Schaffner Holding AG

Switzerland | Industrial Goods & Services

Investor day update

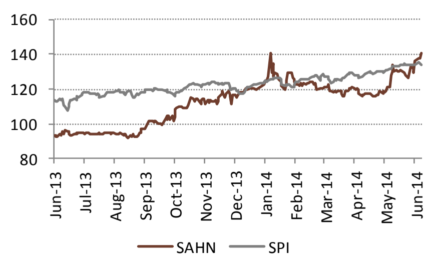
16 June 2014

Company Data

Price:	CHF311
Market Cap:	CHF200mn
Free Float:	100%
No. of shares:	635,940
Avg. traded volume (1 year):	1160
Bloomberg:	SAHN SW
Reuters:	SAHN.S
ISIN:	CH0009062099

Source: SIX Swiss Exchange

Share Price Development



Key Financial Data

	2012	2013	2014e	2015e
Sales	176.9	194.9	221.7	241.1
EBITDA %	8.3	8.8	10.4	13.1
EBIT %	4.1	4.8	7.4	9.6
Net Margin %	2.2	3.2	5.5	7.3
Basic EPS	6.2	9.9	19.2	27.8
Diluted EPS	6.0	9.9	19.1	27.6
DPS	3.5	4.5	5.8	8.3
Equity Ratio %	43.0	44.0	46	51
Capex	4.4	5.2	8.3	9.1
P/E	37.9x	22.8x	16.2x	11.2x
EV/EBITDA	11.8x	9.1x	9.2x	6.9x
EV/EBIT	24.0x	16.6x	12.9x	9.1x

Next Events

FY2014 results	9 Dec 2014
AGM	15 Jan 2015

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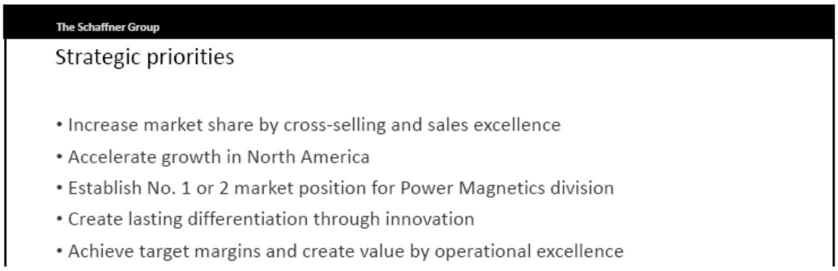
Confidence boost to execution capabilities

Schaffner ('the group') is a market leader in the fields of electromagnetic compatibility (EMC) and power quality. The group's products such as filters, transformers, and chokes help in eliminating electrical distortions, thus improving the reliability of electronic equipments as well as stabilizing power grids. Schaffner also manufactures components for keyless entry antennas used in automobiles as well as filters for electric vehicles. The group recorded sales of CHF195mn and had 2,817 employees as of FY2013, which ended September 30.

Rolling out new strategies

Schaffner on its investor day (held on 12th June 2014) confirmed its commitment to its two-pronged strategy of top-line growth (through the Power Magnetics and Automotive divisions) along with margin expansion at EMC development. Besides the existing focus areas, the group uncovered few additional strategic priorities with emphasis on growing market share in North America and capitalising on cross-selling opportunities between divisions being the top-most on the list.

