

Schaffner Holding AG

Switzerland | Industrial Goods & Services

1H 2016 earnings update

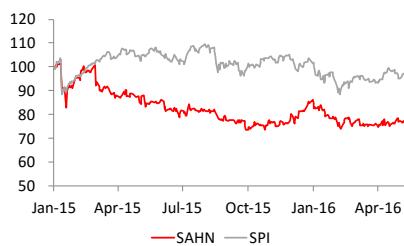
13 May 2016

Company Data

Price:	CHF 212
Market Cap:	CHF 134.8mn
Free Float (% of total shares):	98.5%
No. of shares:	635'940
Avg. traded volume (1 year):	497
Bloomberg:	SAHN SW
Reuters:	SAHN.S
ISIN:	CH0009062099

Source: Bloomberg (As of 12 May 2016)

Share Price Movement (Rebased to 100)



Source: Bloomberg

Key Financial Data

	2014	2015	2016E	2017E
Sales	214.6	201.8	189.2	201.0
EBITDA %	10.8%	8.7%	4.2%	8.1%
EBIT %	7.0%	4.4%	0.7%	4.9%
Net Margin %	5.9%	3.1%	0.0%	3.5%
Basic EPS	19.97	9.96	(0.00)	11.19
Diluted EPS	19.86	9.91	(0.00)	11.14
DPS	6.5	6.5	0.0	3.4
Equity Ratio %	43%	40%	39%	43%
Capex	6.4	4.7	6.1	8.1
P/E	14.8	21.4	na	19.0
EV/EBITDA	8.8	8.4	18.4	9.0
EV/EBIT	13.6	16.7	113.3	15.1

Next Events

Investor's Day	8 Jun 2016
FY2015/16 Annual Results	6 Dec 2016
21 st Annual General Meeting	12 Jan 2017

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Difficult market environment persists

Schaffner ('the Group') is among the leading global players that offer products/solutions ensuring efficient and reliable operations of various electric and electronic systems. The group manufactures products which ensure electromagnetic compatibility and are used in motor controls, drive systems, the energy sectors, rail technology, robots, machine tools, etc., and also support OEMs and equipment manufacturers to develop and implement energy-efficient systems. The Group had 3,143 employees as of FY2015.

- **Strategy 2020 targets seems increasingly difficult to achieve**

Schaffner reported a marginal loss of CHF 0.3mn in 1H2016. The result was expected after the company's profit warning earlier this year. The company's core business is facing strong headwinds from lower activity in oil, gas, mining and construction sectors, as the sharp fall in commodity prices has led to a cut in capital expenditures for most industries. Though the management has maintained its target of reaching an EBITA margin of more than 8% in the next 24 months, we believe this target is becoming increasingly difficult as external factors continue to hamper the company's performance. The company is stepping up its cost reduction program in the current difficult macro environment, with a target of realizing more than CHF6mn (up from CHF5mn earlier) in saving annually. The total cost of the efficiency program now under way amounts to approx. CHF4mn of which CHF0.7mn were charged to the first half results. Most of the savings are expected to be effective from FY2017, and fully effective from FY2018 onwards. However, with slowing economic growth in China, and the commodity process not expected to recover sharply in the near future, we believe it will be difficult for the company to achieve this target.

- **Revenues in-line, EBIT margins ahead of guidance**

Schaffner reported net sales of CHF92.6mn (-9.7% y/y, -9.2% in local currency) for 1H2016. EBIT stood at CHF0.5mn, mostly in line with our expectations. The company earlier had warned that it was likely to post a marginal loss at the operating level in 1H2016. The management called this a transformational year, where it is undertaking structural restructuring to reduce costs. The Power Magnetics business is witnessing a cyclical slowdown. The elevators business in China is slowing, while the Robotics business in the EMC division is witnessing good growth. The Automotive division is also performing well, already meeting medium term targets.

