2019 financial year and mid-term targets

THE ADVANCE OF AUTO-MATION CONTINUES

In 2019, Komax witnessed a fall in revenues, battled with declining profitability, launched a number of innovative digital services, and introduced measures to cut costs. The Board of Directors has adapted the mid-term targets.

Beat Kälin, Chairman

Beat Kälin, how would you assess the 2019 financial year?
Beat Kälin: Following the record results in 2018, the 2019 financial year represents a major setback in a form that we did not expect. Factors such as the trade dispute between the US and China and the emergence of economic slowdown in a number of regions have had an increasingly negative impact on the investment behavior of our customers.
If you're in the business of selling capital goods, you have to be able to deal with exogenous influences that you cannot change. Given the circumstances, we did that well. What is unsatisfactory, however, is that our annual results were additionally impacted by a number of internal difficulties relating to certain customer-specific projects.

Matijas Meyer, at the start of 2019 could you ever have anticipated that revenues would decline by more than 10%?
Matijas Meyer: Right up until the end of 2018, our customers were ordering a very large number of machines from us. We were also anticipating further growth in 2019 on the basis of the forecasts communicated to us. But the whole picture suddenly changed in January and February. In particular, the part of our business that depends on the number of vehicles produced deteriorated dramatically. From that point onwards, we assumed that 2019 could turn out to be a challenging year. At the start of the year we were still hoping that our customers would only postpone their investment projects by one or two months. Unfortunately, as it turned out over the course

of 2019, they repeatedly pushed back their projects – initially into the second quarter, then into the second half of the year, and finally into the following year.

Did you experience a decline in revenues in all regions?
Matijas Meyer: In North/South America we increased revenues by 5.7%. That was attributable in part to the acquisition of Artos Engineering with effect from 1 April 2019. Revenues declined in all other regions. We suffered the strongest fall of all in the Asia/Pacific region, with a drop of 22.5%. In China, which is by far the most important market for us in Asia, our customers had invested a great deal in our automation solutions in 2018. As a result, we experienced excess capacity in a number of plants in 2019, while demand for additional solutions was also more modest.

Matijas Meyer, CEO

Did you sell less in all product categories?
Matijas Meyer: The revenue decline was particularly pronounced in what we call volume business. This essentially involves crimp-to-crimp machines, where our sales figures rise when the number of produced vehicles rises. When production volumes rise, our customers increase their capacity with additional crimp-to-crimp machines in order to be able to manufacture the wire harnesses they require. For the majority of our other machines, sales figures declined much less sharply, or indeed mirrored the sales level of the previous year.

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Matijas Meyer

Why is that?
Matijas Meyer: At the moment, the lion’s share of the wire harness manufacturing process is still carried out manually. Our customers are aware that there is no way of avoiding the trend towards increasing the level of automation going forward. Why? Because factors such as rising wage costs, lack of personnel, the process of wire miniaturization, seamless traceability, and higher quality demands are all strong arguments in favor of automation solutions. For that reason, in 2019 our customers invested above all in new technologies that can help them increase the degree of automation in their factories. For example, these include our machines from the Omega and Zeta ranges, as well as our fully automatic twisting machines.

What strategic considerations lay behind your acquisitions of Artos Engineering and Exmore in 2019?
Beat Kälin: Artos is a traditional US company with a history dating back more than a century. Our acquisition of Artos has brought a significant amount of additional expertise into the Group when it comes to development of innovative applications and allows us to strengthen our customer proximity in North America, thanks to the local engineering skills. From a strategic perspective, both aspects are very important to us. The Belgian company Exmore is extremely experienced in the development of applications relating to the processing of sensor cables. Sensor cables are a key element in enabling vehicles to drive autonomously – or at least in a highly automated way – in the future. The acquisition of Exmore means that we are well positioned to take advantage of this trend in the automotive industry.

Are you planning any further acquisitions?
Beat Kälin: If the opportunity arises to acquire a company that represents a good fit for the Komax Group – both from a strategic and a corporate culture perspective – we will be open to the idea and examine it carefully. Obviously, an important element in assessing such projects is the amount of financial and management resources available. Following numerous acquisitions over the last years, Komax is currently first and foremost preoccupied with integrating the new companies in the best way possible, as well as making the most of the strengths and competencies acquired.

Why did EBIT fall by more than 60% when revenues slid by "only" around 13%?
Matijas Meyer: The above-mentioned machines in the volume business are serial production machines that give us operating leverage if we can produce a high number of units. Due to the significant decline in 2019, EBIT suffered to a disproportionate degree. Moreover, we continued to invest heavily in R&D in 2019. The current process of upheaval that we are witnessing in the automotive industry offers numerous opportunities to develop unique selling propositions, and that's what now has to be worked on. R&D expenses rose by a total of CHF 0.4 million in 2019 – as opposed to falling by CHF 5.3 million, which would have been the case if they had developed in parallel with revenues. As a consequence, the R&D ratio witnessed an increase from 8.6% to extraordinary 9.9%.

Are there any other reasons that explain the EBIT margin of 5.8%, which is unusually low for Komax?
Matijas Meyer: We faced a number of major challenges in certain customer-specific projects in 2019, which led to additional expenditure running into high single-digit millions. Here I am thinking of pioneering projects in the automotive and aerospace industries which have the potential to make a noticeable contribution to growth for Komax. Given the potential here, we decided a few years ago to assume this entrepreneurial risk and work together with customers to build new large-scale equipment for the fully automatic processing of special cables. There's always a likelihood that multiyear projects like these will deviate from planned developments on occasions. That said, we did not anticipate this magnitude of cost consequences.