Exhibit 1: Additional focus areas

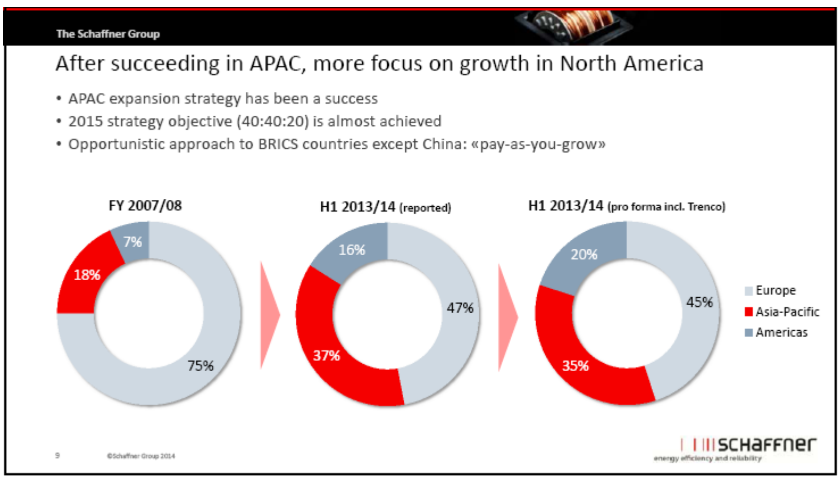


Source: Company data, Research Dynamics

Focus shift to North America

Schaffner's growth focus has primarily been geared towards Asia in recent years. This is amply evident from the rising sales contribution from the Asia-Pacific (APAC) region, which increased to 35% in H1FY2014 from 18% in FY2008, mainly led by China. Schaffner benefited from expansion of production facilities as well as developing products suitable for the Chinese market, both in terms of costs and technology. The group has almost achieved its 2015 objective to generate 40% of its revenue from the APAC. Schaffner has drawn up plans to maintain its existing customer base in the APAC region, but will be selective about enhancing its customers base (lower risk from receivables defaulting), with China and Japan to be exceptions. The company plans to continue focusing on developing sophisticated products for Chinese consumers that are becoming more technologically advanced. Schaffner is also eyeing the renewable energy market in Japan, which offers huge potential.

Exhibit 2: APAC development



Source: Company data, Research Dynamics

With the recent acquisition of US-based Trenco, the group is now targeting to further expand its presence in the North American market, following its success in this region. On the one hand, the shale gas boom has brought the US again at the forefront of being the global growth engine. The shale gas revolution has led to reduction in energy costs, which coupled with increasing inflation in the emerging economies, is compelling companies to consider shifting their manufacturing base back to the US. These so-called "re-shoring" initiatives exist especially in industrial, engineered products where Schaffner has a presence. On the other, hand the over-aged infrastructure in many cities is need of modernization and upgrading, or the transport system needs expansion. For example, Schaffner is now involved in the building of a new mass rapid transit system in Honolulu. In addition, the region also supports the growth of renewable energy, given the available space and favourable climate conditions, and also has energy-efficiency mandates in place. The group has significant exposure to products used in energy-efficient drive systems (23% of its revenue in FY2013) and renewable energy (18%). The acquisition of Trenco enables Schaffner to gain access to the US regulatory-approved products and further shores up its presence in renewable energy and energy-efficient drive systems. The group generates 20% of its revenue (H1 FY2014) from Americas following the Trenco acquisition from 16% earlier, and plans to further increase it.

New Power Quality business unit to increase speed of growth

In order to shorten decision ways and react more quickly to market needs a new business unit was set-up within the EMC division with dedicated, highly trained specialists for engineering, product management and service. Where so far Schaffner's products had very little maintenance component, the increased use of harmonic filters in power electronics call for more after-sales services and life-cylce management, bringing the company closer to the customer. Here, the group values the partnering with authorized sales and service partners, but also with universities. Overall, thanks to its innovation-driven nature, Schaffner believes that differentiation in this core, but complex market of power electronics is possible with the new set- up, which should support growth rates above 10% for Power Quality products.

Emphasis on cross-selling opportunities between business divisions

Schaffner's products are complementary in nature, especially the offerings of the EMC and the power magnetic divisions. In order to capitalize on these opportunities, the group plans to focus more on cross-selling between divisions. The two growth markets which lend themselves best to this task are motor drives and smart grids wherein the EMC division already has a strong hold, especially in motor drives (market share of 20%). The power magnetic division offers transformers with harmonic frequency mitigation & filter inductors that are used in motor drives and grids. In addition to the products, the group is planning to provide end-to-end solutions, which will help in developing strong client relationship. The acquisition of Trenco is expected to facilitate market entry in the US as the group obtains access to its product designs and also to large conglomerates, which would have been difficult for Schaffner to gain on its own. The motor drive market is currently sized at CHF105mn and is expected to grow at a CAGR of 9% over the near-term, while the smart metering sub-market for example is anticipated to grow at 15% per annum. Thus, this opportunity, if successfully addressed, will significantly benefit Schaffner in tapping the potential of both of these markets.

Exhibit 3: Focus on cross selling

Source: Company data, Research Dynamics

Consolidating growth and margin-enhancing products

Schaffner places huge emphasis on developing innovative products, which is evident from the amount of R&D expenditure it incurs every year (~8% of revenue in FY2013), reportedly the highest among peers. For e.g. in the automotive division, 50% of the current portfolio of products has been launched in the last three years. In power quality under EMC, the latest launch (June 2014) has been a 100/120A harmonic filter that will be used in marine applications, which thereby opens up an entirely new end-market for the group. Moreover, Schaffner is also developing a new product named switching frequency filters for which the regulations are favourable and these products find use in wide applications viz. motor drives (opportunity of EUR30mn), photovoltaic (EUR120mn) and wind (EUR112mn). In addition to its top-line growth, the group's efforts to develop innovative products also aid in margin enhancement. Schaffner's integrated CM/DM inductors reduce the size and cost of the product by half. These products in addition to the continuation of lean manufacturing are expected to keep the group on track to achieve its mid-term targets.

