Schaffer Corporation Limited

CHAIRMAN'S ADDRESS TO THE 2013 ANNUAL GENERAL MEETING

SCHAFFER CORPORATION'S 50th AGM AS A LISTED COMPANY

Good morning, ladies and gentlemen

On behalf of my fellow Directors, welcome to Schaffer Corporation's 2013 Annual General Meeting – the 50th Annual General Meeting as a company listed on the Australian Securities Exchange. Of course, back in 1963, the Company was listed on the main board of the Perth Stock Exchange, with its chalkies and open outcry trading.

Whilst I didn't attend that first meeting, as I was a school boy, I don't think I missed any meetings from the fifth onwards. I then joined the Company in 1972, and after becoming Chairman in 1988, I have had the privilege and pleasure of chairing this meeting 25 times. I acknowledge my sister, Danielle Blain, a co-director since 1987, who has been on this journey with me and has given the Company such wonderful service.

No one in any of the 1963, 1972 or 1988 meetings would have imagined the transformation of the world in which we live and the development that your Company has undergone. Certainly, the five years of economic volatility and uncertainty we have experienced since the 2008 global financial crisis has presented challenges unique in the history of our Company.

Your Directors long ago formed the view that diversification was Schaffer Corporation's most effective defence against uncertainty. The steps we have implemented to achieve that diversification across the Group and within each business, have delivered continued annual profits and dividends to our shareholders. In the 2013 financial year, we achieved a marginal increase in net profit after tax (NPAT*) of 1%, as the impact of diversification was reflected in each division:

- Building Materials continued to benefit from the multi-faceted exposure to civil infrastructure projects and civil works for some larger mining and Government projects in Western Australia.
- Contrastingly, Leather was affected by the then-prevailing stronger Australian dollar and an anticipated reduction in shipments due to vehicle model changes.
- The Group also recorded a further $2.3 million after tax in insurance proceeds for the North Coogee building destroyed by fire in 2012.

After diversification, capital management is our next-most-important business strategy.

Again in 2013 we were relentless in reducing net debt and improving the strength of Schaffer Corporation's balance sheet. The achievement of this outcome is assisted by the operating cash flow that each division delivers. The strength in operating cash flow is in part a function of diligent working capital management and cost control, which are constant focuses. At a board level, we continue to apply conservative capital allocation and dividend policies. The result of all these actions is to best position Schaffer Corporation to maintain and grow profits in its diverse businesses.

The Board declared dividends of $0.23 per share fully franked for the 2013 financial year. That is a 9.5% increase on the previous financial year and represents a payout ratio of 43%. The Board's decision to maintain a conservative stance to dividends reflects the ongoing economic volatility.

As we move closer to the end of the first half of the 2014 financial year, I am pleased to report that your Company is on track to record a significant increase in revenues and underlying NPAT*, which excludes abnormal items.

I will now review each division in greater detail.

Automotive Leather

Schaffer Corporation is the 83% owner of the Howe Automotive Group (Howe).

Howe forecast a lower result for the 2013 financial year. A strong Australian dollar prevailed for the majority of the financial year, negatively impacting export revenues. As anticipated, sales volumes declined as existing vehicle programs were changed over to new models. Consequently, revenue decreased by 19% to $72.9 million and earnings before interest and tax (EBIT*) decreased to $5.0 million.

The current year outlook is significantly improved. Increasing demand for new vehicle models has lifted sales volumes, particularly in Slovakia where Howe is expanding its capacity. In that location alone, Howe now employs approximately 700 people.

The returns from the improved volumes are being enhanced by the post-May 2013 weakening of the Australian dollar, notably against the Euro. Whilst the dollar remains strong on a historical basis, the relative weakening is increasing the reported Australian dollar value of Euro-denominated export revenues. Whilst the cost of US dollar-denominated raw material and chemical inputs has increased, a net benefit is presently accruing to Howe.