- **Segmental performance**

EMC: The EMC division's top line was mostly stable with revenues coming in at CHF45.4mn, down by a marginal 2.7% y/y. The segment was supported by strong sales growth in Power Quality. However, the Power Quality business also required high R&D expenditure to build the next generation of the ECOSine harmonic filters, which put pressure on the division's profitability. The segment's EBIT declined 13.6% y/y to CHF3.1mn in 1H2016. The management expects a tentative recovery in the power supplies and machine tools & robotics business.

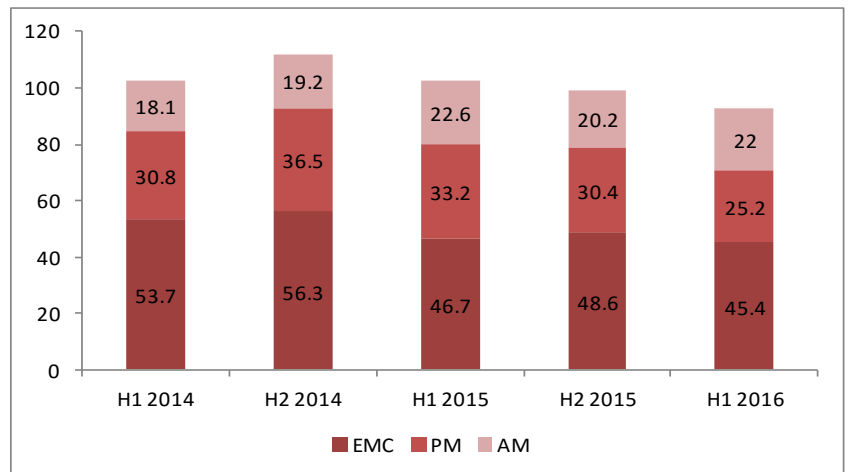
PM: The PM segment's revenues fell 24% y/y to CHF25.2mn in 1H2016 despite strong growth witnessed in China. The weak demand for technology, photovoltaic and rail technology sectors from other regions impacted the division's top line. The division reported an operating loss of CHF 3mn owing to low capacity utilization in North America and European factories. However, the management is positive on the sector's outlook as the division's order intake has risen, suggesting the segment has bottomed out.

AM: The AM division revenues were marginally down in the first half of FY2016 at CHF22.0mn (-2.9% y/y). However, sales volumes increased, supported by continued growth in the keyless entry business. Operating profit surged 68% y/y to CHF4.7mn (68% y/y). Operating margin jumped to 21.2% in 1H2016 from 12.3% in 1H2015. The management believes it will be able to sustain these elevated profit margins for about the next 24 months.

- **Optimistic outlook**

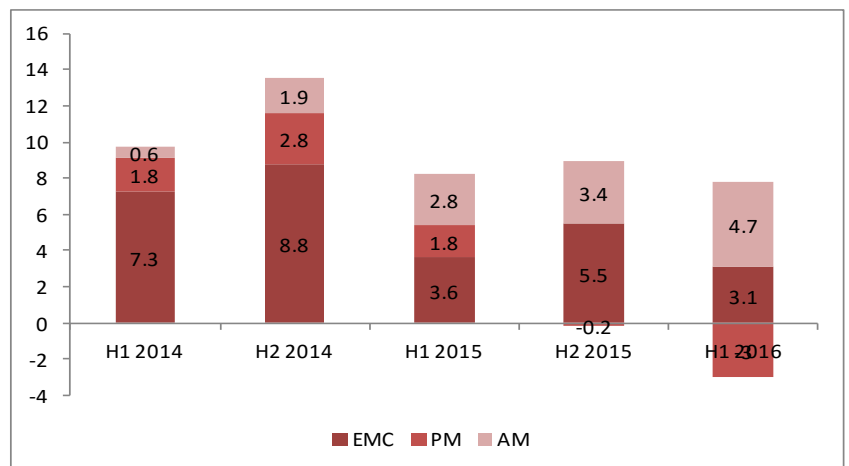
Schaffner management was hopeful about the outlook for the business. An improving book to bill ratio (1.02 in 1H2016 vs. 0.99 in 1H2015) and improving order intake suggests sequential growth in 2H2016. Management reiterated its Strategy 2020 EBITA target of achieving more than an 8% margin.

