

ANNUAL REPORT

06



Schaffer Corporation Limited

**CORPORATE OBJECTIVE:**

To efficiently operate and grow our core business for the benefit of shareholders.

**OPERATIONAL OBJECTIVE:**

To be number one or number two in each of our markets as measured by profitability. We will achieve this by:

- being a world low cost producer
- maintaining a leading distribution network
- constant attention to detail

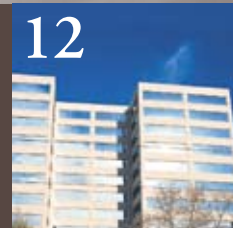
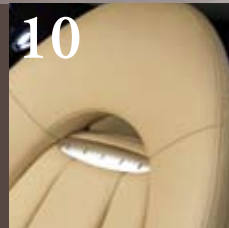
About Schaffer Corporation 01  
Managing Director's Report 02

Review of Operations:

Building Products

Leather

Investments



Financial Statements 13  
Shareholder Information 65

## ABOUT SCHAFFER CORPORATION

### A DIVERSIFIED AUSTRALIAN INDUSTRIAL COMPANY

Schaffer Corporation Limited is a diversified industrial company whose core operating divisions are Building Products, Automotive Leather and Property.

The Company's long-term growth strategy is to organically develop those core businesses and to acquire businesses complementary to the Building Products division.

Schaffer Corporation's key internal performance measure is Return on Capital Employed (ROCE), which reflects the earnings achieved in relation to the capital (debt and equity) invested in its businesses.

The Building Products division is a niche Australian supplier of building, construction and landscaping products. The division manufactures a premium range of paving and natural and reconstituted limestone products. The division also manufactures precast and prestressed concrete floors, beams and wall products.

The Automotive Leather division is a world low cost producer of quality automotive leather. The division operates processing, finishing and cutting operations in Victoria and component cutting plants in Mexico, Slovakia and China (Shanghai). Automotive Leather exports approximately 90% of production to North America, Asia and Europe.

The Property division has joint venture interests in commercial and retail properties in Western Australia and Victoria. The division's activities also include an interest in the successful Mindarie Keys Marina residential land subdivision north of Perth, Western Australia.

#### BOARD OF DIRECTORS



John Schaffer



Anton Mayer



Danielle Blain



David Schwartz



Michael Perrott



## MANAGING DIRECTOR'S REPORT

### EXECUTIVE MANAGEMENT TEAM



**John Schaffer**

BCom(Hons), FCPA  
Age 56

*Mr Schaffer joined the Group in 1972. Since 1988, Mr Schaffer has been Managing Director and Chairman of Schaffer Corporation Limited.*



**Anton Mayer**

Age 64

*Mr Mayer joined the Group in 1998 as Managing Director of Australian Leather Holdings Limited. In 2001, Mr Mayer joined the Board of Schaffer Corporation Limited.*



**Mike Falconer**

TEng, CEI, OMIEAust  
Age 52

*Mr Falconer joined the Group in 1985. Mr Falconer is General Manager UrbanStone Pty Ltd and Limestone Resources Australia Pty Limited.*



**Matt Perrella**

NPCAA  
Age 56

*Mr Perrella joined the Group in 1980. Since 1989, Mr Perrella has been General Manager of Delta Corporation Limited.*



**Geoff Davieson**

MA, F Fin, FCIS  
Age 43

*Mr Davieson joined the Group in 1993. Mr Davieson is Company Secretary and Chief Financial Officer for the Group.*



**Nick Filipovic**

BEc, CPA  
Age 47

*Mr Filipovic is Deputy Managing Director of Howe and Co Pty Ltd. Mr Filipovic joined the Group in 1994.*



**Warren Horton**

BBus(Acc), ASCPA, FTA  
Age 39

*Mr Horton joined Howe in 1999 as Finance Manager. In 2005, Mr Horton was appointed Chief Financial Officer of Australian Leather Holdings Limited.*

Key Financial Indicators	2006	2005
Revenue (\$million)	145.3	142.6
Net Profit (\$million): Headline	8.1	9.4
Net Profit (\$million): Excluding investment property disposals	8.1	8.7
Earnings per Share (\$) (excl. disposals)	\$0.58	\$0.62
Return on Capital Employed (excl. disposals)	16%	16%
EBITDA (\$million)	21.1	21.6
Cash flow from Operating Activities (\$million)	16.1	(1.5)
Cash Reserves (\$million)	13.6	12.7
Interest Cover (EBIT/Net Interest)	4.6	5.9
Net Debt to Equity	89%	81%
Ordinary Dividend per Share	\$0.50	\$0.75

## MAINTAINING FOCUS.

Schaffer Corporation focuses on efficiently operating and growing its core operating divisions.