Howe will accrue a further EBIT increase in the first half, as the majority of first half export sales will be made from hide stock purchased at higher US dollar rates. That is, those higher rates reduced the Australian dollar cost of import purchases held as stock at 30 June. With the dollar now having fallen, Howe will benefit from first half export sales that achieve higher prices in Australian dollar terms from imported materials purchased at effectively a lower cost.

We cannot predict or control exchange rate movements and so Howe's focus is on a constant process of reviewing and upgrading the things we can control. Technology, processes and materials sourcing are all examples. These actions continue to improve our quality and cost effectiveness to support Howe's strategy of being a high quality, low cost global producer of automotive leather.

Building Materials

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

The impacts to Building Materials' performance were similar to the previous year, and resulted in a 4% increase in revenue and an improvement in margin.

Delta manufactures pre-stressed and pre-cast concrete. Delta benefited from the ongoing investment into civil infrastructure projects and civil works for major resource projects in Western Australia. This included such projects as the Perth City Link Tunnel and the Perth NIB Stadium.

Building Products comprises UrbanStone, Urbanstone Central, Archistone (including Archistone Masonry products), Limestone Resources, Imported Stone products and Lumeah. Subdued and competitive conditions in the residential and commercial markets were offset somewhat by government-funded projects. Whilst there was some improvement in the first half, the tough market conditions were apparent in the second half.

Building Products have been busy with product development in order to bolster sales. This includes our new Masonry Products, including honed and polished finishes, which have progressed well. We supplied a wide variety of building types with our unique value-added range of Masonry Products suitable for the Architectural Market during the 2013 financial year. We have also broadened our product offering with an exclusive range of Australian granite. These strategies offer some assistance to sales volumes but generally we remain ready and leveraged for an upturn in commercial and residential spending.

The first half of the current year should be somewhat lower than in 2013. Whilst current order books are strong, resources investment and related civil works are tapering, the commercial and residential sectors are subdued and project margins are lower.

Property

Underlying EBIT* increased by 23% to $3.5 million and was achieved on the back of the portfolio of syndicated investment properties being almost 100% tenanted for the majority of the 2013 financial year. Reported EBIT, which included $4 million of proceeds from the insurance claim for the loss of the building at North Coogee, Western Australia, increased by 64% to $7.5 million.

For the first half of 2014, there is evidence of softening in the office rental market. We expect vacancies to rise and underlying results for Property to be slightly lower than the first half of 2013.

There are some events flowing from the North Coogee insurance claim that are important to mention.

We are close to finalising the insurance claim, which related to a fire that destroyed our property at 10 Bennett Avenue, North Coogee in April 2012. On 13 November 2013, we signed a contract for the purchase of a commercial property. The purchase price is $7.75 million and will be funded 60% by debt with recourse to the property only. That purchase is considered reinstatement of the lost building under our insurance policy coverage and will trigger final payments of approximately $1.2 million to reach the agreed total Cost of Reinstatement estimate of $6.7 million.

The property at North Coogee is owned by Gosh Leather Pty Ltd. Gosh Leather is 83% owned by Schaffer Corporation and presently also has small investments in two property unit trusts and cash, the majority of which will be utilised in the purchase of the new commercial property.

Gosh Leather will be renamed Gosh Investments Pty Ltd and Schaffer Corporation will report it as a separate investment business. Its mandate will be to maximise the returns from the North Coogee property, which it will retain, and from the reinvestment of other profits it generates. Its objective will be to pay fully franked dividends to shareholders from those profits. Schaffer Corporation has a long track record of successful investment, particularly in property. We believe that this dedicated investment unit, separated from our operating divisions and funded from its own resources, has the potential to deliver significant returns for shareholders over time.