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> **Beat Kälin**

How will you be able to prevent this from recurring in the future?
Matijas Meyer: The first thing to point out is that the various pioneering projects that we have been pursuing simultaneously are now completed or on the road to completion. In addition, in 2019 we strengthened our risk management function, adjusted our processes, and – in an extra step – decided to focus on projects with lower risk profiles going forward. We have analyzed the mistakes made and learned the corresponding lessons so that we can be successful in the future in the project business, too.

Does it make strategic sense to continue to pursue the project business? After all, Komax did not have a lasting success with its Solar and Medtech activities in the past...
Beat Kälin: Customer-specific projects are a core component of our strategy and an important element in continuing to expand our technology leadership, in particular with regard to key customers. Unlike the former activities you mention, today's customer-specific projects always involve systems for automatic wire processing – which is our core competency. The things we learn and develop on these projects often feed through into our serial production machines further down the line. With such projects, the objective must always be for there to be as many repeat orders as possible and not to involve just one system. An advantage of customer-specific projects is that we work on these together with customers, hence we know that they meet a particular need. In contrast, when developing a serial production machine we conduct market appraisals several years in advance, with the expectation that these will prove accurate when we bring the machine to market a few years down the line. The risk with serial production machines is thus structured differently and, as a consequence, can be much higher – particularly in times of radical upheaval such as being experienced by the automotive industry currently. In addition, we have to bear all the development costs ourselves. This means they are a form of up-front investment. From a strategic perspective, it is important that we strike the right balance between the development of serial production machines and customer-specific projects, whereby the project business is much smaller and will remain so.

Komax has invested more than CHF 90 million in expanding capacity at four locations in recent years. Are you facing a problem of excess capacity at the moment?
Matijas Meyer: We moved into two new buildings in Germany and one in Hungary in 2019. We have long had space problems at these three locations, so it's pleasing that we now have more capacity here. We will move into the new build-

> “We once again demonstrated our position as technology leader in 2019.”
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> **Matijas Meyer**

ing at our headquarters in Switzerland in the first quarter of 2020, and then give up the premises that we currently lease in Küssnacht am Rigi. In order to be able to grow further in the future, we planned right from the start to have reserves of space once the various construction projects were complete. However, due to the current development of business these reserves are greater than anticipated.

What measures are you taking by way of a response?
Matijas Meyer: Our 20 production sites have different levels of capacity utilization. Where necessary and possible, we have made preparations for short-time working, or indeed already initiated this. In addition, we are currently reviewing the structures of the entire Komax Group with a view to streamlining them and increasing profitability. We will complete this process in the first half of 2020. Redundancies have been implemented at certain locations in connection with this process. But the structural measures we take will not have an impact on costs until the second half of the year at the earliest.

What pleasing developments did you see in 2019?
Matijas Meyer: We launched a number of new products in 2019, once again demonstrating our position as technology leader. We also launched a number of digital services for the first time, thereby showing the importance we attach to digitalization. Innovative products are obviously valuable things in their own right, but I get particular pleasure from seeing how well our innovations go down with customers. I was also pleased to see how committed our employees were to Komax throughout this difficult financial year, and how they are adapting to what remains a challenging situation. I am extremely grateful to all of them for their dedication.

The Board of Directors is proposing to the AGM a dividend of CHF 1.80 per share, after CHF 7.00 the previous year. Why are you not distributing more?
Beat Kälin: In our strategy, we specified that we would be distributing 50%–60% of Group profit after taxes. If this profit figure falls, so too will the dividend. The proposed dividend of CHF 1.80 corresponds to a payout ratio of 52.3%, which keeps us within our stated strategic bandwidth. We have positioned ourselves clearly with our payout strategy. In other words, our shareholders know that there is no reason to expect a minimum dividend – it will be aligned with business performance each year.

What can we expect to see from Komax in 2020?
Matijas Meyer: Making concrete forecasts from today’s standpoint is difficult. Our visibility as regards business development is very low, which means we cannot yet properly appraise the first half of the year. The spread of the coronavirus has added another layer of complication. How long this epidemic will last and what consequences it will have for global economic development – and for the automotive industry in particular – is not something that can be accurately predicted right now. But basically, we are assuming that 2020 will be another very challenging year, as existing forecasts – even prior to the outbreak of coronavirus – assumed similar annual vehicle production figures to 2019.

What consequences will this have for the 2017–2021 strategic targets?
Beat Kälin: The Board of Directors has been scrutinizing these targets for quite some time now. In view of the developments forecast for the automotive industry over the next few years, it has decided to adapt the targets and define a new time horizon – 2023 – for them. We defined the 2017–2021 targets in the second half of 2016, and were aware at the time that they were ambitious. Up until 2018 we were well on track to meet them. The 2019 financial year has set us back considerably, however, and we cannot assume that we will make a major step forward in 2020. Consequently, we would have to make up all this lost ground in 2021, which appears to us to be unrealistic. For 2023 we are targeting revenues of CHF 450–550 million and EBIT of CHF 50–80 million. These targets reflect Komax’s unchanged ambition to outstrip growth in the market and achieve above-average profitability. In addition, we are continuing to distribute 50%–60% of EAT.

How confident are you of achieving the targets set by the Board of Directors?
Matijas Meyer: As I mentioned, there are still a number of reasons why our customers are seeking to significantly increase the degree of automation in their factories. Trends such as e-mobility and autonomous driving are also important growth drivers for us. Assuming there is no serious slowdown in global economic growth to the point where our customers become even more reticent about investing, I’m confident we can meet the targets set. With our product portfolio and unique sales, service, and engineering network, we are extremely well positioned to harness any pent-up demand that emerges.