Investor day update boosts confidence in the company's execution capabilities

In addition to the continuation of its previous strategy, the company's newly-introduced plan to focus on North America and explore the cross-selling opportunities is expected to be beneficial for the group to achieve its mid-term targets. Schaffner confirmed its FY2014 (10-15% net sales growth at 7% EBIT margin) and mid-term targets (net sales between CHF260-290mn). Management also reiterated that the current organisational set-up will support surpassing the CHF 300 million mark with very little additional costs (no new manufacturing plants, no new management layers) and thus the operational structure is highly leveraged, supporting the targeted margin expansion to 9-12% for the group by FY2015/16. This unchanged outlook highlights that the execution is on track and supports our conviction that the group has embarked on its growth story. We make no changes to our model as we already are at the top end of the earlier provided guidance and we would prefer to wait for these new measures to take shape.

The company also mentioned the following trends globally, which will help it to grow in the medium to long term:

- Renewing infrastructure and modernisation in the US and Europe. The company recently got involved with the upgradation of Bordeaux Metro power substations to 690V; this alone provided opportunity in the upper 6-digit figures for the company.
- The two big economies offer favourable environment: Japan which is moving from nuclear to renewable while in the US, the regions like Texas, Arizona provide a perfect environment for development of the renewable industry.
- Growing automation in China aids the growth of this industry. As the government continues to invest in infrastructure and there is a trend towards localization of high-tech industries, we will see a continued growth in the industry
- Increasing regulation globally. As EMC filters eliminate electrical noise to ensure safe operation of electronic equipment, the increasingly stricter regulatory environment bodes well for the company and the industry.
- In the automotive division, increased demand for electric vehicles is seen from the long waiting list of the latest electric vehicles launched by BMW (e.g. i3). We will also see many more me-too products in the market, providing further fillip to the industry
- The company is also witnessing a move by clients towards consolidating their vendors. This will further enable the market to consolidate in a fragmented industry (top 20 players have only 30% market share in power magnetics). This works well for the company as it is a market leader and also has embarked on a buy-and-build strategy.

Valuation

The stock looks attractive even after the recent run up (18% YTD vs 9% for SPI); on 2015 multiples it currently trades at a discount of 14%, 13% and 21% on EV/EBITDA, EV/EBIT and P/E basis to its product peers, respectively. And at a discount of 34% on both EV/EBITDA and EV/EBIT and 41% on P/E basis to its industry peers. Given the improved visibility we believe the discount still offers an attractive entry point.

Table 1: Schaffner – Comparison with Product peers

Company (Product peers)	EV/EBITDA			EV/EBIT			P/E		
	3 year average	CY2014E	CY2015E	3 year average	CY2014E	CY2015E	3 year average	CY2014E	CY2015E
Schaffner Holding AG	7.5x	8.5x	6.8x	10.9x	11.7x	9.0x	13.5x	14.6x	11.1x
Omron Corp	6.0x	8.9x	7.8x	9.9x	11.2x	10.9x	14.2x	18.8x	16.4x
Laird Plc	7.1x	0.1x	0.1x	10.3x	0.1x	0.1x	10.8x	15.7x	13.8x
Ablerex Electronics Co Ltd	NA	NA	NA	NA	NA	NA	13.3x	NA	NA
Rongxin Power Electronic	16.7x	36.1x	24.1x	20.3x	62.3x	38.7x	18.5x	37.5x	24.6x
Yokogawa Electric Corp	7.7x	8.2x	7.2x	11.8x	11.8x	9.7x	17.3x	20.1x	14.4x
Lem Holding SA	10.3x	13.7x	13.2x	12.3x	15.9x	15.2x	17.3x	19.6x	19.8x
Komax Holding AG	6.1x	9.0x	8.1x	8.5x	11.1x	9.7x	11.7x	15.0x	13.3x
Gavazzi Carlo Holding AG	3.7x	6.4x	6.0x	5.0x	7.8x	7.2x	9.3x	12.9x	11.9x
Eaton Corp Plc	8.5x	12.1x	10.6x	10.9x	16.4x	13.7x	12.0x	15.9x	13.6x
Cosmo Ferrites Ltd	NA	NA	NA	NA	NA	NA	NA	na	na
Apator SA	8.7x	11.0x	NA	11.0x	13.0x	NA	12.9x	15.0x	NA
Median	7.7x	9.0x	7.9x	10.9x	11.8x	10.3x	13.1x	15.9x	14.1x
High	16.7x	36.1x	24.1x	20.3x	62.3x	38.7x	18.5x	37.5x	24.6x
Low	3.7x	0.1x	0.1x	5.0x	0.1x	0.1x	9.3x	12.9x	11.9x
Premium (disc) to product peers	(2%)	(6%)	(14%)	0%	(1%)	(13%)	3%	(8%)	(21%)

