

Schaffner Holding AG

Switzerland | Industrial Goods & Services

Investors' day update

10 June 2016

Company Data

Price:	CHF 228
Market Cap:	CHF 145mn
Free Float (% of total shares):	78.5%
No. of shares:	636'000
Avg. traded volume (1 year):	506
Bloomberg:	SAHN SW
Reuters:	SAHN.S
ISIN:	CH0009062099

Source: Bloomberg (As of 8 June 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	20.3
EV/EBITDA	8.8	8.4	11.2	8.3
EV/EBIT	13.6	16.7	119.9	16.0

Next Events

FY2015/16 Annual Results	6 Dec 2016
21 th Annual General Meeting	12 Jan 2017

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Uncertain scenario weighing on outlook

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 develops and manufactures products that are used in motor controls, drive systems, the alternative energy sector, rail technology, robots, machine tools, etc., and also supports OEMs and equipment manufacturers to develop and implement energy-efficient systems. Schaffner also manufactures components for keyless entry antennas used in automobiles.

Management maintains "Strategy 2020" targets

On occasion of its Investors' Day (held on 8 June 2016), Schaffner management presented an update of its business, market situation and management focus for the next couple of years. Essentially, the group is maintaining the targets it set out under the Vision 2020, which was unveiled about 9 months back. The Group's EBITA margin is targeted to reach more than 8% within the next 24 months, while organic revenue growth is targeted to be above 5%. Though management is working hard to achieve these targets in the current difficult market scenario, entering new markets and making use of new opportunities by providing innovative technologies, we think these targets are looking increasingly difficult to be achieved. The current uncertain economic scenario, in addition to the volatile forex markets, makes the targets increasingly challenging.

Management currently is prioritizing to cut costs, while at the same time investing into the most promising growth technologies such as in Power Quality and Automotive. The first is being targeted by consolidating production facilities and cutting overhead costs. The group thus plans to continue with only one factory each in the US, Europe, China and Thailand. Further, it is transferring more of production (mostly from Shanghai) to its Thailand factory, which is the lowest cost production facility for the company. These initiatives should help Schaffner in reducing its production and overhead costs by CHF 6 million annually.

The company's external growth plans seem to have currently been put on the back burner as management concentrates on improving efficiencies and reducing costs, as well as a lack of suitable acquisition targets. Though management remains open to acquisitions in the range of CHF 20 – 70 million, nothing is imminent not least due to current uncertain market scenarios.

Automotive and Power Quality to drive growth

The Automotive division currently has the best visibility and offers consistent and stable growth potential. The segment is expected to increase its contribution to the top line on the back of a strong order book and growing markets. The company here intends to leverage its existing facility in Thailand to increase production volumes, which should support the division's profit margin. Power Quality is the other business division which management is excited about. Though the division is currently loss-making due to unabated investments into innovation, its future growth potential is enticing. The development of the second generation of harmonic filters, which offer state of the art technology, lower costs and extended functionality thanks to their modularity, is expected to boost top line growth. The company has made and continues to make significant investments into the unit, setting up a hi-tech power lab at corporate headquarters in Switzerland, strengthening its sales organization as well as the service and support network. These efforts are expected to drive the business unit's top line as well as profitability.

Management priority for the next twelve months

EMC:

- Execute COGS and overhead cost reduction.
- Gain market share in all regions to expand Schaffner's lead

Power Quality:

- Complete the development of Generation 2 product platforms
- Launch and global roll-out of new products

Power Magnetics:

- Complete restructuring of division and reduce break-even
- Diversify customer base and return to growth

Automotive:

- Win customer RFQ to further expand market share in keyless entry
- Develop innovative EMC filter solutions for market introduction in 2017
- Manage volume ramp up at Thailand plant

Segmental analysis

EMC (Electro Magnetic Compatibility): Focus on profitable growth

Schaffner is a leader in the niche market of EMC filters with a 24% market share and has the most global presence among its peers. The traditional EMC filter business has been stagnating (especially in the US and Europe) over the past few years, on the back of a sluggish global economy and severe competition in the photo-voltaics business. The appreciation of the Swiss franc last year put further pressure on the division’s business. However, management indicated that it is witnessing small signs of recovery from the cyclical downturn, though competition remains intense in its largest market, Germany. Over the next twelve months, management’s priority is to execute its cost saving initiatives to reduce COGS and other overhead costs as well as gain market share across all regions.

The company is looking to drive growth in the segment by expanding its product portfolio, enter new markets, develop new sun-rise markets like 3D printing and home automation, and strengthening its trading business. The division has targeted major companies in the 3D printing and home automation space and has seen significant growth in these markets after its first design wins in 2013 and 2014, respectively. In addition, management also sees opportunity in other areas. Smart elevators, where strong growth is forecast for the Asia Pacific region, provide a good opportunity. Motors is another market where growth is seen, as only 30% motors are equipped with motor drives. Increasing automation in machine tools and robotics also provides opportunities for the company’s EMC filters.

