Schaffer Corporation Limited

CHAIRMAN'S ADDRESS TO THE 2015 ANNUAL GENERAL MEETING

Good Morning, Ladies and Gentlemen

My fellow Directors and I have great pleasure in welcoming you to Schaffer Corporation's 2015 and 61st Annual General Meeting.

At Schaffer Corporation, our focus is on creating long-term shareholder value.

Over many years, we have developed and refined a resilient organisational structure. We own and operate a diverse combination of sustainable profit-producing businesses and investments. All of this is targeted at building value for our loyal shareholders.

Whilst that value is not always immediately reflected in our share price, we continue to grow the market value of our investments and the profit-producing capacity of our operating businesses. In addition, Schaffer Corporation has paid an annual dividend every year since it first listed on the then Perth Stock Exchange in 1963. We have paid approximately $115 million as fully franked dividends to shareholders over the last 15 years, an amount that is almost double our current market capitalisation.

To protect future value, Schaffer Corporation has not shied away from difficult decisions to restructure or resize its operating businesses in response to the numerous threats or opportunities that are encountered. An important recent example is Automotive Leather's success in securing new program supply for Mercedes Benz. That new supply provided the opportunity to significantly increase sales volumes and further invest in and expand our European manufacturing operations.

Schaffer Corporation also generates value from its interests in a diverse property portfolio. The investment portfolio had a market value at 30 June of $96.7 million gross and $62.1 million net of debt. This includes property used by Schaffer Corporation's manufacturing operations, and also investments in rental properties and longer-term development sites. We look at the property providing manufacturing and rental income as generating cash to support the provision of annual dividends for shareholders. The longer-term developments, across various sites, underpin potential future value creation.

For the 2015 financial year, Schaffer Corporation recorded a reduction in profits, as anticipated. At the Group level the results were:

- A 4% decrease in revenue to $157.3 million
- A 55% decrease in earnings before interest and tax (EBIT*) to $8.7 million
- A 43% decrease in net profit after tax (NPAT*) to $3.5 million
- A decrease in earnings per share from $0.44 to $0.25 per share
- An annual dividend of $0.25 per share, which was the same as the prior year.

I will now review each of our divisions in greater detail.

Automotive Leather

Schaffer Corporation owns 83% of Howe Automotive Limited (Howe or Automotive Leather), which supplies high quality leather to the global automotive industry.

In last year's Chairman's address, I advised that new supply programs from automotive manufacturers in Asia and Europe, particularly Mercedes Benz, should increase volumes significantly. Howe is rolling out 16 new programs in total over the latter part of the 2015 financial year and the 2016 financial year. As a result of the increased forecast expectations, Howe embarked on a strategy to expand its capacity and presence in Europe with the development of a new 15,000 square metre facility. This facility will accommodate increased leather cutting capacity for the region but, of more significance, established Howe's first leather finishing facility outside Australia.

Profitability during the start-up phase of programs is generally reduced due to extra development work, testing costs, customer visits, start-up delays, and lower cutting yields. These factors, plus higher hide costs and negative foreign currency movements, impacted profitability last year.

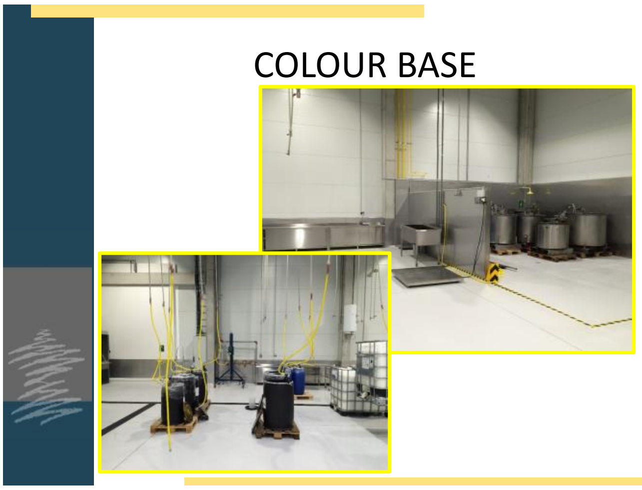
Establishing leather finishing in Slovakia will approximately halve the number of inventory days, reducing the amount of working capital required in the business. There are also freight savings and the operational efficiency and flexibility of having the leather finishing and cutting processes in one region. An expanded presence in closer proximity to our customers is a distinct advantage for future program opportunities.

