Schaffer Corporation Limited

CHAIRMAN'S ADDRESS TO THE 2019 ANNUAL GENERAL MEETING

Good Morning, Ladies and Gentlemen, and welcome to the 65th Annual General Meeting of Schaffer Corporation Limited.

The Board and I are delighted to see so many familiar faces attending the AGM.

The AGM is an important event for us. I understand from directors of other companies that, for many, the AGM has long been a perfunctory event: a quick reading and passing of resolutions in front of a handful of shareholders.

In this and many ways, Schaffer Corporation is different. Our AGM is a wonderful opportunity each year to meet with you face to face. To discuss the challenges and opportunities of your Company and how the Board and executive are addressing them.

We are here to discuss the 2019 financial year. In many ways, it is best assessed as a pair with the 2018 financial year. Both years' profits were at similar levels. Both were outstanding results.

They reflect consolidation of transformative change. That change has been successfully implemented by the Board, management teams and employees – on a global basis – over recent years.

The 2019 results were:

- Revenue from continuing operations of $203.6 million, a 10% decrease
- Net profit after tax (NPAT*) of $22.9 million, a 2% decrease
- Underlying NPAT* was $23.9 million, up 6%
- Underlying earnings per share were $1.72
- Annual dividends increased to 70c per share from 45c per share, a 56% uplift.

Total Shareholder Return (TSR*) measures the combined returns to shareholders from share price movements, dividends and dividend imputation credits. Over the last five years, our average annual TSR is outstanding at 36%.

One focus throughout the year was capital management. The strategies we have employed includes buying back shares where this allows us to create shareholder value.

SFC's financial position is very strong and strengthened further during the year. This was primarily from the continued strong performance of the Automotive Leather division.

The Group ended the financial year with $134.4 million in net equity of tangible property and investment assets. This was an increase of $23.8 million compared to last year. What's more, that is after distributing dividends to Schaffer shareholders of $8.3 million and buying back shares valued at $0.7 million.

Group Net Debt remains low at just $4.8 million. Relative to the Group's net equity position, this is inherently conservative. It positions us well to navigate successfully through the uncertain economic environment the world is currently experiencing.

I will now review each division in greater detail.

Automotive Leather

The Automotive Leather division supplies high quality leather to the global automotive industry. Schaffer Corporation is the 83% owner of the division.

Automotive Leather's revenue decreased by 13% compared to the previous financial year. However, Automotive Leather's profit was only marginally lower.

During the year, global automotive sales volumes fell across most original equipment manufacturers, known as OEMs. In Europe, OEM measures to meet new emission requirements and concerns regarding the impact of Brexit hit automotive sales volumes. In China, domestic demand slowed, impacted by the ongoing trade issues with the United States.

Automotive Leather continues to focus on operational efficiencies. The executive and employees are constantly assessing and implementing new processes and technology. Automotive Leather has expanded its investment in Computer Numerical Cutting or CNC machines. CNC has been introduced into the production process alongside traditional leather cutting methods. That successful initiative is reflected, amongst other areas, in the division's improved profitability.

Approximately 75% of the division's revenue is earned in Euro (EUR). During the financial year, the division's profitability was favourably impacted by foreign exchange rate movements, with the average AUD:EUR exchange rate depreciated by 4%. This resulted in increased revenue and margins in the Group's reporting currency of Australian dollars.

For the first half of the current financial year, Automotive Leather anticipates profit to be significantly lower. This is driven by lower forecast sales volumes from existing programs and the delayed start of a material new program. That program will commence serial production in the second half of the financial year and should increase sales volumes.

Additionally, we anticipate that global automotive sales will likely be negatively impacted by the current uncertainties and risks. Those uncertainties include Brexit, the US/China trade war and European emission regulations. All major manufacturers are citing reduced sales volumes and profitability.

Building Materials

Delta Corporation produces pre-cast and pre-stressed concrete products.

In the year under review, Delta recorded a 15% increase in revenue. The bulk of that increase was achieved in the first half. The second half presented both opportunities and challenges. Overall, Delta achieved a break-even result, compared with a prior year loss.

The increased revenue was largely associated with the completion of a large civil infrastructure project. Realised margins were below our expectations for a variety of reasons. These included high labour costs driven by increased complexity, project administration costs and tight production schedules. However, that and other projects led to a return to profitability in the first half.

During the second half, Delta's margin was impacted by project schedule delays. This resulted in revenue and production being lower than expectations.

Conditions in the Western Australian construction market remain challenging and competitive. Delta's revenue and profit should improve for the first half compared to the preceding six months. This is supported by Delta's order bank. Delta continues to tightly control costs to align with the level of production.

Group Investments

Group Investments comprises investments made by SFC, including its 83%-owned subsidiary Gosh Capital.

At 30 June 2019, the Group's investment portfolio (including SFC's share of subsidiaries) had an estimated net equity market value before tax of $134.4 million. The estimated figure at 30 June 2018 was $110.6 million.

During the year ended 30 June 2019, SFC made new investments totalling $17.6 million in property and equity investments. It also retained $21.1 million of short-term cash deposits at balance date.

The Group carries property assets in its accounting records at depreciated book values. The exception is units in property unit trusts, which are carried at fair value. SFC's assessment of market values is supported by ongoing, independent, accredited valuations.

The difference between the Group's book and market values represents unrealised property value of $74.0 million before tax.

The most recent independent valuation of SFC's property at Jandakot, Western Australia (on an 'as is' basis) was $37.2 million. SFC is continuing development planning for the property. The site has an approximate developable area of 29 hectares. That figure is after excluding planned internal and external roads, drainage, buffer zones and an area designated as "Bush Forever".