Source: Bloomberg (as on 12 June 2014)

Table 2: Schaffner – Comparison with Industry peers

Company (Industry peers)	EV/EBITDA			EV/EBIT			P/E		
	3 year average	CY2014E	CY2015E	3 year average	CY2014E	CY2015E	3 year average	CY2014E	CY2015E
Schaffner Holding AG	7.5x	8.5x	6.8x	10.9x	11.7x	9.0x	13.5x	14.6x	11.1x
Lem Holding SA	10.3x	13.7x	13.2x	12.3x	15.9x	15.2x	17.3x	19.6x	19.8x
Kudelski SA	5.9x	7.0x	6.4x	12.5x	12.0x	10.6x	12.7x	15.1x	12.8x
Inficon Holding AG	8.2x	13.0x	12.5x	9.7x	15.2x	14.7x	14.8x	20.0x	19.0x
Also Holding AG	6.0x	4.7x	4.4x	7.5x	6.0x	5.6x	11.1x	na	na
Comet Holding AG	6.5x	11.1x	10.4x	11.1x	14.9x	13.6x	13.5x	20.9x	18.7x
Cicor Technologies	4.3x	NA	NA	7.6x	NA	NA	8.2x	NA	NA
Elma Electronic AG	NA	NA	NA	NA	NA	NA	NA	na	na
Datacolor AG	5.3x	8.0x	NA	7.7x	10.5x	NA	13.7x	na	NA
Infranor Inter AG	NA	NA	NA	NA	NA	NA	NA	na	na
Median	6.0x	9.6x	10.4x	9.7x	13.5x	13.6x	13.5x	19.8x	18.8x
High	10.3x	13.7x	13.2x	12.5x	15.9x	15.2x	17.3x	20.9x	19.8x
Low	4.3x	4.7x	4.4x	7.5x	6.0x	5.6x	8.2x	15.1x	12.8x
Premium (disc) to Industry peers	25%	(12%)	(34%)	13%	(13%)	(34%)	(0%)	(26%)	(41%)

Source: Bloomberg (as on 12 June 2014)

DETAILED FINANCIAL STATEMENTS

Income Statement

CHF mn (except per share)	FY09	FY10	FY11	FY12	FY13	FY14e	FY15e
EMC sales	82	111	129	106	110	113	117
PM sales	43	61	36	46	54	73	82
AM sales	8	17	18	25	31	36	41
Sales	**133**	**189**	**183**	**177**	**195**	**222**	**241**
Cost of goods sold	(98)	(130)	(126)	(128)	(142)	(153)	(163)
Gross profit	35	59	56	49	53	68	79
Marketing and sales	(15)	(16)	(15)	(17)	(17)	(21)	(22)
R& D expenses	(12)	(13)	(14)	(14)	(15)	(19)	(21)
General and administration	(12)	(15)	(14)	(11)	(10)	(11)	(11)
Other income	0	0	0	1	0	0	0
Total operating costs	(43)	(44)	(43)	(41)	(42)	(51)	(54)
Profit before amortization of customer relations	(9)	16	13	8	10	17	24
Amortization of customer relations	(1)	(1)	(1)	(1)	(1)	(1)	(1)
Operating profit (EBIT)	(9)	15	13	7	9	16	23
Depreciation	3	3	3	4	4	4	5
Amortization of intangible assets	2	2	2	3	3	1	1
EBITDA	(3)	21	19	15	17	23	31
Finance costs	(5)	(4)	(13)	(4)	(7)	(1)	(1)
Finance income	3	1	11	2	5	0	0
Total financial income (expenses)	(2)	(3)	(2)	(2)	(2)	(1)	(1)
Profit before taxes	(12)	12	11	5	7	15	22
Taxation	1	(0)	(1)	(1)	(1)	(3)	(4)
Profit attributable to the parent	(11)	12	10	4	6	12	18
Basic EPS	(18.0)	18.9	16.0	6.2	9.9	19.2	27.8
Diluted EPS	(18.0)	18.7	15.4	6.0	9.9	19.1	27.6
DPS	0.0	4.5	4.5	3.5	4.5	5.8	8.3

Source: Research Dynamics, Company data
Note: The group reorganized its divisional reporting structure in FY2011; numbers for FY2009 and FY2010 are not restated.