I am proud to announce that the new Slovakian facility has been completed on schedule and is now successfully producing finished automotive leather hides. We can now have a look at some images from the new facility.

The facility is situated in Košice, the largest city in Eastern Slovakia with a population of around 240,000. Košice is the location of our existing leather cutting plant and once the new facility has been fully established, Howe's European cutting process will be spread over both locations, employing close to 1,500 people.

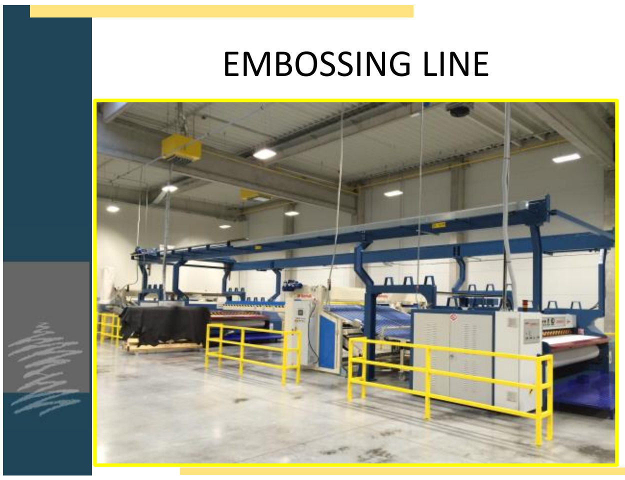
The processes that will be accommodated by this new facility are:

This process reinvigorates the natural properties of the semi-finished hide using a combination of moisture and machine pummelling to soften the leather.

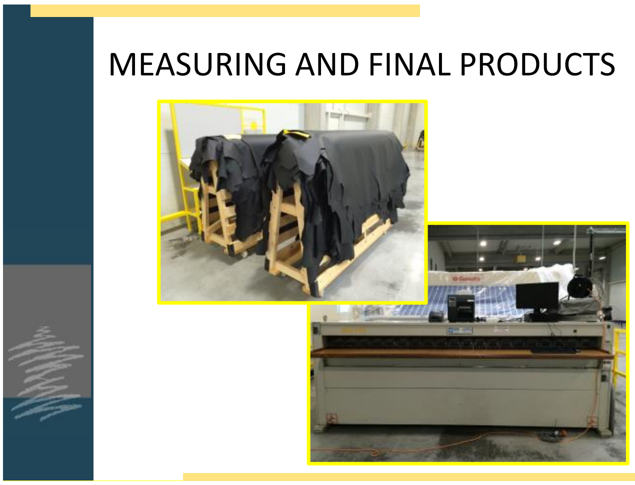


This activity prepares the mix of colours and chemicals prior to application to the leather hides.

The leather finishing process applies the colour and chemical mix to the hide. Consistency of the application and minimisation of wastage are key objectives. In between applications, the hide is dried using infra-red technology.

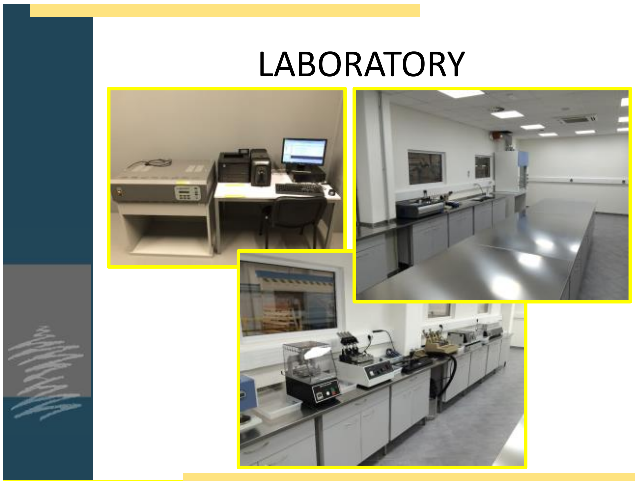


If embossing is specified for a program, a print is impressed onto the leather to achieve a certain look and feel.



