Schaffer Corporation Limited

CHAIRMAN'S ADDRESS TO THE 2017 ANNUAL GENERAL MEETING

Good Morning, Ladies and Gentlemen

On behalf of the Board, it is my great pleasure to welcome you to the 63rd Annual General Meeting of Schaffer Corporation Limited.

Change is a constant and the speed of change seems to be increasing every year.

To survive and prosper, organisations must have the flexibility to adjust their business models to address changes and then capitalise on the opportunities that change presents.

Schaffer Corporation is a very different organisation than it was when it started trading in 1955 as a company specialising in the production of Building Products. Indeed, it is a very different organisation than it was even two years ago. In two years, Schaffer Corporation has implemented some of the biggest changes it has experienced in its history.

Amidst change, Schaffer Corporation maintains unwavering focus on two reference points. First is to manage our businesses to maximise long-term shareholder value. Second is to realise value where appropriate opportunities arise.

The first reference of managing for long-term value is reflected in the transformation of the Howe Automotive Leather business from an Australian-centred niche player to a globally competitive automotive leather components business.

During the 2016 financial year, Howe invested in establishing a new finishing and cutting plant in Slovakia. This was in response to the successful award of numerous new programmes. In the 2017 financial year, Howe transferred all European customer production to Slovakia.

We saw the opportunity to invest in the division and drive such a change. The benefits of the changes are visible in Howe's 2017 financial year result. We expect further significant improvement during the current financial year and as a consequence, further benefits to shareholder value.

The second reference of realising value is evident in recent events.

Schaffer Corporation will shortly complete the sale to Brickworks of the Urbanstone paving, masonry and natural stone business. That follows the earlier sale of the Limestone Resources and Archistone production assets. Together those businesses comprised our Building Products division.

Because of our years of investment in operational flexibility and focus on long-term value, the Building Products businesses were attractive to potential acquirers. Those acquirers could see that the businesses didn't require 'fixing', but that rather, they could potentially generate greater value for the owners of complementary operations than they would generate for Schaffer Corporation.

In real terms, that meant that we have been able to realise the best possible value for our shareholders from our Building Products division, and the new owners have acquired operations from which their shareholders will generate value. Importantly, we will retain ownership of the land and buildings from which Urbanstone operates, so will gain both lease income and the opportunity for increases in the capital value of the site.

Having released capital from the sale of Building Products, we have increased Schaffer Corporation's financial flexibility to grow both Howe and our property portfolio. That includes the Jandakot and North Coogee sites, as well as our growing property assets and investments.

In respect of the 2017 financial year, Schaffer Corporation increased its profit. At the Group level, the results were:

- A 1% increase in revenue to $215 million
- An 18% increase in earnings before interest and tax (EBIT*) to $16.4 million
- A 3% increase in net profit after tax (NPAT*) to $5.9 million
- An increase in earnings per share from $0.41 to $0.42 per share
- A 4% increase in annual dividends to $0.26 per share.

Our Total Shareholder Return (TSR*) is a measure of the combined returns to shareholders from share price movements, dividends and dividend imputation credits. In 2017, we achieved a TSR of 45%. Over the last five years, the average TSR is 22%.

I will now review each division in greater detail.

Automotive Leather

Schaffer Corporation owns 83% of Howe Automotive Limited. Howe supplies high quality leather to the global automotive industry.

Howe has successfully bedded down the new programmes to which I referred earlier. It continues to significantly benefit from increased economies of scale, more efficient production, lower working capital requirements, lower freight costs and lower processing costs.

As such, Howe's profitability and cashflow generation grew in the 2017 financial year. The division increased EBIT to $13.5 million with revenue growing to $170.9 million, up 10%.

Working capital reduced by $9.7 million. This was mainly due to shorter lead times for shipping hides direct to Slovakia. The previous supply chain required hides to be shipped via Australia for finishing.

With the release of working capital and improved EBIT, Howe's net debt reduced by 41% to $20.5 million.