### Financial performance

For the 2006 financial year (FY 2006), Schaffer Corporation reported a headline net profit after tax (NPAT) of \$8.1 million (FY 2005: \$9.4 million). The FY 2005 result included a \$0.67 million contribution on the disposal of surplus land at West Perth, Western Australia. Removing the impact of that disposal, the underlying FY 2005 NPAT was \$8.7 million. At Group level, revenue was stable at \$145.3 million (FY 2005: \$142.6 million).

The Company's automotive leather business (Automotive Leather or Howe) experienced difficult trading conditions and reduced earnings. Significantly improved performance from the Building Products division and, to a lesser extent, Schaffer Corporation's joint venture property activities partially offset the Howe outcome.

SFC generated ROCE of 16%, in line with the FY 2005 ROCE result.

### Financial position

The Company recorded a net cash inflow of \$16.1 million – a significant improvement over FY 2005 (\$1.5 million). The increase in cash flow was largely attributable to Automotive Leather's improved working capital position.

The Company applied FY 2006 cash flow as follows:

• Dividends Paid	\$12.3 million
• Capital Expenditure	\$4.5 million
• Increase in Cash	\$0.9 million
• Increase in Borrowings	(\$1.6 million)
TOTAL	\$16.1 million

At balance date, Schaffer Corporation's net debt totalled \$58.0 million.

That debt is effectively structural, consisting of:

- A subordinated loan of \$38.7 million associated with Howe
- A facility of \$17.6 million linked directly to the Company's property interests.

At balance date, the Group had \$25.0 million of undrawn debt facilities available to fund future growth.

### Dividends

In FY 2006, Schaffer Corporation generated 58 cents of earnings per share.

The Company's policy is to pay a large proportion of profits as dividends to shareholders. In line with that policy, Schaffer Corporation paid dividends of 50 cents per share (FY 2005: 75 cents per share).

As in previous years, all dividends were fully franked. Over the past five years, the Company has paid to shareholders a total of \$68.6 million in fully franked dividends.

Schaffer Corporation intends to maintain a high ordinary dividend payout ratio of at least 75%, subject to capital expenditure requirements, acquisition activity, liquidity needs and the availability of franking credits.



### Building Products

In FY 2006, the Building Products division delivered significantly improved performance, generating EBIT of \$6.6 million (FY 2005: \$2.9 million) on revenue of \$39.0 million (FY 2005: \$28.8 million).

The division consists of:

- Delta, which manufactures precast and prestressed concrete floors, beams and wall products primarily for the Western Australian construction market and also for South Australia
- UrbanStone, which supplies a premium range of paving products for the national market through its established distribution network of twelve sales offices across Australia.

Building Products' improved performance was driven by:

- A rebound in Western Australian commercial and infrastructure projects, to which Delta is a major supplier.
- UrbanStone's exposure to the buoyant Western Australian market, although weak demand in the eastern states (particularly New South Wales) did have an impact.

For some time, Schaffer Corporation has considered opportunities to acquire a business complementary to UrbanStone in order to leverage UrbanStone's national distribution network and extend the range of product offerings available

In July 2006, the Company settled the acquisition of the Limestone Resources business. Limestone Resources is Western Australia's largest producer of natural and reconstituted limestone products. The business services the residential, commercial and land subdivision markets. Limestone Resources' product is a natural and complimentary fit with the UrbanStone product range. Over time, UrbanStone will distribute Limestone Resources' product through its national distribution network.

The Company has acquired a 4,800 m<sup>2</sup> property in Osborne Park, Perth's premier home-improvement retail destination. The property will act as a focal marketing point for UrbanStone and Limestone Resources' providing a prestige showroom and retail distribution centre.

### Automotive Leather

Howe's earnings before interest and taxes (EBIT) of \$6.2 million were lower than in FY 2005 (\$8.3 million) on revenue of \$91.0 million (FY 2005: \$98.0 million).

Howe's automotive business is global in the broadest sense

– production at five sites around the world, a global customer base and competition on a global scale. In FY 2006, the division exported approximately 90% of production to a diverse customer base in Asia, Europe and North America.