Exhibit 1: Division-wise revenue performance



Source: Company reports

Exhibit 1: Division-wise profitability



Source: Company reports

- Restructuring to save CHF6mn annually:** Schaffner management has raised its target from its cost saving steps from CHF5mn earlier to CHF6mn annually. The company will consolidate its US factories to Wytheville VA. It is also considering additional production transfers as well as a 5% net reduction of fixed cost positions. Further, it is working on next generation harmonic filters. All these initiatives are expected to result in CHF6mn in savings annually.
- Measures for growth:** In addition to cost saving measures, the company is taking steps to return to sustainable growth. For this, Schaffner is taking regional initiatives in USA, India and Taiwan. It has won new projects in the automotive division. Management also sees 3D printing as a new opportunity, which has a strong potential to boost growth. In the EMC division, investments in the Power Quality business, which is not yet profitable, continues. The next generation harmonic filters would also support future growth. While focusing on the cost side this year, management intends to give greater emphasis to external growth from FY2017 onwards.
- Discount to peers on 2017 estimates:** Schaffner is going through yet another transitory phase where the group is undertaking several restructuring steps to reduce costs and improve growth prospects. Due to the low profitability in 2016, mostly due to one-off expenses and high costs, we compare Schaffner to its peers based on 2017 estimates. Based on 2017 EV/EBITDA estimates, the company is trading at a 9% discount to product peers and at a 23% discount to industry peers. Looking at the 3-year average EV/EBITDA, the company trades at a discount of 16% to product peers and 23% discount to industry peers. The company's cost saving measures will be fully effective from FY2018 onwards, which is expected to significantly improve profitability. However, we believe it will be difficult for the company to meet its 2020 sales targets and margins targets, which is a major risk for the stock.

Exhibit 2: Schaffner – Comparison with Product peers

Company (Product peers)	EV/EBITDA			EV/EBIT			P/E		
	3 year average	CY2016E	CY2017E	3 year average	CY2016E	CY2017E	3 year average	CY2016E	CY2017E
Schaffner Holding AG	8.4x	14.3x	8.1x	16.2x	43.1x	13.9x	20.8x	75.8x	17.3x
Omron Corp	8.0x	7.2x	6.4x	12.3x	10.3x	9.4x	18.5x	19.0x	16.5x
Laird Plc	11.8x	10.5x	9.4x	21.7x	11.6x	10.4x	20.4x	14.8x	13.1x
Yokogawa Electric Corp	8.3x	5.5x	5.4x	14.6x	7.6x	7.7x	21.6x	15.5x	12.8x
Lem Holding SA	13.3x	16.3x	14.9x	16.0x	19.1x	17.3x	18.9x	18.1x	16.4x
Komax Holding AG	9.0x	10.8x	10.4x	13.1x	12.6x	12.1x	16.7x	11.8x	11.3x
Gavazzi Carlo Holding AG	5.7x	6.6x	6.5x	7.4x	8.0x	7.9x	13.7x	13.9x	13.4x
Eaton Corp Plc	11.2x	10.9x	10.4x	20.4x	15.0x	14.2x	14.3x	12.1x	11.3x
Aparator SA	11.5x	8.8x	8.3x	14.7x	12.6x	11.1x	14.9x	NA	NA
Median	10.1x	9.6x	8.9x	14.6x	12.1x	10.8x	17.6x	14.8x	13.1x
High	13.3x	16.3x	14.9x	21.7x	19.1x	17.3x	21.6x	19.0x	16.5x
Low	5.7x	5.5x	5.4x	7.4x	7.6x	7.7x	13.7x	11.8x	11.3x
Premium (disc) to product peers	(16%)	49%	(9%)	11%	256%	29%	18%	412%	32%

Source: Bloomberg (as on 12 May 2016)