SFC has received subdivision application approval to cede sufficient land for the duplication of Jandakot Road and the establishment of a roundabout entrance to the site. SFC is hopeful this construction will commence during the 2020 calendar year. Jandakot Road borders the site and currently carries over 15,000 vehicles per day. SFC also has a subdivision application in progress with the Western Australian Department of Planning, Land and Heritage for the remaining developable area.

The Group owns 2.1 hectares of high-density residential land in North Coogee, Western Australia. Prior to rezoning, the site was the Gosh Leather manufacturing facility.

Gosh Capital has recently completed a land rationalisation to square up the properties with neighbouring sites. Consultants have produced conceptual plans that assess the best opportunity to maximise the value to be realised from the land in the medium term. Gosh Capital is working with local government and planning authorities to apply planning guidelines that permit residential products relevant to the current market.

Gosh Capital also owns a bulky goods property at Dixon Road, Rockingham, Western Australia. During the 2019 financial year, the Directors elected to impair the site's carrying value. This reflects the decline in the bulky goods property market in the region. It also reflects the likely requirement for significant capital investment and incentives to fully tenant the property. Gosh Capital has recently leased a vacant tenancy at Dixon Road. That tenancy may result in the reversal of a proportion of the impairment in the current financial year.

SFC has established a US-based investment vehicle for US opportunities. During the year, SFC US invested the equivalent of A$4.1 million in four syndicated property investments. Those investments are operated by managers with good track records. Those managers are also known to SFC and its Directors. The strategy for SFC US is similar to the Group's syndicated property investment activity in Australia. The four investments comprise a US multi-family residential project, two hotel refurbishment and repositioning opportunities and a fund with a range of residential property investments.

At 30 June 2019, the Group had equity investments valued at $16.7 million. This represents approximately 12% of SFC's Group investment portfolio. A portion is invested via fund managers specialising in various sectors. The balance includes meaningful direct investments in three listed companies and one unlisted company.

Group Outlook

As released to the Exchange in August, for the first half of the 2020 financial year, SFC anticipates Group profit to be significantly lower than the prior corresponding period.

This is due to lower forecast sales volumes for Automotive Leather. The volume decreases reflect the challenging economic and geopolitical backdrop, as well as the delay in commencement of a material new program. That program is now scheduled to start serial production during the second half.

As normal, the Board will provide an update on the full year outlook in February, when we release our first half results.

Dividends

SFC's operating cash flows remain strong. Its balance sheet and financial position are also excellent. The underlying value of Schaffer Corporation is backed by significant tangible assets, including property, equities and cash. As such, the Directors intend to increase the level of the interim dividend to 40 cents per share (fully franked) from 30 cents per share (fully franked).

This intention is supported by the abundance of caution, strategic business investment and focus on Total Shareholder Returns that are paramount for this organisation. It reflects our confidence in what we have built and continue to build, despite what are uncertain macroeconomic and microeconomic conditions.

Conclusion

Over several years, Schaffer Corporation has implemented significant transformational changes. Those changes include the restructuring of Automotive Leather and the sale of Building Products.

During the 2019 financial year, SFC achieved an increase in underlying profit. This reflects the continued successful implementation of those strategies and the drive for further operational efficiencies.

The Group's low gearing provides significant capacity to help fund future growth opportunities. These include the development of Group properties at Jandakot and North Coogee, as well as other investments. This financial strength places us in an advantageous position while we navigate the uncertain economic conditions that are impacting on the first half of 2020.

I wish to thank our global teams in Australia, Slovakia and China. Their continued dedication and efforts to maximise our profits and shareholder value are critical. The Group management and employees are appropriately incentivised and aligned to be focused on creating further long-term value for shareholders.

A special thank you to my co-executive director and friend Anton Mayer. Anton continues to lead, develop and motivate our large team at Automotive Leather in an outstanding fashion.

Some other important matters to note before I close.

Vale – Michael Falconer

In August, I advised of Michael Falconer's sudden passing.

For 34 years, Mike was a dedicated, passionate and highly valued member of Schaffer Corporation.

His contribution to the Group was remarkable. He was a man of great integrity, insight and versatility.

Mike's career with Schaffer Corporation started in 1985, when he joined Calsil Bricks. In 1989, Mike was appointed General Manager of Raffles Paints. He was also involved with Gosh Leather and Howe Leather.

In 1993, Mike founded the UrbanStone paving business. The business was highly successful and demonstrated Mike's business acumen and creative abilities. His legacy can be seen at many prominent urban hardscapes in Western Australia and nationwide.

Following the sale of UrbanStone, Mike returned to part-time consulting at head office.

Mike was my close friend for more than 30 years. I miss him dearly, as does the rest of the Schaffer Corporation team.

Vale – Brian Tennant AM

It was with much sadness that we recently learnt of the passing of Brian Tennant AM.

Brian was a long-term shareholder in the Group from the 1980s onwards. Brian also had a personal relationship with my late father, George Schaffer AM. Brian helped many people during his lifetime and will be sorely missed.

Brian was passionate about his investment in Schaffer Corporation. In 2017, we were fortunate to have Brian visit our leather factory in Slovakia. We enjoyed catching up with Brian at our AGMs and on other occasions. We will miss his colourful input, as well as his colourful attire.

As always, I will close with my and my fellow Directors' thanks to you, our shareholders. Providing future value to you is and will always remain our top priority. The future always contains unknown challenges. We remain confident that we will make the right decisions and adapt appropriately.

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

John Schaffer
Chairman

13 November 2019

* *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 2019 Annual Report for the definitions of non-IFRS measures and page 57 for our definition of Total Shareholder Returns.*