Starrag Group

Half-year report

2016

Significant increase in order intake and order backlog – sales revenue steady

- Order intake plus 64% to CHF 231 million
- Order backlog plus 29% to CHF 284 million secures capacity utilization for about one year
- Sales held at CHF 183 million
- EBIT CHF 3.4 million or 1.9% margin
- Net profit CHF 2.0 million or CHF 0.56 per share
- Positive outlook

CHF m	**2016** **01.01. – 30.06.**	2015 01.01. – 30.06.	Change
Order intake	231.2	141.1	63.9%
Sales revenue	183.4	181.8	0.8%
Earnings before interest and taxes EBIT	3.4	7.0	-51.1%
Net income	2.0	3.1	-35.3%
Earnings per share (in CHF)	0.56	0.92	-39.0%
EBIT as % of sales revenue	1.9%	3.9%	n/a
Net income as percentage of sales revenue	1.1%	1.7%	n/a
Return on equity ROE	2.2%	3.2%	n/a
Cash flow from operating activities	6.8	-4.8	n/a
Capital expenditure in fixed assets	9.6	9.6	0.3%
Free cash flow	-2.8	-14.4	n/a
Employees (average number of FTEs during the reporting period)	1'535	1'603	-4.2%

CHF m	**30.06.2016**	31.12.2015	Change
Order backlog	284.4	237.8	19.6%
Total assets	355.4	341.5	4.1%
Net debt	23.4	15.9	n/a
Shareholders' equity	181.2	186.1	-2.6%
Equity ratio	51.0%	54.5%	n/a

Dear shareholders

Significantly higher order backlog

Starrag Group's order backlog for new machines amounted to CHF 284 million at the end of June 2016. Compared to the end of 2015, this corresponds to an increase of 20%. Compared to the mid-year mark of 2015, the order backlog has increased by an even greater 29%. These orders ensure a solid rate of capacity utilization for approximately one year as orders for new machines always entail substantial additional services and support.

Order intake jumps by two-thirds

Due to the increasingly volatile levels of business activity, a topic that Starrag Group has referred to on various occasions along with heightened price pressure, order intake can fluctuate considerably from one reporting period to the next, either to the upside or downside. The operational business model is therefore constantly being adapted to this volatility. The large increase in order intake during the first half of 2016 compared to the prior-year period can be viewed in this context. New orders received throughout the Group during the first six months of 2016 jumped by 64% y-o-y to CHF 231 million (+62% at constant exchange rates). Extending the order intake period to the past twelve months (July 2015 to June 2016) to take into account the long-term nature of Starrag Group's capital goods business, new orders amounted to CHF 424 million, which corresponds to a pleasing 18% increase in local currency versus the preceding twelve-month period.

Every region and almost every customer industry contribute to order growth

Viewed by region, Asia showed the fastest order growth in absolute terms after a relatively weak performance last year, contributing by more than a third to the Group's order intake, followed by Europe. New orders from the Americas were also higher year-on-year. Viewed by customer industry, Aerospace contributed the largest volume to the increase in new order inflows after a below-average intake in the first half of 2015. The Industrial segment also took in significantly more orders. Order activity picked up primarily in the classic manufacturing segments, whereas order intake from the Luxury Goods segment – the watch industry in particular – was slightly below the already depressed level seen in the prior-year period. Energy received considerably more orders, albeit still from a low level, while Transportation could not match the year-ago order intake. A focus on strategic customer industries once again helped to steady the business and thus minimize risk.

Sales held at year-ago level

Sales in the first six months of 2016 amounted to CHF 183 million, 0.8% above the prior-year figure (CHF 182 million). At constant exchange rates, sales showed a slight decline of 1.0%. This decline is attributable primarily to the downturn in demand from the watch industry, which was only partially offset by the growth in other market segments.

Operating profit (EBIT) came in at CHF 3.4 million (prior year: CHF 7.0 million), resulting in an operating profit margin of 1.9% (3.9%). This margin contraction is primarily attributed to selective cost overruns in isolated customer orders and the lower rate of capacity utilization due to weaker demand from the watch industry. Moreover, restructuring costs of CHF 1.0 million were incurred as a result of personnel measures at various operating sites with the aim to adjust capacity and increase efficiency, having an adverse impact on the operating profit.