Exhibit 3: Schaffner – Comparison with Industry peers

Company (Industry peers)	EV/EBITDA			EV/EBIT			P/E		
	3 year average	CY2016E	CY2017E	3 year average	CY2016E	CY2017E	3 year average	CY2016E	CY2017E
Schaffner Holding AG	8.4x	14.3x	8.1x	16.2x	43.1x	13.9x	20.8x	75.8x	17.3x
Lem Holding SA	13.3x	16.3x	14.9x	16.0x	19.1x	17.3x	18.9x	34.6x	31.4x
Kudelski SA	8.3x	9.0x	8.6x	15.2x	13.7x	13.1x	17.1x	13.2x	12.2x
Inficon Holding AG	13.0x	12.5x	11.2x	15.0x	14.5x	12.9x	19.8x	18.0x	16.4x
Also Holding AG	6.4x	NA	NA	8.3x	NA	NA	10.2x	NA	NA
Comet Holding AG	12.9x	12.7x	9.8x	19.1x	19.2x	14.4x	27.6x	28.5x	21.5x
Cicor Technologies	7.5x	NA	NA	13.6x	NA	NA	16.7x	NA	NA
Datacolor AG	10.9x	8.9x	NA	15.6x	12.3x	NA	21.8x	20.9x	NA
Median	10.9x	12.5x	10.5x	15.2x	14.5x	13.8x	18.9x	20.9x	19.0x
High	13.3x	16.3x	14.9x	19.1x	19.2x	17.3x	27.6x	34.6x	31.4x
Low	6.4x	8.9x	8.6x	8.3x	12.3x	12.9x	10.2x	13.2x	12.2x
Premium (disc) to Industry peers	(23%)	15%	(23%)	7%	197%	1%	10%	263%	(9%)

Source: Bloomberg (as on 12 May 2016)

DETAILED FINANCIAL STATEMENTS

Income Statement

CHF mn (except per share)	FY11	FY12	FY13	FY14	FY15	FY16E	FY17E
EMC sales	129	106	110	110	95	93	98
PM sales	36	46	54	67	64	54	57
AM sales	18	25	31	37	43	43	46
Sales	183	177	195	215	202	189	201
Cost of goods sold	(126)	(128)	(142)	(152)	(145)	(138)	(143)
Gross profit	56	49	53	63	57	51	58
Marketing and sales	(15)	(17)	(17)	(18)	(18)	(20)	(19)
R&D expenses	(14)	(14)	(15)	(15)	(17)	(18)	(19)
General and administration	(14)	(11)	(10)	(13)	(13)	(12)	(10)
Other income	0	1	0	0	1	0	0
Total operating costs	(43)	(41)	(42)	(47)	(47)	(53)	(48)
EBITA	15	10	12	18	11	7	12
Operating profit (EBIT)	13	7	9	15	9	1	10
Depreciation	3	4	4	4	5	5	5
Amortization of intangible assets	2	3	3	3	3	2	2
EBITDA	19	15	17	23	18	8	17
Finance costs	(13)	(4)	(7)	(7)	(5)	(2)	(1)
Finance income	11	2	5	6	4	1	0
Total financial income (expenses)	(2)	(2)	(2)	(1)	(1)	(1)	(1)
Profit before taxes	11	5	7	14	8	(0)	9
Taxation	(1)	(1)	(1)	(1)	(2)	0	(1)
Profit attributable to the parent	10	4	6	13	6	(0)	7
Basic EPS	16.0	6.2	9.9	20.0	10.0	(0.0)	11.2
Diluted EPS	15.4	6.0	9.9	19.9	9.9	(0.0)	11.1
DPS	4.5	3.5	4.5	6.5	6.5	0.0	3.4