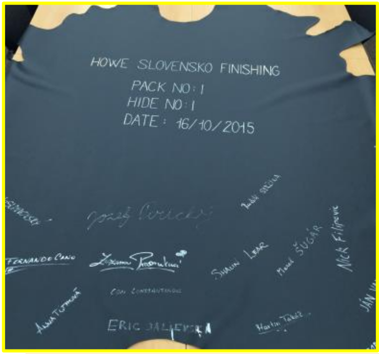
Measuring is the final stage before the product is to be cut into specific patterns.

Support services located at the new facility are:



The finishing of leather is highly technical and the product must adhere to comprehensive testing to ensure the product meets the manufacturer's specifications.

FIRST HIDE



I congratulate Anton Mayer, Nick Filipovic and their wonderful team for successfully completing this long project in 12 months. This is a great effort, and here is the picture of the first hide produced on 16 October 2015.

The building, which we are leasing, was completed in just 9 months; I'm far from sure we could have achieved that result here in Australia. The Howe team has managed the installation and commissioning of machinery, hiring and training of staff and associated logistics extremely well in order for the facility to ready without delay. The Board congratulates them on their efforts.

Howe will continue to primarily purchase its raw materials – semi-processed hides – from South America. Those hides will now be finished at a combination of our facilities in Slovakia and Australia and then cut for supply at our component cutting plants in Slovakia and China. Howe supplies a strong and regionally diverse customer base in Asia and Europe, including major motor vehicle manufacturers Audi, Land Rover, Nissan, Toyota and Ford and, now, Mercedes Benz.

For the 2015 financial year, revenue decreased by 2% to $101.1 million, and EBIT decreased to $6.3 million from $15.2 million.

As mentioned, new programs necessitate additional start-up costs that initially decrease profitability until the program delivery is well established. The finishing of the leather to suit the exacting standards of the programs needs to be fully developed and tested. Timing can be delayed and yields affected until the cutting teams become proficient with the new program. These factors impacted the profitability of the 2015 financial year and, with so many new programs rolling out, are understandably expected to also affect our margins for 2016.

Hide costs in 2015 were also very high. This was compounded by the effect on our import costs of a stronger US dollar and weakened Australian dollar. A significant amount of stock was held at 30 June at these higher costs and they will take some time to sell through. The benefit of the current cost of hides decreasing will not be realised for at least 6 months into the current financial year when that opening stock is sold through.

Howe's volumes are increasing as the new programs ramp up and the profitability benefits of increased scale should be more visible in the 2017 financial year.

Currency fluctuations are important to Howe. Most of Howe's revenue is denominated in Euros. The majority of expenses (hides and chemicals) are denominated in US dollars. Therefore a weakening Euro and a strengthening US dollar are negatives for our profits. The converse is also true. Currency is unpredictable and has been volatile in the current financial year. This makes profits difficult to predict. As we cannot control these movements, we focus on areas of the business where we can make a difference.

Building Materials

Building Materials comprises Delta Corporation and Building Products, both of which are 100% owned by Schaffer Corporation.

For the 2015 financial year, Building Materials EBIT decreased to $1.4 million, while revenue decreased by 5% to $49.1 million.

Delta Corporation produces and supplies pre-cast and pre-stressed concrete products. The boom in resources sector construction in Western Australia has subsided steeply over the past two years. This continues to have an impact on the available amount of work and the intensity of competition to win the work. This directly impacts Delta's volumes and margins. The business performs a diverse range of projects using specialised precast products in order to maintain a satisfactory level of appropriately profitable work. Delta has entered the current financial year with good order books but we are cautious with our expectations having regard to the current industry climate.

