Schaffer Corporation Limited

CHAIRMAN'S ADDRESS TO THE 2018 ANNUAL GENERAL MEETING

Good Morning, Ladies and Gentlemen

Welcome to the 64th Annual General Meeting of Schaffer Corporation Limited.

As always, the Board and I are delighted to see so many familiar faces attending the AGM.

As a Group, we hold our shareholders very close. It informs our thinking; it necessarily informs our decision making.

The AGM is a wonderful opportunity each year to meet with you face to face and to discuss the challenges and opportunities of your Company and how the Board and executive are addressing them.

I am proud to be presenting todays financial results which are the culmination of transformative changes successfully implemented by the Board, management teams and employees on a global basis.

Over the past three years, we have invested in initiatives required to ensure our Automotive Leather division remains globally competitive and is able to maximise shareholder returns after having won new programmes. In anticipation of the substantial increase in volumes we saw the strategic need to increase capacity in both our finishing and cutting operations in Europe. As part of this decision, it was clear that we would also need to move our production closer to our European customers and other suppliers. These changes have resulted in significantly improved profits and cash generation for the Automotive Leather division and the Group as a whole.

We have used the cash generated to pay down debt. This has created additional financial capacity for the Group to fund growth and create long-term shareholder value, which remains – as always – our focus.

In the 2018 financial year, the Group increased its profit substantially.

The results were:

- A 20% increase in revenue from continuing operations to $227 million
- A 295% increase in net profit after tax (NPAT*) to $23.3 million
- An increase in earnings per share from 41c to $1.67 per share
- A 73% increase in annual dividends to 45c per share.

Our Total Shareholder Return (TSR*) measures the combined returns to shareholders from share price movements, dividends and dividend imputation credits.

In 2018, our TSR was 134%. This is an outstanding result. Our average annual TSR over the past five years is 42%.

I will now review each division in greater detail.

Automotive Leather

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

Automotive Leather's NPAT* increased to $23.7 million. Revenue grew 19% to $203.4 million.

As I noted earlier, in the past two years, the growth in the number of programs and volumes for Automotive Leather created the opportunity to establish additional leather finishing and cutting facilities in Slovakia, close to our European customers.

The expanded Slovakian facilities and programs have been operating at 'steady state' for over a year. The one-off costs associated with establishing the new operations have now been eliminated from our operating costs. As such, this year's financial result for Automotive Leather reflects the benefits from cost efficiencies. In addition, there were material currency gains included in this year's financial results.

The management team continues to look for further operational efficiencies. Late in the 2018 financial year, we invested in CNC (Computer Numerical Controlled) cutting machines to work alongside our current press-based leather cutting methods. This will potentially drive further efficiencies in our cutting operations.

Automotive Leather is a multicurrency business. As such, it is impacted positively and negatively by currency movements.

Automotive Leather receives around 80% of its revenues in euros (EUR). It also has around 10% of revenues in Chinese Renminbi which remains volatile from the recent trade war between the US and China.

Automotive Leather incurs more than 50% of its costs in US Dollars (USD) and requires Australian Dollars (AUD) for its Australian operations and to pay dividends. As such, we sell a large proportion of Automotive Leather's EUR receipts to buy AUD and USD.

To reduce the potential negative impact of currency risk on the business, Automotive Leather hedges certain operational currencies, locking in rates for most of its USD and AUD requirements. Our current program is to hedge a percentage of our exposure up to ten months forward.

In the 2019 financial year, leading global car manufacturers have announced a slowdown in global sales volumes. Typically, this has been associated with challenges of achieving emission controls in Europe, and the effects of tariffs imposed by the US on China. The Board is also conscious of the uncertainties in the global economic environment, including the impending Brexit, impact from higher interest rates and tightening global liquidity.

Given these factors, for the first half of the 2019 financial year, Automotive Leather anticipates a similar result to the first half of the 2018 financial year, assuming stable foreign exchange rates.

Building Materials

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

The Western Australian economy and the building industry remain depressed in terms of work volumes. Margin pressures from increased competition between suppliers continued to impact Delta's profitability.