Source: Research Dynamics, Company data

Key Ratios

	FY11	FY12	FY13	FY14	FY15	FY16E	FY17E
Growth Ratios							
Sales Growth	(3%)	(3%)	10%	10%	(6%)	(6%)	6%
EMC division	16%	(18%)	4%	0%	(13%)	(2%)	5%
PM division	(41%)	29%	16%	25%	(5%)	(16%)	7%
AM division	6%	40%	27%	19%	15%	(1%)	8%
Operating profit Growth	(15%)	(43%)	30%	60%	(41%)	(85%)	651%
Net Income Growth	(15%)	(61%)	61%	101%	(50%)	NM	NM
Profitability Ratios (%)							
Operating margin (%)	7%	4%	5%	7%	4%	1%	5%
EMC division (OPM)	16%	12%	13%	14%	9%	8%	7%
PM division (OPM)	(1%)	(1%)	5%	6%	1%	(8%)	2%
AM division (OPM)	(2%)	2%	(6%)	7%	15%	22%	19%
EBITDA Margin %	10%	8%	9%	11%	9%	4%	9%
Net Margin (%)	6%	2%	3.2%	5.9%	3.1%	(0.0%)	3.5%
Return Ratios							
Profit Margin	6%	2%	3%	6%	3%	(0%)	4%
Asset Turnover	1.4x	1.3x	1.4x	1.4x	1.3x	1.3x	1.4x
Financial Leverage	2.3x	2.4x	2.3x	2.3x	2.4x	2.5x	2.4x
Dupont ROE (%)	18%	7%	10%	20%	10%	(0%)	12%
ROCE (%)	23%	8%	11%	16%	10%	1%	11%
ROA (%)	8%	3%	4%	8%	4%	(0%)	5%
Leverage Ratios							
Debt - Equity Ratio	0.6x	0.6x	0.5x	0.5x	0.6x	0.7x	0.5x
Net Debt - Equity Ratio	0.4x	0.4x	0.2x	0.2x	0.3x	0.4x	0.2x
Interest Coverage	14.1x	4.9x	6.5x	15.3x	8.9x	0.5x	6.1x
Liquidity Ratios							
Current Ratio	1.1x	2.2x	2.0x	2.1x	2.5x	2.2x	2.2x
Quick Ratio	0.7x	1.4x	1.4x	1.4x	1.6x	1.5x	1.5x
Valuation Ratios							
EV/EBITDA	9.1x	11.8x	9.1x	8.8x	8.4x	18.4x	8.6x
P/E	14.6x	37.9x	22.8x	14.8x	21.4x	na	19.0x
P/BV	2.6x	2.5x	2.3x	2.8x	2.3x	2.4x	2.2x

Source: Research Dynamics, Bloomberg, Company data

Balance Sheet

In CHF mn	FY11	FY12	FY13	FY14	FY15	FY16E	FY17E
Assets							
Non-current assets							
PPE	18.2	21.1	20.9	24.8	22.7	23.9	26.6
Intangible assets	24.1	22.3	19.6	24.1	22.1	20.3	18.2
Investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other long term assets	11.8	13.3	12.5	4.8	2.2	2.2	2.2
Deferred tax	2.7	2.9	3.0	3.7	4.6	5.6	5.6
Total Non Current Assets	56.8	59.6	56.1	57.4	51.7	52.0	52.7
Current assets							
Inventories	29.1	29.9	28.1	31.3	32.0	30.2	31.4
Trade receivables	32.4	34.8	34.0	38.5	34.7	34.7	36.3
Income tax receivables	0.4	0.6	0.5	0.5	0.3	0.4	0.4
Other receivables	3.7	3.7	3.8	3.2	3.0	4.1	4.1
Other financial assets	0.2	2.1	4.1	4.9	5.6	2.0	2.0
Cash and cash equivalents	14.2	10.3	17.0	18.6	19.6	18.1	17.7
Total assets	136.8	140.8	143.7	154.5	146.9	141.5	144.7
Shareholders' Equity and Liabilities							
Shareholders' Equity							
Share capital	20.7	20.7	20.7	20.7	20.7	20.7	20.7
Reserves & Surplus	40.1	40.3	36.5	35.3	28.4	24.5	24.5
Retained earnings	(3.9)	(0.6)	5.4	10.7	10.4	10.4	17.5
Total equity	56.9	60.3	62.5	66.6	59.4	55.6	62.7
Non-current liabilities							
Long term borrowings	0.4	36.0	29.8	35.1	37.5	34.0	29.5
Deferred tax liabilities	1.9	2.2	2.3	1.2	0.4	0.2	0.2
Provisions	6.6	6.1	5.6	6.1	10.9	11.6	11.6
Total Non-Current Liab.	8.9	44.2	37.6	42.4	48.8	45.9	41.4
Current liabilities							
Trade and other payables	31.0	32.2	40.3	41.9	36.7	35.1	36.1
Income tax liabilities	1.9	1.0	0.7	1.0	1.0	1.0	1.0
Short term borrowings	34.6	0.2	0.5	0.2	0.3	3.8	3.3
Provisions	3.5	2.9	2.0	2.3	0.7	0.9	0.9
Total Current Liabilities	71.0	36.3	43.5	45.4	38.6	40.8	41.3
Total liabilities	79.9	80.5	81.1	87.8	87.4	86.6	82.7
Total equity and liab.	136.8	140.8	143.7	154.5	146.9	142.2	145.4