Some years ago, Howe identified that its industry was changing and that the business required substantial repositioning to ensure that it remained internationally competitive. Howe has repositioned the business, shifting labour intensive operations offshore to lower labour-cost countries and closer to our markets. To this end, Howe has brought online new cutting operations in Slovakia and China, which provide lower labour costs than in Australia and a local sales and service presence for the divisions' European and Asian customers. Today, Howe has completed the process of relocating its cutting requirements to its offshore plants (also in Mexico). In the medium term, the offshore cutting plants will strengthen the division's competitive position and substantially improve Howe's market presence in Europe, China and the US.

Howe generates approximately one half of its revenue in US dollars (USD) and one third in Euros (EUR). Associated costs in USD and EUR provide a natural hedge for a substantial amount of those revenues. The remaining revenues are unhedged against movements in the USD and EUR against the Australian dollar (AUD). Accordingly, currency movements can cause Howe's EBIT to fall or to rise by approximately AUD 250,000 and AUD 400,000 for each US cent or Eurocent, respectively, that the AUD strengthens or weakens.

For several years, the Gosh (furniture leather) business has been operating in a fiercely competitive market and has not achieved an acceptable ROCE. Over the last three years, the Company has scaled back the Gosh business. Competition from finished imported furniture has virtually eliminated Australia's furniture business.

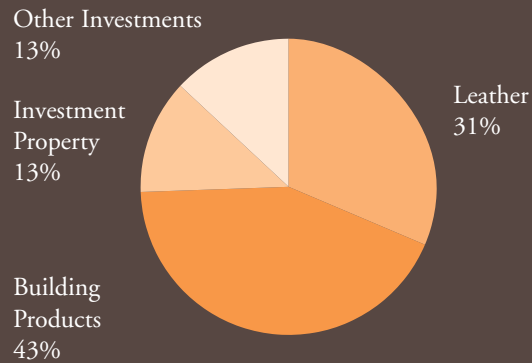
In August 2006, Gosh ceased production – a disappointing but ultimately inevitable outcome. Schaffer Corporation's NPAT figure included a \$0.6 million (after tax) charge relating to the winding up of Gosh.

The Company anticipates a further \$0.3 million (after tax) in closure costs in the first half of the 2007 financial year (FY 2007).

### Investments/Divestments

In FY 2006, Schaffer Corporation's investment property leasing operations contributed \$1.9 million in EBIT (FY 2005: \$1.6 million) and \$1.1 million of cash (FY 2005: \$0.9 million).

## EBIT contribution by operating division



At year end, the Company held joint venture interests in seven commercial and retail properties. Those interests are collectively valued at approximately \$32.5 million, with \$16.2 million of associated debt.

Schaffer Corporation also holds a 15% joint venture interest in the highly regarded Mindarie Keys Marina residential land subdivision north of Perth, Western Australia. Mindarie contributed \$1.9 million to Group EBIT in FY 2006. Over the next two years, the Company expects Mindarie Keys to generate at least another \$3.0 million of EBIT and \$4.0 million of cash, after repaying \$1.4 million of associated debt.

The Board continuously reviews Schaffer Corporation's exposure to the property sector and will consider further acquisitions should suitable opportunities arise.

### People

A fundamental strength of Schaffer Corporation is the quality of its people. Across all operations, the Company has a total workforce of approximately 950 people, about 50% of whom work offshore. The commitment and dedication of the Company's employees are fundamental to its success. I would like to take this opportunity to thank our people for their efforts. I look forward to working with them in the challenging times ahead.

Safety is an absolute priority for Schaffer Corporation's employees and a shared responsibility. In recognition of the need for safe work practices, the Company has safety awareness and improvement programs at all operations.

### Outlook

#### Earnings

Schaffer Corporation expects Howe's trading conditions to continue to be challenging during the 2007 financial year.

Supplier overcapacity, increasing hide prices and aggressive pricing expectations across the global automotive market will place further pressure on margins. The North American market will be difficult as General Motors and Ford continue restructuring their operations. As noted earlier, currency movements have the potential to impact earnings.

Automotive Leather's business sales focus is primarily on growth opportunities in the Asian and European markets. The Company anticipates volume increases in Europe and China to largely offset reduced demand from Howe's North American customer base.