Balance Sheet

CHF mn	FY09	FY10	FY11	FY12	FY13	FY14e	FY15e
Assets							
Non-current assets							
PPE	13.9	14.9	18.2	21.1	20.9	24.2	26.7
Intangible assets	15.8	14.8	24.1	22.3	19.6	19.0	19.2
Investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other long term assets	13.1	12.2	11.8	13.3	12.5	12.5	12.5
Deferred tax	0.6	2.2	2.7	2.9	3.0	3.0	3.0
Total Non Current Assets	43.5	44.1	56.8	59.6	56.1	58.7	61.5
Current assets							
Inventories	25.4	31.1	29.1	29.9	28.1	35.7	37.9
Trade receivables	21.4	36.9	32.4	34.8	34.0	42.5	46.2
Income tax receivables	1.1	0.8	0.4	0.6	0.5	0.5	0.5
Other receivables	4.9	5.7	3.7	3.7	3.8	3.8	3.8
Other financial assets	0.0	0.0	0.2	2.1	4.1	4.1	4.1
Cash and cash equivalents	30.6	8.1	14.2	10.3	17.0	10.2	12.8
Total assets	**126.9**	**126.6**	**136.8**	**140.8**	**143.7**	**155.5**	**166.8**
Shareholders' Equity and Liabilities							
Share capital	20.7	20.7	20.7	20.7	20.7	20.7	20.7
Reserves & Surplus	50.4	47.1	40.1	40.3	36.5	33.6	30.0
Retained earnings	(23.8)	(11.8)	(3.9)	(0.6)	5.4	17.6	35.2
Total equity	47.3	56.0	56.9	60.3	62.5	71.8	85.8
Non-current liabilities							
Long term borrowings	0.0	18.1	0.4	36.0	29.8	31.8	27.3
Deferred tax liabilities	3.7	2.7	1.9	2.2	2.3	2.3	2.3
Provisions	6.3	7.1	6.6	6.1	5.6	5.6	5.6
Total Non-Current Liab.	10.0	27.9	8.9	44.2	37.6	39.7	35.2
Current liabilities							
Trade and other payables	21.3	34.3	31.0	32.2	40.3	37.8	40.1
Income tax liabilities	0.8	1.9	1.9	1.0	0.7	0.7	0.7
Short term borrowings	42.5	1.7	34.6	0.2	0.5	3.5	3.0
Provisions	5.0	4.9	3.5	2.9	2.0	2.0	2.0
Total Current Liabilities	69.6	42.8	71.0	36.3	43.5	44.0	45.8
Total liabilities	79.6	70.7	79.9	80.5	81.1	83.7	81.0
Total equity and liab.	**126.9**	**126.6**	**136.8**	**140.8**	**143.7**	**155.5**	**166.8**