The net profit of CHF 2.0 million was less than in the previous year (CHF 3.1 million) and corresponded to 1.1 percent of top-line sales. Earnings per share amounted to CHF 0.56 (H1 2015: CHF 0.92).

Balance sheet remains strong

Total assets of CHF 355 million as per 30 June 2016 are CHF 14 million higher than at the end of 2015. Net debt increased by CHF 7.5 million to CHF 23.4 million due to input costs incurred to process orders on hand. At 51.0% (year-end 2015: 54.5%), Starrag Group's equity ratio remains high.

Starrag delivers ultra-modern manufacturing system to customer

Starrag was pleased to celebrate the delivery of a new flexible manufacturing system for adaptive production of turbine blades to AVIC, a Chinese aerospace company, at its Rorschach plant in May. This new system creates an individual CNC program for every single turbine blade. Consisting of four intelligently linked machining centers, this system can manufacture up to 40'000 turbine blades a year, which would have required 40 conventional turbine-making machine tools in the past. The new system is representative of the "Industry 4.0" philosophy (smart factory) that Starrag is systematically pursuing and promoting throughout the Group.

Technology Days a focal point of successful innovation

"Technology Days" are internal events that Starrag has organized for several years now and they have become a blueprint for success. They are also being viewed as a constructive gathering of experts from around the world in the respective market segments. No less than three such events were held during the period under review and Starrag Group was pleased to present its latest innovations to representatives from industrial sectors, trade journals and media, and the academic world.

At the Aero Structure Technology Days in Mönchengladbach, the invited guests were introduced to the new Ecospeed F1540 system for high-precision manufacturing of aluminum aircraft structures. Technology Days in Chemnitz were devoted to the Industrial and Transportation segments and featured the premiere of the new Focus machining centers, among other highlights. The advantages these new Focus machining centers offer, besides the high performance specs, reliability and enduring accuracy customers have come to rely on, are a small footprint and significantly shorter delivery times. At the 4th Turbine Technology Days organized in Rorschach, this time in partnership with the German firm Haimer, attendees were informed about the latest developments in efficient manufacturing of turbines for aircraft and power generation plants.

Scores of new and ongoing developments presented at trade fairs

Besides these internal events for invited guests, Starrag Group will, as in previous years, be showcasing its innovation at the AMB in Stuttgart and IMTS in Chicago, two leading trade fairs held in September, with a special focus on new applications in the medtech, transportation and industrial segments.

Optimal solutions for individual needs

In order to meet market needs more precisely and effectively, Starrag Group is continuously optimizing its product range in alignment with the divergent demands of its customers. The focus here is on various machine concepts offering optional solutions thanks to a modular design that allow customers to select exactly what they want to satisfy their individual needs and demands.

New factory in Vuadens/Switzerland on track

The scheduled move-in in the new factory in Vuadens/Switzerland will enhance competitivity, Starrag Group being in an excellent position for the long run thanks to its recent new product developments and forthcoming innovations addressing the market segments of Luxury Goods, Medical Technology and Micromechanics. This applies irrespective of the recent slack in business activity in the watch industry and the ongoing consolidation in the medical technology industry, a trend that was further accentuated by the effects of the highrated Swiss franc.

Outlook

Business activity remains influenced by various external uncertainties relating to the economy and geopolitics, not to mention the persisting price pressure and volatile order platform on the customer side. This situation has only strengthened Starrag Group's resolve to focus on its defined market segments and leverage its marketing and sales resources more effectively to secure and grow incoming order flows.

Management has initiated scores of action plans designed to optimize order execution and other processes with the ultimate aim of improving profitability and operational excellence. Other examples here are the holistic review and revision of assembly processes, organizational adjustments with a view to optimizing quote engineering as well as general project management, and investments in factory management resources (shopfloor management). Projects for lowering costs and increasing productivity are also being continuously evaluated at all operating sites to ensure that the mid-term margin targets are met.

From today's standpoint and in view of the developments observed during the first six months of the year, Starrag Group expects full-year order intake in local currency to significantly exceed the figure reported for the 2015 fiscal year. Sales in local currency are expected to be slightly higher than in the previous year. As for the operating margin, Starrag Group expects a substantial improvement in the second half of 2016, offsetting to some extent at least the shortfall reported in the first half in comparison with 2015.

A word of thanks

The Board of Directors and the Executive Board would like to take this opportunity to acknowledge the hard work and dedication of all employees. We also appreciate the good business relationships we share with our customers and suppliers. A special word of thanks also goes to our shareholders for their enduring trust.