Howe is currently evaluating the implementation of CNC or Computer Numerical Controlled cutting machines. The automotive industry is evolving at a dramatic rate and in order to satisfy the demands of our customers we need to be responsive, flexible and efficient. Initial trials with a number of providers have shown promising results and we expect to implement a number of machines in the next one to two years to complement our existing manual press cutting.

Production volumes continue to increase. As such, Howe has recently built a partial third finishing line in the Slovakian finishing facility.

As I invariably note in this Address, Howe is a multicurrency business.

It can be impacted positively and negatively by currency movements. Howe receives more than 80% of its revenues in euros (EUR) and incurs more than 50% of its costs in US Dollars (USD). Howe also requires Australian Dollars (AUD) for its Australian operations and to pay dividends. As such, we sell a large proportion of Howe's EUR receipts to buy AUD and USD.

This financial year, to reduce currency risk and the impact volatility can have on the business, Howe has hedged – and thereby locked in rates for – most of its USD and AUD requirements.

For the first half of the 2018 financial year, Howe expects a significant increase over the second half of the 2017 financial year in both revenue and profitability, including positive impacts from currency gains.

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Building Materials

For the 2017 financial year, the Building Materials division's revenues decreased by 27% to $38 million. This resulted in a break-even EBIT, compared to a $2.9 million profit for the prior year.

The result was split between a profitable contribution from Building Products and a loss at Delta Corporation, which produces pre-cast and pre-stressed concrete products.

Tough economic conditions impacted Delta and revenue declined sharply. With intense competition and aggressive pricing, Delta recorded a loss for the year.

The sale of Urbanstone to Brickworks for $13.5 million is unconditional. Completion of the transaction is scheduled for 22 November. Schaffer Corporation will retain the land and buildings from which Urbanstone currently operates. These will be leased to Brickworks on a long-term lease arrangement.

Schaffer Corporation expects to realise profit after tax of approximately $3.9 million on the sale, which will be included in the earnings for the 2018 financial year.

We previously completed the sale of the Archistone and Limestone Resources quarry tenements and property, plant and equipment associated with the production of limestone products. These sales netted $5.0 million. An associated $2.3 million non-cash pre-tax impairment was brought to account at 30 June 2017. In effect, Schaffer Corporation realised $5.0 million of value for assets that were operating below profitable production volumes.

The divestment of Building Products was the culmination of a multi-year process that reflects our values.

In recent years, conditions in Building Products' markets tightened and competition increased. We made operational and efficiency changes to put the division on the best possible competitive footing. These steps enabled us to maximise the value of the assets on an operational basis.

As time passed, conditions remained difficult. It was your Board's view that opportunities at Howe and in property represented greater long-term value for shareholders. As a result, we assessed options for divestment of the units within Building Products.

Naturally, I'm sad to see the end of the Building Products unit within Schaffer Corporation. It was an integral part of our Group for 24 years, however I am looking forward to the wonderful management team and staff we have developed having future opportunities to further grow and develop those businesses with the new owners.

Following the divestment of the Building Products businesses, Delta Corporation is the division's sole unit.

In line with Schaffer Corporation's focus, Delta's costs are managed in line with business levels. Delta has been well positioned for the modest cyclical upturn in construction in Western Australia, mainly coming from civil projects. Delta commenced the current financial year with a significantly higher order bank after successfully winning a major contract. That project commenced production mid-way through the current half.

We expect the first half to record an improvement in underlying profit compared to second half of last year, excluding the profit on sale of the Building Products businesses and assets in this half.

Investment Property

The Investment Property division comprises Schaffer Corporation's interests in syndicated property investments and our 100% ownership in several other properties.

EBIT (excluding property sales) decreased to $1.9 million from $2.3 million. The prior year result included the sale of our share in the 616 St Kilda Road syndicate.

Weak market conditions in Western Australia have required high rental incentives. The incentives impacted EBIT from the IBM Building syndicate.

I noted previously that we will retain the land and buildings for Urbanstone's manufacturing operations at Jandakot, Western Australia. The Investment Property division will receive rental income from this property from 22 November.

