins in the area of hybridisation with OEM customers and wheel bearings for fully electrified car platforms.

In terms of operational performance, we ramped up major projects in engine components and shift systems, which will help us play an important role in meeting the upcoming RDE requirements with increased reliability for our customers.

Automotive Aftermarket segment

In 2022, the Automotive Aftermarket achieved a strong financial performance (20%+ revenue growth), owing to an improved product mix. The division added new products to the portfolio and expanded the range of products across all categories.

In terms of other business highlights, the division build up infrastructure and doubled warehouse space, continued to invest in partnerships and branding activities.

Industrial segment

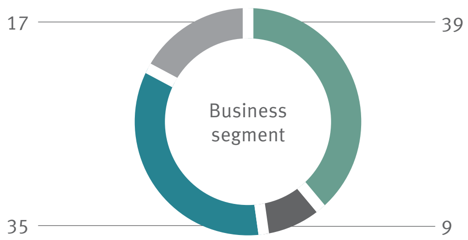
The Industrial business contributed around 33% of our overall revenue and sustained revenue growth of 12.4% in 2022. Our differentiated advantage in precision and efficiency saw us win significant business order wins. In 2022, we won key business wins for CRBs, SRBs, and TRBs in our off-road segment, new business win for SRBs, TRBs, and LSBs in our energy segment, and for linear guides in the industrial automation segment, and DGBB and NRBs in the TW segment.

Financial performance review

In 2022, we achieved a strong 23.5% increase in our revenue compared to the previous year, a testament to our unwavering faith in India's growth story and commitment to becoming a manufacturing hub for the Schaeffler Group. This strong financial performance was driven by our stellar export performance and consistent domestic performance.

We experienced remarkable success across all of our businesses in the past year, with exports skyrocketing by 59.6%. We expanded our capacity, developed our expertise, and broadened our international reach to drive this growth. The Automotive Technologies and Automotive Aftermarket segments both saw impressive revenue increases of 23.8% and 18.3% respectively, while our Industrial segment also enjoyed a notable 12.4% increase in revenue.

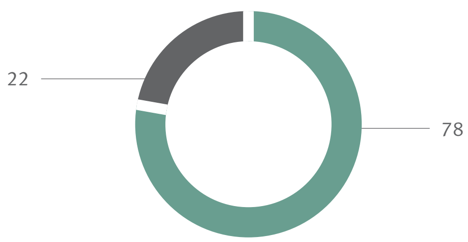
Revenue mix: 2022 (%)



■ Automotive Technologies ■ Automotive Aftermarket
■ Industrial ■ Exports & Others*

* Exports mainly includes exports to group companies, scrap sale and other operating income

Revenue mix: 2022 (%)



■ Mobility component and related solutions
■ Others

₹15,000 mn

Investment over next three years

(₹ in million)

Particulars	2022	2021	Change (%)
Net revenue	68,674	55,605	24%
EBITDA [1]	13,076	9,950	31%
Less: Depreciation/Amortisation	2,065	1,971	5%
Less: Finance cost	36	37	(3%)
Add: Interest income	645	489	32%
Profit before exceptional items and tax	11,620	8,431	38%
Add: Exceptional items	150	-	100%
Provision for tax	2,978	2,140	39%
Profit after tax	8,792	6,291	40%

Revenue

(₹ in million)

Particulars	2022	2021	Change (%)
Net revenue	68,674	55,605	24%
Mobility component and related solutions	53,877	43,850	23%
Others	14,797	11,755	26%

Profitability

(₹ in million)

Particulars	2022	2021	Change (%)
EBITDA [1]	13,076	9,950	31%
Less: Depreciation/Amortisation	2,065	1,971	5%
Less: Finance cost	36	37	(3%)
Add: Interest income	645	489	32%
Profit before exceptional items and tax	11,620	8,431	38%

Taxes

(₹ in million)

Particulars	2022	2021	Change (%)
Provision for tax	2,978	2,140	39%

Profit after tax

(₹ in million)

Particulars	2022	2021	Change (%)
Profit after tax	8,792	6,291	40%

Cashflow

(₹ in million)

Particulars	2022	2021
EBITDA [1]	13,076	9,950
Income tax	(3,136)	(1,895)
Change in working capital and others	(1,841)	(3,408)
Capital expenditure [2]	(4,788)	(1,826)
Interest income [2]	457	456
Free cash flow	3,768	3,277

[1] Earnings before Interest, Tax, Depreciation and Amortisation.
[2] Figures are net.

Internal control systems

In parallel to the risk management system, Schaeffler India has a system of internal controls over financial reporting (IFC), which ensure 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 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.

Our IFC is conceptually based on the regulatory framework, as applicable. The controls defined in the framework are applied at all levels – entity level, process level and IT systems level. Each year-end, the management assesses the appropriateness and effectiveness of the IFC in place. To this end, we use 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, which is performed using a risk-based approach. The process controls are self-evaluated and are audited by the internal and statutory auditors. Wherever control weaknesses exist, actions to eliminate them are defined and monitored regularly to overcome them.

Cautionary statement

Statement made in the Management Discussion and Analysis describing the Company's objectives, projections, estimates, 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 the Company's operations include economic conditions affecting demand supply and price conditions in the domestic and overseas markets in which the Company operates, changes in the government regulations, tax laws, other statutes and other incidental factors.