Yours sincerely

Daniel Frutig
Chairman of the Board of Directors

Walter Börsch
CEO

Rorschacherberg, 27 July 2016

Financial commentary

Order situation

The order situation is comfortable with an order backlog of CHF 284 million, which is 20% more than at the end of 2015. Compared to 30 June 2015, the order backlog has increased by an even greater 29%. These orders ensure a solid rate of capacity utilization for approximately one year as orders for new machines always entail substantial additional services and support.

Order intake is characterized by considerable fluctuations. Orders received during the first six months of the year amounted to CHF 231 million, which is 64% more than in the same period of last year. At constant exchange rates, order intake increased by 62%. Extending the order intake period to the past twelve months (July 2015 to June 2016) to take into account the long-term nature of Starrag Group's capital goods business, new orders amounted to CHF 424 million, which corresponds to a pleasing 18% increase in local currency versus the preceding twelve-month period.

Income statement

Sales revenue for the first half of 2015 amounted to CHF 183 million, an increase of 0.8% year-on-year. At constant exchange rates, sales revenue showed a slight decline of 1.0%. This decline is attributable primarily to the downturn in demand from the watch industry, which was only partially offset by the growth in other market segments.

Gross profit (sales revenue minus cost of materials plus/minus change in self-manufactured products) amounted to CHF 101 million, or 55.3% of sales revenue. The gross profit margin is 3.5 percentage points lower or CHF 5.5 million less than the respective figures for the year-ago period. A reduction in sourcing costs had a positive impact on the gross margin. Negative factors were a shift in the product mix to lower-margin products, a lower percentage of completion of work in progress, which meant a higher stock of materials to complete these orders, and selective project revaluations.

Operating profit (EBIT) declined from CHF 7.0 million in the first half of 2015 to CHF 3.4 million in the period under review, which resulted in a margin contraction from 3.9% to 1.9%. This margin contraction is primarily attributed to selective cost overruns in isolated customer orders and the lower rate of capacity utilization due to weaker demand from the watch industry. Moreover, restructuring costs of CHF 1.0 million were incurred as a result of personnel measures at various operating sites with the aim to adjust capacity and increase efficiency, having an adverse impact on the operating profit. Thanks to strict cost management, personnel expenses (excl. restructuring charges) were reduced from 37.4% to 36.7% of sales revenues, despite higher unit wage costs, largely due to industry-wide pay increases in Germany, and other operating expenses were also reduced, from 14.5% to 13.3% of sales revenues.

The net financial result was positively impacted by exchange-rate gains of CHF 0.2 million. This contrasts to last year, when exchange-rate losses of CHF 2.3 million were incurred after the revaluation of euro positions. Tax expense declined to CHF 0.7 million (prior-year period: CHF 1.0 million) as a result of the lower pretax profit, despite the increase in the tax rate from 23% to 25%. Net profit receded from CHF 3.1 million in the prior-year period to CHF 2.0 million and earnings per share dropped to CHF 0.56 (prior-year period: CHF 0.92).

Balance sheet

Total assets as of 30 June 2016 amounted to CHF 355 million, an increase of CHF 14 million from the end of 2015. Current assets rose by CHF 7.7 million due to upfront payments for the higher level of orders in progress. Fixed assets increased by CHF 6.2 million, which primarily reflects expansion-related investments in the company's new factory in Vuadens, Switzerland.

The higher level of capital employed was financed via an increase in liabilities, which rose by CHF 18.8 million during the period. Of this sum, CHF 9.8 million pertained to operating liabilities and CHF 9.5 million to financial liabilities. As cash and cash equivalents also increased by CHF 2.0 million, the net debt position increased by a lower amount of CHF 7.5 million and amounted to CHF 23.4 million. This increase is largely attributable to the increase in orders in progress and input costs incurred to process orders on hand, while the level of funding for orders in progress rose slightly to 82.4%.

Shareholders' equity declined by CHF 4.9 million from the end of 2015. Retained earnings from the CHF 2.0 million in net profit for the year were more than offset by the remeasurement of pension plan liabilities (CHF -3.1 million) arising from the application of lower interest rates in accordance with IFRS and the dividend payout of CHF 4.0 million.

Given the increase in total balance sheet assets, the equity ratio receded by 3.5 percentage points to 51.0% compared to the end of 2015, a level that is still consistent with an above-average degree of financial flexibility.