Source: Research Dynamics, Company data

Cash Flow Statement

CHF mn	FY09	FY10	FY11	FY12	FY13	FY14e	FY15e
Net profit for the period	(10.9)	12.0	10.2	3.9	6.3	12.2	17.6
Non-cash adjustments:	9.2	7.2	4.4	4.6	4.2	5.7	6.3
Change in current assets and liabilities:							
(Increase)/decrease in inventories	3.9	(8.0)	0.3	0.0	1.3	(7.6)	(2.2)
(Increase)/decrease in receivables	18.9	(19.7)	6.4	(3.5)	(0.0)	(8.5)	(3.7)
(Decrease)/increase in current liabilities	(5.3)	15.9	(3.5)	(0.4)	9.0	(2.5)	2.3
Change in operating working capital	17.5	(11.9)	3.2	(3.9)	10.3	(18.6)	(3.6)
Cash flows from operating activities	15.8	7.4	17.8	4.6	20.8	(0.7)	20.4
Purchase of PPE	(3.0)	(5.3)	(6.9)	(3.7)	(4.8)	(7.7)	(7.5)
Disposal of PPE	0.1	0.2	0.2	1.4	0.3	-	-
Purchase of intangible assets	(2.3)	(1.4)	(1.4)	(0.7)	(0.4)	(0.6)	(1.6)
(Acquisition)/divestment	(2.3)	(0.0)	(10.6)	(0.4)	(0.4)	-	-
Change in other assets	0.1	0.6	(0.0)	(0.0)	(0.9)	-	-
Cash flow generated (used) in investment activities	(7.3)	(6.0)	(18.7)	(3.4)	(6.2)	(8.3)	(9.1)
Change in treasury shares	3.8	(1.1)	(7.3)	(1.0)	(1.1)	-	-
Proceeds from Share issues	-	0.2	4.4	0.5	1.2	-	-
Repayment of excess share premium	(2.1)	-	(2.8)	(2.8)	(2.2)	(2.9)	(3.7)
Net proceeds/(repayment) from debt	(6.4)	(22.9)	13.4	(1.8)	(5.5)	5.0	(5.0)
Amortization related to finance lease	-	-	-	(0.1)	(0.2)	-	-
Cash flow generated (used) in financing	(4.7)	(23.8)	7.6	(5.3)	(7.7)	2.1	(8.7)
Exchange (losses)/gains	(0.1)	(0.1)	(0.5)	0.2	(0.2)	-	-
Net change in cash	**3.7**	**(22.6)**	**6.2**	**(4.0)**	**6.8**	**(6.9)**	**2.6**
Opening cash balance	26.9	30.6	8.1	14.2	10.3	17.0	10.2
Closing cash balance	**30.6**	**8.1**	**14.2**	**10.3**	**17.0**	**10.2**	**12.8**

Source: Research Dynamics, Company data

Key Ratios

	FY09	FY10	FY11	FY12	FY13	FY14e	FY15e
Growth Ratios							
Sales Growth	(27%)	42%	(3%)	(3%)	10%	14%	9%
EMC division	(38%)	35%	16%	(18%)	4%	3%	4%
PM division	9%	43%	(41%)	29%	16%	35%	13%
AM division	(21%)	99%	6%	40%	27%	15%	15%
Operating profit Growth	NM	NM	(15%)	(43%)	30%	74%	42%
Net Income Growth	NM	NM	(15%)	(61%)	61%	94%	45%
Profitability Ratios (%)							
Operating margin (%)	(7%)	8%	7%	4%	5%	7%	10%
EMC division (OPM)	0%	16%	16%	12%	13%	15%	17%
PM division (OPM)	(0%)	5%	(1%)	(1%)	5%	8%	8%
AM division (OPM)	9%	9%	(2%)	2%	(6%)	1%	8%
EBITDA Margin %	(2%)	11%	10%	8%	9%	10%	13%
Net Margin (%)	(8%)	6%	6%	2%	3%	5%	7%
Return Ratios							
Profit Margin	(8%)	6%	6%	2%	3%	5%	7%
Asset Turnover	1.0x	1.5x	1.4x	1.3x	1.4x	1.5x	1.5x
Financial Leverage	2.6x	2.5x	2.3x	2.4x	2.3x	2.2x	2.0x
Dupont ROE (%)	(21%)	23%	18%	7%	10%	18%	22%
ROCE (%)	(18%)	21%	23%	8%	11%	17%	21%
ROA (%)	(8%)	9%	8%	3%	4%	8%	11%
Leverage Ratios							
Debt - Equity Ratio	0.9x	0.4x	0.6x	0.6x	0.5x	0.5x	0.4x
Net Debt - Equity Ratio	0.3x	0.2x	0.4x	0.4x	0.2x	0.4x	0.2x
Interest Coverage	(4.2x)	12.1x	14.1x	4.9x	6.5x	11.0x	16.4x
Liquidity Ratios							
Current Ratio	1.2x	1.9x	1.1x	2.2x	2.0x	2.2x	2.3x
Quick Ratio	0.8x	1.2x	0.7x	1.4x	1.4x	1.4x	1.5x
Valuation Ratios							
EV/EBITDA	NM	13.8x	9.1x	11.8x	9.1x	9.2x	6.9x
P/E	NM	23.2x	14.6x	37.9x	22.8x	16.2x	11.2x
P/BV	2.3x	5.0x	2.6x	2.5x	2.3x	2.8x	2.3x

Source: Research Dynamics, Bloomberg, Company data

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