Source: Research Dynamics, Company data

Cash Flow Statement

<i>In CHF mn</i>	FY11	FY12	FY13	FY14	FY15	FY16E	FY17E
Net profit for the period	10.2	3.9	6.3	12.6	6.3	(0.0)	7.1
Non-cash adjustments:	11.7	9.0	8.8	9.1	14.6	22.1	25.2
Change in current assets and liabilities:							
(Increase)/decrease in inventories	0.3	0.0	1.3	(1.2)	(2.5)	1.8	(1.2)
(Increase)/decrease in receivables	6.4	(3.5)	(0.0)	(0.8)	2.5	0.0	(1.6)
(Decrease)/increase in current liabilities	(3.5)	(0.4)	9.0	(0.2)	(3.5)	(1.6)	1.1
Change in operating working capital	3.2	(3.9)	10.3	(2.2)	(3.6)	0.2	(1.8)
Cash flows from operating activities	17.8	4.6	20.8	15.3	8.2	7.7	12.7
Purchase of PPE	(6.9)	(3.7)	(4.8)	(6.4)	(4.7)	(6.1)	(8.1)
Disposal of PPE	0.2	1.4	0.3	0.3	0.3	-	-
Purchase of intangible assets	(1.4)	(0.7)	(0.4)	(0.4)	(0.8)	-	-
(Acquisition)/divestment	(10.6)	(0.4)	(0.4)	(8.6)	-	-	-
Change in other assets	(0.0)	(0.0)	(0.9)	(0.7)	(0.7)	-	-
Cash flow generated (used) in investment activities	(18.7)	(3.4)	(6.2)	(15.8)	(5.9)	(6.1)	(8.1)
Change in treasury shares	(7.3)	(1.0)	(1.1)	(3.1)	(0.9)	0.3	-
Proceeds from Share issues	4.4	0.5	1.2	2.7	1.3	-	-
Repayment of excess share premium	(2.8)	(2.8)	(2.2)	(2.9)	(4.1)	(4.1)	-
Net proceeds/(repayment) from debt	13.4	(1.8)	(5.5)	5.2	2.9	-	(5.0)
Amortization related to finance lease	-	(0.1)	(0.2)	(0.2)	(0.2)	-	-
Cash flow generated (used) in financing	7.6	(5.3)	(7.7)	1.8	(1.0)	(3.8)	(5.0)
Exchange (losses)/gains	(0.5)	0.2	(0.2)	0.3	(0.4)	-	-
Net change in cash	6.2	(4.0)	6.8	1.6	1.0	(1.5)	(0.4)
Opening cash balance	8.1	14.2	10.3	17.0	18.6	19.6	18.1
Closing cash balance	14.2	10.3	17.0	18.6	19.6	18.1	17.7

Source: Research Dynamics, Company data

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