Asset Backing

In valuing the property portfolio, Schaffer Corporation maintains its conservative accounting policy of historical cost less accumulated depreciation. We estimate – backed by qualified independent valuations – that, at 30 June, there were approximately $33.2 million of post tax unrealised gains on property that are not reflected in those book values. At 30 June 2013, the addition of those unrealised gains increases Group Net Tangible Assets to $6.58 per share compared to the book value of $4.24 per share.

Cash and Net Debt

In uncertain economic times, the Board believes that financial prudence includes reducing the Group's net debt. In 2013, the Group generated surplus operating cash flow of $8.6 million, which after capital expenditure and dividends was applied to reduce net debt by $4.0 million. This reduction followed a $12.2 million reduction in 2012. At 30 June 2013, Group net debt stood at $35.4 million.

The Group has 3 distinct debt pools. At 30 June 2013, they were:

Debt Pool	Net Debt	Debt Security
Gosh Investments	$4.9m net cash	N/A
Building Materials and Corporate	$0.6m net cash	N/A
Automotive Leather	$18.4m net debt	Debt non-recourse to assets of other divisions
Syndicated Investment Property	$22.5m net debt	16% of debt recourse to Schaffer Corporation
Total	**$35.4m net debt**	

As I mentioned, the majority of Gosh Investments' net cash will be utilised in the purchase of a commercial property.

Outlook

Building on my earlier comments on each division, we anticipate the consolidated Group to record a significant increase in revenue and underlying profit for the first half of the 2014 financial year. This result will be derived from:

- a significant increase in the results for Automotive Leather
- a decrease in the results for Building Materials; and
- a slight decrease in the results for Property.

In addition, we anticipate an additional and approximate $0.7 million in after tax proceeds from the North Coogee insurance claim.

We are unable to make reliable assessments on trading conditions and results for the second half of the 2014 financial year. The world is uncertain. Europe and the US continue to work through significant economic issues; economic projections from China continually fluctuate; questions exist over the strength of the Australian economy. Increases and decreases in uncertainty affect business and consumer confidence and exchange rates, all of which in turn will affect our businesses – either positively or negatively.

We do know that current foreign exchange rates are relatively beneficial to our revenues and results compared with those in the 2013 financial year. If they remain around these levels, the positive impact on Automotive Leather results will continue.

We also know that Building Materials' order books are strong. Nonetheless, we are cautious of a reduction in activity flowing from decreases in resource project investment, as many projects pass from the development to the production phase.

As always, your Board and management will maintain close attention to those factors that we can control. I've spoken in previous years about building as many 'switches' as we can into our businesses to enable them to respond as effectively and quickly as possible to prevailing conditions.

Dividend Increase

During January 2014, the Board will consider the interim dividend after reviewing the preliminary half-year results and the anticipated conditions for the second half. At present, the Board expects to declare and pay a fully franked interim dividend of at least $0.12 per share, which is a 9% increase on the dividend for the same period last year.

Conclusion

In summary, your Board expects yet another challenging year due to the combination of global and local economic conditions. We have confidence that we have considered and installed the ‘switches’ our businesses need to strategically position them to respond. That combined with our diversification and conservative capital management puts Schaffer Corporation in excellent condition to tackle the challenges and – importantly – embrace the opportunities presented.

As always, your Board appreciates your support of the Company, with a special mention for those shareholders who have been with us for each of the 50 years that we have been listed.

I would like to give sincere thanks to our key managers today, with special mention of Matt Perrella, our Executive Director of Delta Corporation, who has been with us for 45 years. The executive management team remains strongly focused on creating long-term shareholder value and positioning our various businesses to achieve the best long-term result for shareholders.

Those managers are only able to achieve what they do with the hard work and commitment of our growing number of employees globally. Together we strive to meet daily challenges and build on what is a strong corporate culture now more than 50 years in the making. I take this opportunity to thank them collectively and individually.

I look forward to seeing you all again next year.

John Schaffer
Chairman

19 November 2013

* *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 2013 Annual Report for the definitions of non-IFRS measures.*