Urbanstone occupies only part of the Jandakot site. The remainder of the site has substantial development potential. The Group has made a submission for a Scheme Amendment to increase the scope and area of light industrial and commercial uses on approximately 38.8 hectares of the land. This excludes the "Bush Forever" portion, which will be taken over by the State Government. The submission has been approved by the local Council and is under review by the Western Australian Planning Commission.

We expect the first half profit for Investment Property to be similar to the second half. The lease to Urbanstone will only have slightly more than one month's contribution to revenue and earnings.

Gosh Capital

Schaffer Corporation owns 83% of Gosh Capital, which is an investment company. Gosh Capital continues to reinvest profits in a range of diversified investments.

At 30 June 2017, the market value of the asset portfolio was $30.7 million ($24.6 million net of debt).

The portfolio's foundation asset is the North Coogee land on which Gosh Leather formerly operated. It also includes a bulky goods retail centre and various other investments in property unit trusts, managed funds and equities.

Late in the 2017 financial year, Gosh Capital made a $0.25 million investment in a managed fund with exposure to global mining and energy companies. This has provided further diversification to its portfolio. In the current half, Gosh Capital has made an investment of $0.5 million in another managed fund.

Gosh Capital forecasts similar profit for the current half compared to the second half of last year.

Outlook

Automotive Leather has the greatest impact on the profitability and cash flow of the Group.

We expect increasing volumes and efficiency improvements during the 2018 financial year.

The cash flow generated last year by Howe has enabled the full repayment of the loan from the Commonwealth Government. That facility, which originated 20 years ago, carried a high rate of interest.

Subject to no major geopolitical event occurring and at current exchange rates, Schaffer Corporation forecasts a significant improvement in the first half results compared to the second half of last year.

The drivers of the expected outcome include:

- A significantly improved profit for Automotive Leather.
- An increase in underlying profit for Building Materials.
- A non-recurring profit of $3.9 million after tax on the divestment of Building Products.
- A similar profit for Investment Property.
- A similar profit for Gosh Capital.

The Board will provide an update on the full year outlook in February, when Schaffer Corporation releases its first half results.

Dividends

The Board is pleased to advise of our intention to increase the interim dividend to $0.15 per share fully franked (2017: $0.12). This reflects a 25% increase on the prior corresponding period. The Directors will confirm and ratify the interim dividend when the Group releases its half year results in February 2018.

Conclusion

This has been another year of change – some of the greatest changes in our history.

Howe has a team of nearly 1,500 employees. They have contributed outstandingly to Howe's transformation. Their loyalty, dedication and sacrifice are fully appreciated as they continue to strive for operational excellence and investigate opportunities to improve the business. The business would not be what it is today without them.

On behalf of the Board, I thank all the members of the Howe team.

I would like to make particular mention of Anton Mayer, Howe's Executive Chairman and minority shareholder, and Dan Birks, Howe's General Manager. Those two gentlemen have had the vision to transform Howe and the leadership to drive that transformation. Their achievements to date have been profound.

I sincerely thank the employees of Building Materials. The team at Delta who are battling tirelessly to meet the economic challenges, and the Urbanstone employees for their hard work and efforts over the past 24 years.

I make special thanks to Michael Falconer, Schaffer Building Products' General Manager. Mike has been a valued member of the Schaffer Group for 32 years, working in several of our divisions. He has been instrumental in the creation, development and growth of the Urbanstone business from its inception in 1993.

It is good to know that almost all staff will retain employment with the new owners of the Buildings Products businesses. I will watch their progress closely and fondly.

Again, a special thank you to you, our shareholders.

You entrust us to create a sustainable diversified group focused on long term value. We are confident that the Group's progress during the first half of 2018 fully aligns with that objective. We appreciate your support.

I trust that I will see you all again at next year's Annual General Meeting.

John Schaffer
Chairman

15 November 2017

* *Schaffer Corporation results are reported under Australian Accounting Standards and International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board. The Company discloses certain non-IFRS financial measures. The non-IFRS measures should only be considered in addition to, and not as a substitute for, other measures of financial performance prepared in accordance with IFRS. Please refer to page 5 of the 2017 Annual Report for the definitions of non-IFRS measures and page 54 for our definition of Total Shareholder Returns.*