As a result of these tough conditions, the Board decided to impair the carrying value of Delta's assets by $3.2 million (after tax) during the 2018 financial year.

Delta's revenue increased during the year. However, a large civil infrastructure project resulted in increased complexity, project administration and compliance requirements, and challenging production schedules. This led to an increase in Delta's production costs. Profits declined compared to the prior year. That project has continued into the 2019 financial year with profitability impacted by extra costs to meet demanding deadlines.

Delta's order bank was satisfactory at the start of the financial year. However, continued tough industry conditions make guidance and forecasting future revenues extremely difficult. Delta continues to right size its cost structures to minimise the negative impact on profitability.

We expect Building Materials' performance will be close to breakeven for the first half of the year, compared with the loss recorded in the prior corresponding period.

Property Portfolio

At 30 June 2018, the Group's property portfolio, including Schaffer Corporation's share of Gosh Capital, had an estimated current market value of $111.7 million (30 June 2017: $90.5 million).

The increase in value related primarily to the most recent valuation of the property at Jandakot, Western Australia. The valuation followed the gazettal of a local Scheme Amendment. The Scheme Amendment increased the scope and area of light industrial and commercial uses on 38.8 hectares of the land.

The local Council subsequently approved a Local Development Plan, which added an additional native vegetation buffer on one boundary. This restricts development on 5.5 hectares, reducing the overall site to 33.3 hectares.

The valuation of the property on an 'as is' basis increased to $37.2 million (previously $19.1 million).

Schaffer Corporation carries property assets in its accounts at depreciated book values. The exception is units in property unit trusts, which are carried at fair value. Market values are supported by ongoing, recent independent accredited valuations. Schaffer Corporation provides the valuation detail to improve transparency and reflect 'real world' values.

The market value of $111.7 million is $73.8 million greater (before tax and debt) than the depreciated book value of $37.9 million.

SFC Investments

SFC Investments includes Schaffer Corporation's interests in syndicated property investments, group-owned property for development and/or leasing activities, and equity investments.

For the 2018 financial year, the division contributed NPAT* of $1.1 million (2017 financial year: $0.7 million).

Schaffer Corporation sold the UrbanStone manufacturing business in November 2017. The Group retained the Jandakot land and building assets occupied by UrbanStone (Lot 701 Jandakot Road). Schaffer Corporation has leased the site on a long-term basis to UrbanStone's purchaser.

Gosh Capital

Schaffer Corporation owns 83% of Gosh Capital.

Gosh Capital has interests in direct owned property, including land at North Coogee. The North Coogee site was formerly the location of the Gosh Leather business.

Gosh Capital reinvests profits in investments including syndicated property trusts and equities.

At 30 June 2018, the market value of its asset portfolio was $31.9 million ($25.9 million net of debt) including minority interests.

Gosh Capital contributed NPAT* of $0.4 million (2017: $0.4 million).

During the current half-year, one of our syndicate investment properties was sold, creating a 61% return on capital for that investment and a contribution to profit of $0.5 million for Gosh Capital.

Group Outlook

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

Subject to stable foreign exchange rates to the end of the calendar year, Schaffer Corporation anticipates that Automotive Leather's performance for the first half will be similar to the first half of last year. As such, Schaffer Corporation also expects Group underlying profit to be similar to the first half of last year.

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

Dividends

The Board is pleased to advise of our intention to double the interim dividend to $0.30 per share fully franked. The Directors will confirm and ratify the interim dividend when the Group releases its half-year results in February 2019.

Conclusion

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

During the 2018 financial year, the successful implementation of those strategies drove a $46.2m operating cash flow and a $42.5 million reduction in net debt.

The current low gearing provides significant capacity to help fund future growth opportunities such as the development of Group properties at Jandakot and North Coogee, as well as other investments.

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

Again, a special thank you to you, our shareholders. We appreciate your patience and support while we have transformed the Group.

Providing future value for our shareholders is and will always remain our top priority. While the future always contains unknown challenges, we remain confident 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

14 November 2018

* *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 2018 Annual Report for the definitions of non-IFRS measures and page 57 for our definition of Total Shareholder Returns.*