The division's fundamentals are strong. Howe operates free of any subsidies, is internationally competitive and has an

established global market presence from which to build in the medium term.

In the Building Products division, Schaffer Corporation expects first half project timing issues to result in lower revenue for UrbanStone and Delta.

The Company expects Limestone Resources to contribute annual revenues of \$12.0-14.0 million at lower margins than the existing Building Products businesses. The Board anticipates allocating \$1.0-2.0 million of capital expenditure at Limestone Resources to improve efficiency and increase capacity. The division expects the recently acquired Osborne Park showroom to open in the second half following refurbishment.

Demand for floor space continues to be strong, particularly in Western Australia. Accordingly, the Board expects strong and sustainable earnings from its investment property leasing. In addition, earnings from Mindarie should show an improvement on the first half of FY 2006. The Board expects earnings from Mindarie Keys to be biased to the second half of FY 2007.

At Group level, the Board expects the result for the first half of FY 2007 will not be less than the \$3.6 million NPAT achieved for the first half of FY 2006.

I commend to shareholders the detailed review of operations that follows this report.

JOHN SCHAFFER  
Managing Director



# BUILDING PRODUCTS



Revenue <i>(\$million)</i>	EBIT <i>(\$million)</i>	EBIT contribution
\$39.0	\$6.6	43%

## LEADING THE WAY.

UrbanStone, Limestone Resources and Delta deliver niche products and design solutions for the construction and landscaping markets.

Schaffer Corporation's Building Products division consists of its wholly owned subsidiaries UrbanStone Pty Limited and Delta Corporation Limited.

On 6 July 2006, the Company acquired the Limestone Resources business.

### UrbanStone



[www.urbanstone.com.au](http://www.urbanstone.com.au)

UrbanStone supplies a premium range of paving products for the national market through its established distribution network of twelve sales offices across Australia.

UrbanStone's performance in FY 2006 was boosted by exposure to the buoyant Western Australian market, although weak demand in the eastern states (particularly New South Wales) did impact on revenue and earnings.

FY 2006 represented UrbanStone's first full year of trading with its new "Ultra Premium" product range. The range's market place acceptance and contribution to the Residential Products division exceeded expectations.

UrbanStone's position in the market continues to be maintained by the excellent quality of its product, exceptional customer service and the continued appreciation of the UrbanStone brand in the market.

UrbanStone utilises focussed marketing strategies and persistent brand positioning. The outcome is that UrbanStone is recognised by consumers as the market leader and industry benchmark – a remarkable achievement in an extremely competitive business.

The continuing integration of the "Ultra Premium" range with UrbanStone's Standard Residential product range provides designers and customers the necessary design flexibility to develop projects of outstanding appeal.

UrbanStone's innovation and cooperative approach with commercial clients has developed relationships that generate projects of exceptional status and intricate detail.

The projects during FY 2006 to which UrbanStone was specified for end supply product included:

NSW	Bradfield Park, Kirribilli Sydney International Terminal Terrigal Foreshore, Gosford Oxford Street, Bondi Optus Communications, North Ryde
NT	Holiday Inn, Darwin
QLD	Southport Streetscape
SA	Moseley Square, Glenelg Ceduna Town Centre Waverley Showgrounds James Place, Adelaide
VIC	Geelong City Centre Queensbridge Square, Southbank
WA	Point Frazer Stage II James Street, Northbridge South Metropolitan Train Stations Fremantle Mausoleum Ellenbrook Streetscapes Fremantle City Streetscapes



## Delta



[www.deltacorp.com.au](http://www.deltacorp.com.au)

Delta manufactures precast and prestressed concrete floors, beams and wall products primarily for the Western Australian construction market and also for South Australia.

FY 2006 witnessed a rebound in Western Australian commercial and infrastructure projects, to which Delta is a major supplier. Delta's state-of-the-art production facilities were at full capacity during the year, with exceptionally high demand for the full range of precast and prestressed products.

In the current financial year, activity in all sectors of the construction industry remains at high levels. Delta continues to provide contractors with high quality products, ahead of time and site requirements, which delivers flexibility on site and increases the speed of construction.

The majority of Delta's production related to structural precast and prestressed work. In addition, Delta supplied high quality architectural wall panels to the Waikiki and Rockingham Railway Stations. Delta also supplied Noise Walls and Parapet Panels for the Perth-to-Mandurah Railway project.