The Power Quality (PQ) business is a comparatively small, but important business unit within the EMC segment, which has been growing rapidly over the past few years. This business unit is expected to drive the majority of growth for the EMC segment. The addressable market for the unit alone stands at CHF 300-350mn, and Schaffner only commands a market share of 3% currently. With expected market growth at 7% (CAGR) until 2020, the potential of this business unit is significantly higher than the potential of the more mature traditional filter business. We believe that Schaffner has the opportunity to leverage its market leadership in the EMC space to boost market shares in the PQ business. The division is investing heavily to achieve accelerated growth with its second generation of active and passive harmonic filters which offer a modular approach to its customers (thus enabling them to start small and expanding by just adding additional modules instead of having to exchange the entire system). The new generation harmonic filters provide state of the art technology, substantial cost reductions (up to 30% in some cases) and extended functionality.

Exhibit 1: New product introduction schedule



Source: Company reports

In addition to continuously improving its product portfolio, the PQ unit is also investing to improve its sales network as well as its service and support centres. The company is expanding its international sales network, and strengthening its presence in underserved regions like US, and high growth countries like India. The main objectives for management for the next twelve months is completing the development of the new generation of product platforms and rolling out the new products at a global scale.

PM (Power Magnetics): Turnaround in difficult market

The Power Magnetics (PM) business segment is going through a difficult phase as sales dropped in FY2015 after consistently rising over the previous few years. Revenues declined further in H1 FY2016 as market conditions continued to deteriorate and industry overcapacity. Capital expenditures were reduced across regions due to the sharp fall in commodity prices and slowing economic growth. The company was impacted negatively as railway projects were suspended in Russia, US motor drives demand fell in US due to halted investments into the oil & gas industries, and photovoltaic inverter demand slipped in Japan.

Nevertheless, the group is committed to turnaround the division through 1) lowering the breakeven point and 2) accelerating R&D and sales.

To achieve these objectives, the company targets a lean manufacturing network with one factory each in Europe, North America and Asia. As a result, Schaffner will be shutting down its Büren production (Germany) plant, and also transfer the US Cleveland production and integrate into the existing Wytheville (VA) factory. The Büren site will be turned into a global R&D center of excellence. The restructuring is expected to cost about CHF4mn, and is likely to be completed by the end of 2016. Significant cost savings post restructuring and a strong pipeline of projects indicates that the division is likely to turnaround over the next months. Management's priority over the next twelve months is to diversify its customer base and return to growth.

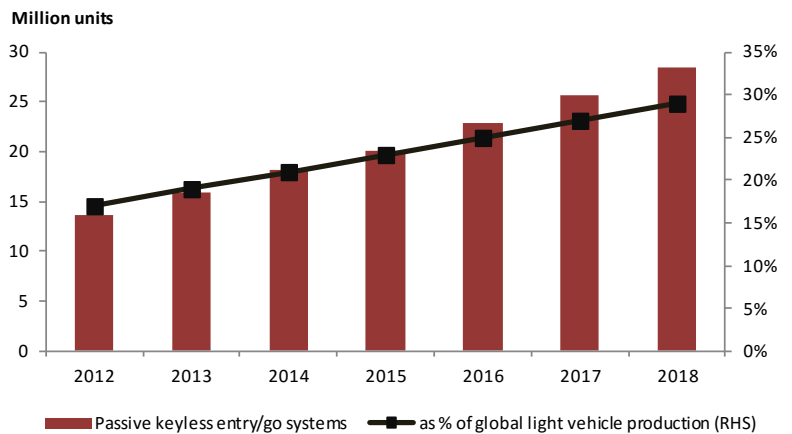
AM (Automotive): Unabated growth prospects

Schaffner's Automotive (AM) division includes two major products: 1) Keyless entry antennas and 2) Filter technology for electric vehicles. Currently, the keyless entry business accounts for nearly ~99% of the segment's sales. The company is the number two player in the keyless entry systems market with a global market share of 25%. The segment has witnessed strong and consistent top line growth over the last four years and, with the penetration of keyless systems continuing, healthy growth is further in the cards. While the keyless entry market is expected to grow at a CAGR of 12% between during 2015-2018 period, the group expects to outgrow this rate by leveraging its world-class design and production capabilities, its product quality attributes and cost effective manufacturing.

The filter market for electric vehicles (EVs) is still at a nascent stage. However, given Schaffner's expertise in EMC filters, we believe the electronic filter market for EVs provides an opportunity for growth in the future as sales of electric vehicles continues to increase. The company targets to present a complete family of filters for batteries and DC/DC convertors by 2017, and to also develop a complete EMC solution for hybrid electric vehicles (HEV).

For the AM division, management focus is on increasing customer requests for quotation (RFQ) in order to increase market shares, developing innovative EMC filter solutions for the EV market introduction in 2017, and ramping up production volumes at its Thailand plant (with very little additional fixed costs).