Cash flow statement

Cash flow (before changes in net current assets) amounted to CHF 8.8 million (previous year: CHF 12.0 million). Operating cash flow after changes in non-cash net working capital amounted to CHF 6.8 million (previous year: CHF -4.8 million).

The CHF 9.6 million of investment in non-current assets reflect expenditures on the new factory in Vuadens, Switzerland; improvements to existing production sites; and IT upgrades. Mainly because of the capacity expansion expenditure in Vuadens, Switzerland, free cash flow for the first half was a negative CHF -2.8 million (prior-year period: CHF -14.4 million).

Cash flow from financing activities amounted to CHF 5.2 million, which largely reflects the CHF 9.4 million increase in financing liabilities minus the withholding tax-free dividend of CHF 4.1 million paid out of capital contribution reserves in April 2016 for fiscal year 2015.

Income statement

CHF 1'000	**2016** 01.01. – 30.06.	2015 01.01. – 30.06.	2015 01.01. – 31.12.
Sales revenue	183'374	181'842	363'728
Change in self-manufactured products	2'096	2'173	-4'023
Material expenses	-84'069	-77'146	-147'949
Personnnel expenses	-68'260	-67'922	-131'583
Operating expenses	-24'387	-26'328	-54'357
Other operating income	682	593	1'239
Earnings before interest, taxes, depreciation and amortization EBITDA	**9'436**	13'212	27'055
Depreciation and amortization	-6'009	-6'208	-12'395
Earnings before interest and taxes EBIT	**3'427**	7'004	14'660
Financial income	735	226	241
Financial expenses	-1'455	-3'126	-3'000
Earnings before tax	**2'707**	4'104	11'901
Income tax	-675	-962	-2'368
Net income	**2'032**	3'142	9'533
Thereof:			
‣ Shareholders of the company	1'888	3'094	9'352
‣ Minority shareholders	144	48	181
Earnings per share in CHF	0.56	0.92	2.78
Diluted earnings per share in CHF	0.56	0.92	2.78

Statement of comprehensive income

CHF 1'000	**2016** 01.01. – 30.06.	2015 01.01. – 30.06.	2015 01.01. – 31.12.
Net income	**2'032**	3'142	9'533
Remeasurements employee benefits	-3'727	-2'428	-2'085
Income taxes on remeasurements employee benefits	655	426	361
Items not recyclable to the income statement	-3'072	-2'002	-1'724
Cash flow hedges	650	271	1'226
Income taxes on cashflow hedges	-173	-8	-377
Currency translation	-295	-16'570	-12'314
Items recyclable to the income statement	182	-16'307	-11'465
Comprehensive income	**-2'890**	-18'309	-13'189
Total comprehensive income	**-858**	-15'167	-3'656
Thereof:			
‣ Shareholders of the company	-922	-15'164	-3'788
‣ Minority shareholders	64	-3	132

Balance sheet

CHF 1'000	**30.06.2016**	31.12.2015	30.06.2015
Cash and cash equivalents	11'451	9'427	9'363
Receivables	106'661	104'339	99'410
Other financial assets	8'165	7'681	7'979
Inventories	87'406	84'525	83'672
Total current assets	**213'683**	205'972	200'424
Tangible fixed assets	101'733	94'315	84'706
Intangible assets	40'025	41'257	41'064
Total fixed assets	**141'758**	135'572	125'770
Total assets	**355'441**	341'544	326'194

CHF 1'000	**30.06.2016**	31.12.2015	30.06.2015
Financial liabilities	30'924	21'415	23'844
Operating liabilities	69'603	61'546	54'416
Accured expenses and deferred income	26'457	24'743	27'434
Current income tax	2'462	5'308	4'692
Provisions	5'272	6'026	5'206
Total current liabilities	**134'718**	119'038	115'592
Financial liabilities	3'942	3'935	3'865
Deferred income tax	23'458	23'888	22'395
Pension benefit obligations	10'259	6'445	7'773
Provisions	1'907	2'172	1'910
Total non-current liabilities	**39'566**	36'440	35'943
Total liabilities	**174'284**	155'478	151'535
Share capital	28'560	28'560	28'560
Additional paid-in capital	63'644	67'676	67'676
Retained earnings	131'243	129'355	123'097
Other reserve	-43'244	-40'434	-45'552
Total shareholders' equity of the company	**180'203**	185'157	173'781
Minority shareholders	954	909	878
Total shareholders' equity	**181'157**	186'066	174'659
Total liabilities	**355'441**	341'544	326'194