During the year, Delta supplied TeeRoff Bridge Beams to projects in the Perth metropolitan area and marine grade precast products to resource infrastructure projects including the North West Shelf LNG Jetty Extensions and the Robe River Mining E11 Ore Loading Wharf at Dampier.

Deltacore production was steady throughout the year with supply contracts to projects including (all in Western Australia):

- Showrooms, Osborne Park
- Mt Hawthorn Shopping Centre, Mt Hawthorn
- Presbyterian Ladies College, Peppermint Grove
- Office development, Herdsman
- Imola Project, Kewdale
- Marine Townhouses, Geraldton
- Rocky Road Winery, Margaret River.

During the year, Delta purchased a Deltacore DC300 Extruder, enabling Delta to complete its range of products. Delta can now provide thicknesses from 150 mm to 400 mm, which provides the construction industry with a full range of panels up to spans of 17.5 m. Delta's outlook for the remainder of FY 2007 is strong. Projects already on Delta's order book include (all in Western Australia):

- Commercial development, Leederville
- University of Western Australia School of Business, Nedlands
- Central Law Courts, Perth
- IKEA Megastore, Innaloo
- Multi-story apartments at Adelaide Terrace, Perth
- Australian Marine Complex Wharf, Henderson
- Champion Lakes Bridges, Armadale.



THE LIMESTONE RESOURCES ACQUISITION WILL ADD APPROXIMATELY \$12 - \$14 MILLION OF ANNUAL REVENUE TO THE COMPANY'S BUILDING PRODUCTS DIVISION.

### Limestone Resources



[www.limestone-resources.com.au](http://www.limestone-resources.com.au)

For some time, Schaffer Corporation has considered opportunities to acquire a business complementary to UrbanStone in order to leverage UrbanStone's national distribution network and extend the range of product offerings available.

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Schaffer Corporation expects Limestone Resources to contribute annual revenues of \$12.0-14.0 million at lower margins than the existing Building Products businesses. The Board anticipates allocating \$1.0-2.0 million of capital expenditure at Limestone Resources to improve efficiency and increase capacity.

Limestone Resources has excellent long-term prospects as part of the Building Products division, driven by access to UrbanStone's national distribution network and considerable scope for the introduction of value-adding processing within the business.



## INVESTMENTS

### A PORTFOLIO OF QUALITY PROPERTY ASSETS.

#### Investment property

Schaffer Corporation's Investment Property division consists of seven properties.

In FY 2006, Investment Property leasing operations generated EBIT of \$1.9 million and \$1.1 million of cash.

Approximately 60% of the portfolio by value is invested in five commercial properties. The remainder relates to two retail properties.

The properties are:

- IBM Building, Hay Street, West Perth, Western Australia (22.1% interest)
- Oce House, St Kilda Road, Melbourne, Victoria (20% interest)
- 89 St George's Terrace, Perth, Western Australia (20% interest)
- Hometown, Albany Highway, Cannington, Western Australia (25% interest)
- 71 Queens Road, Melbourne, Victoria (9% interest)
- Parks Centre, Bunbury, Western Australia (16.7% interest)
- Joondalup House, Joondalup, Western Australia (11% interest)

At balance date, the investment properties were valued at approximately \$170 million. Schaffer Corporation's interests in those properties was valued at \$32.5 million.

The level of gearing varies within the portfolio.

At balance date, the portfolio's average gearing was 50%. The Company's share of portfolio debt was \$16.2 million. Of that amount, \$1.6 million has recourse to Schaffer Corporation. The remaining \$14.6 million is non-recourse debt secured against the individual properties.

The Board continuously reviews Schaffer Corporation's exposure to the property sector and the Company may make further acquisitions should suitable opportunities arise.

#### Property projects

Schaffer Corporation holds a 15% interest in the successful Mindarie Keys Marina residential land subdivision north of Perth, Western Australia.

During the first half of FY 2006, subdivision staging issues restricted stock availability, limiting first half EBIT to \$0.1 million. In the second half, stock releases received stronger than expected demand. As a result, the full year EBIT contribution totalled \$1.9 million.

In the first half of FY 2007, earnings should exceed those from the previous corresponding period. In the second half, earnings should improve again as a result of stock availability and the timing of stock releases.

Over the next two years, Schaffer Corporation expects the Mindarie Keys investment to generate a further \$3.0 million in EBIT and \$4.0 million in cash (after debt reduction of \$1.4 million).