Exhibit 2: Growing market for keyless systems



Source: Company reports

Valuation

Schaffner's share price has been moving higher over the past few months, supported by the overall rise in global markets. The company is going through yet another transitory phase where it is undertaking several restructuring steps to reduce costs. Due to the low profitability in 2016, we compare the group's valuations based on 2017 earnings expectations. Based on an 2017E EV/EBITDA basis, the company is at par with its product peers (discount to industry peers). However, looking on a PE basis, the stock is trading in line with its 3-year historical average. Its 2017E PE is at a premium to its peer group, which can be attributed to the transition year. Given management's confidence on execution, we believe a discount to peers at the EV/EBITDA level is not necessarily warranted.

Exhibit 3: 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	9.6x	11.2x	8.3x	16.8x	119.9x	16.0x	20.8x	NA	20.3x
Omron Corp	8.8x	7.4x	6.5x	12.2x	10.6x	9.5x	18.3x	16.9x	14.7x
Laird Plc	12.1x	9.1x	8.3x	22.6x	11.5x	10.3x	20.0x	12.8x	11.4x
Yokogawa Electric Corp	9.2x	6.4x	5.6x	14.2x	7.6x	7.7x	21.4x	12.3x	12.5x
Lem Holding SA	13.7x	16.5x	15.5x	16.1x	19.2x	18.2x	19.1x	23.7x	22.4x
Komax Holding AG	10.0x	10.7x	10.4x	12.9x	12.6x	12.0x	16.1x	15.5x	14.9x
Gavazzi Carlo Holding AG	6.1x	6.7x	6.6x	7.4x	8.2x	8.0x	13.8x	14.8x	14.2x
Eaton Corp Plc	13.5x	11.0x	10.5x	20.1x	15.1x	14.3x	14.2x	14.5x	13.5x
Aparator SA	11.5x	8.7x	8.0x	14.8x	12.5x	11.0x	15.1x	NA	NA
Median	10.8x	8.9x	8.1x	14.5x	12.0x	10.7x	17.2x	14.8x	14.2x
High	13.7x	16.5x	15.5x	22.6x	19.2x	18.2x	21.4x	23.7x	22.4x
Low	6.1x	6.4x	5.6x	7.4x	7.6x	7.7x	13.8x	12.3x	11.4x
Premium (disc) to product peers	(11%)	26%	2%	16%	898%	50%	21%	NA	43%

Source: Bloomberg (as on 08 June 2016)

Exhibit 4: 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	11.2x	8.3x	16.8x	119.9x	16.0x	20.8x	NA	20.3x
Lem Holding SA	13.7x	16.5x	15.5x	16.1x	19.2x	18.2x	19.1x	23.7x	22.4x
Kudelski SA	8.4x	8.5x	8.0x	15.0x	12.8x	12.0x	16.3x	16.0x	14.4x
Inficon Holding AG	13.1x	12.5x	11.3x	15.2x	14.6x	13.0x	20.0x	20.4x	18.6x
Also Holding AG	6.5x	6.2x	5.4x	8.4x	7.1x	6.0x	10.2x	9.0x	7.5x
Comet Holding AG	13.0x	13.5x	10.1x	19.2x	21.0x	14.8x	27.5x	31.3x	22.4x
Cicor Technologies	7.6x	NA	NA	13.6x	NA	NA	16.8x	NA	NA
Datacolor AG	11.0x	8.9x	NA	15.8x	12.3x	NA	22.0x	19.7x	NA
Median	9.7x	10.7x	10.1x	15.1x	13.7x	13.0x	18.0x	20.0x	18.6x
High	13.7x	16.5x	15.5x	19.2x	21.0x	18.2x	27.5x	31.3x	22.4x
Low	5.9x	6.2x	5.4x	7.3x	7.1x	6.0x	10.2x	9.0x	7.5x
Premium (disc) to Industry peers	(13%)	5%	(18%)	11%	775%	23%	16%	NA	9%

Source: Bloomberg (as on 08 June 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	14	19
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	19.5	18.3
Total assets	136.8	140.8	143.7	154.5	146.9	143.1	145.2
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	35.9	36.0
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	41.6	41.2
Total liabilities	79.9	80.5	81.1	87.8	87.4	87.5	82.5
Total equity and liab.	136.8	140.8	143.7	154.5	146.9	143.1	145.2

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	7.4	7.1
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	1.3	(1.6)
(Decrease)/increase in current liabilities	(3.5)	(0.4)	9.0	(0.2)	(3.5)	(0.7)	0.1
Change in operating working capital	3.2	(3.9)	10.3	(2.2)	(3.6)	2.5	(2.7)
Cash flows from operating activities	17.8	4.6	20.8	15.3	8.2	9.9	11.5
Purchase of PPE	(6.9)	(3.7)	(4.8)	(6.4)	(4.7)	(6.1)	(7.7)
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)	(7.7)
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)	(3.9)	(5.0)
Exchange (losses)/gains	(0.5)	0.2	(0.2)	0.3	(0.4)	0.1	-
Net change in cash	6.2	(4.0)	6.8	1.6	1.0	(0.1)	(1.2)
Opening cash balance	8.1	14.2	10.3	17.0	18.6	19.6	19.5
Closing cash balance	14.2	10.3	17.0	18.6	19.6	19.5	18.3

Source: Research Dynamics, Company data

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