The Building Products business unit supplies paving and walling products, and comprises UrbanStone, Urbanstone Central retail outlets, Archistone (including Archistone Masonry products), Limestone Resources and Imported Stone products. Competition remains intense and the residential market subdued. However, Building Products successfully maintained its revenue in 2015. The profitability of Building Products also improved from the continued focus on cost reductions.

Infrastructure projects in the commercial and government sectors are driving manufactured and natural stone sales and, as a result, Building Products entered the financial year with good order books that it has been able to maintain.

We expect the first half result for Building Materials to improve compared to the prior year.

Investment Property

The Investment Property division comprises the Group's interests in syndicated property investments. Revenue decreased by 2% to $6.0 million and EBIT decreased by 22% to $2.4 million. The level of incentives required to attract and maintain tenants, particularly in the office rental markets, is high. This affected the 2015 profits although approximately 95% occupancy was achieved.

The market value of investment property at 30 June was $46.5 million gross and $23.1 million net of debt. We expect similar rental profits in the 2016 financial year.

Gosh Capital

Schaffer Corporation owns 83% of Gosh Capital.

The Gosh Capital investment company was set up to maximise the value of the land asset on which the Gosh Leather business previously operated at 10 Bennett Avenue, North Coogee, Western Australia. Gosh Capital reinvested the capital from the proceeds of a large building loss insurance payment and reinvests the profits in a range of diversified investments.

The Cockburn Coast area, encompassing North Coogee, is presently undergoing conversion to a high-density residential precinct. Landcorp, as majority land owner, has started significant work on the properties and public spaces surrounding our 2.1 hectare site, enhancing their and our future development potential.

During the last financial year, Gosh Capital has made smaller investments totalling $1.5 million in two property investments, including a rented industrial property yielding 12% and a longer term residential sub-division with an expected internal rate of return of 20%.

The market value of Gosh Capital's portfolio at 30 June was $22.7 million gross or $17.4 million net of debt.

During the current half-year, a special distribution of $1.05 million has been received from the sale of the Space 207 property by the Space 207 and Harbour Park Trust, of which Gosh Capital is a unit holder. This will yield EBIT of approximately $0.3 million this half-year. Otherwise, we expect a modest increase in Gosh Capital profits resulting from our investment program to date.

Outlook

We are comfortable with our Group's potential growth and positioning. Nonetheless, we are mindful of the risks and potential threats that each of our businesses may encounter. We are also conscious of volatility within the local and international economies.

In light of my preceding comments, it is prudent for us to advise that our expectation of the first half is for a similar result to the prior corresponding period including:

- A significant increase in volume and revenue for Automotive Leather, but similar profit to last year as a result of high cost hide stocks and start-up costs of 16 new programs
- A modest increase in profits for Building Materials
- A modest increase in profits for Gosh Capital, including additional profit associated with the sale of Space 207.

Dividends

The Board is pleased to advise that we intend to continue with an interim dividend of $0.12 fully franked, the same as last year. The interim dividend will be finally reviewed and ratified when the Group releases its half year results in February 2016.

Conclusion

Your Board and management have continued to evolve and increase the value of the Group's operations for the long-term benefit of our shareholders.

A significant milestone has been achieved with the completion and commissioning of the new finishing and cutting facility in Slovakia. This is a move that could yield significant financial benefits and position us well for future growth opportunities.

We will continue to manage the Automotive Leather expansion so that our path to improved profitability is as quick as possible. We will also continue to constantly monitor our businesses, and their environments, in order to tweak our strategies where necessary in order to maximise our profits.

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

On behalf of the Board, I would like thank our management and employees. Each area has its own unique set of challenges. Our teams have addressed these challenges proactively and positively. It is our people who enable Schaffer Corporation to be positioned as it is today. We also welcome the growing number of international management and employees who have embraced our business and culture.

Finally, I would again like to thank you, our shareholders. I do this every year and it is important and appropriate that I mention shareholders at the beginning and conclusion of this address. We are more than pleased to accomplish our aim of providing long-term value to a loyal and supportive group of shareholders. We are confident we are employing the right strategies to be able to continue providing you with value into the future.

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

John Schaffer
Chairman

18 November 2015

* *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 2015 Annual Report for the definitions of non-IFRS measures.*