Cash flow statement

CHF 1'000	**2016** 01.01. – 30.06.	2015 01.01. – 30.06.	2015 01.01. – 31.12.
Net income	2'032	3'142	9'533
Income tax expenses	675	962	2'368
Interest expenses	187	197	492
Interest income	-4	-36	-63
Depreciation and amortization	6'009	6'208	12'395
Change in non-current provisions	-193	-24	-818
Other non-cash items	53	1'504	1'325
Change in inventory	-2'594	-973	360
Change in other non-cash net current assets	4'218	-13'946	-12'322
Income tax paid	-3'603	-1'830	-2'286
Cash flow from operating activities, net	**6'780**	-4'796	10'984
Capital expenditure for:			
‣ Tangible fixed assets	-9'225	-9'375	-21'370
‣ Intangible fixed assets	-582	-561	-1472
Disposals of fixed assets	195	355	572
Cash flow from investing activities, net	**-9'612**	-9'581	-22'270
Change in current financial liabilitites	9'548	19'735	16'919
Repayment of non-current financial liabilities	-134	-124	-249
Interest paid	-182	-170	-362
Interest received	4	36	63
Dividend payment	-4'051	-6'048	-6'152
Cash flow from financing activities, net	**5'185**	13'429	10'219
Currency translation	-329	-995	-812
Net change in cash and cash equivalents	2'024	-1'943	-1'879
Cash and cash equivalents at beginning of period	9'427	11'306	11'306
Cash and cash equivalents at end of period	**11'451**	9'363	9'427

Statement of shareholders'equity

CHF 1'000	Share capital	Additional paid-in capital	Retained earnings	Other reserve	Shareholders' equity of the company	Minority share-holders	Total share-holders' equity
01.01.2015	28'560	73'724	120'003	-27'294	194'993	881	195'874
Net income	-	-	9'352	-	9'352	181	9'533
Other comprehensive income	-	-	-	-13'140	-13'140	-49	-13'189
Total comprehensive income	-	-	9'352	-13'140	-3'788	132	-3'656
Dividend payment	-	-6'048	-	-	-6'048	-104	-6'152
30.06.2015	28'560	67'676	123'097	-45'552	173'781	878	174'659
31.12.2015	28'560	67'676	129'355	-40'434	185'157	909	186'066
Net income			1'888		1'888	144	2'032
Other comprehensive income				-2'810	-2'810	-80	-2'890
Total comprehensive income	-	-	1'888	-2'810	-922	64	-858
Dividend payment		-4'032			-4'032	-19	-4'051
30.06.2016	**28'560**	**63'644**	**131'243**	**-43'244**	**180'203**	**954**	**181'157**

Notes to the interim consolidated financial statements

1. Accounting principles

The unaudited interim consolidated financial statements for 2016 were prepared in accordance with International Financial Reporting Standards (IFRS). They have been prepared in condensed form in accordance with IAS 34 Interim Financial Reporting.

The consolidated interim financial statements do not contain all of the information found in the consolidated annual financial statements and should be read together with the financial statements for the 2015 fiscal year. The key accounting principles correspond to those applied in the 2015 consolidated financial statements (see pages 92 to 95 of the 2015 Annual Report).

The present interim report includes estimates and assumptions that affect the reported figures and the associated disclosure. The actual results may differ from these estimates.

2. Fair value of financial instruments

Foreign currency exposure is partially hedged by derivative financial instruments in order to react to short-term exchange rate fluctuations. These instruments are stated at fair value. The measurement of fair value is based on quoted market prices as of the reporting date (Level 2 of the fair value hierarchy). The fair value of the following balance sheet items roughly corresponds to their carrying amounts: Cash and cash equivalents, accounts receivable, other financial assets, financial liabilities and operational liabilities.

3. Additional information

The Starrag Group is not affected by seasonal or cyclical factors as steady sales and margins are assured in the event of any brief fluctuations in order intake by the order backlog, which is currently equivalent to more than half a year's sales.

Restructuring costs of CHF 1.0 million related to personnel cuts at various sites are included in reported personnel expenses for the first half of 2016.

4. Approval of interim consolidated report

No events have occurred after 30 June 2016 that would have a material effect on the interim accounts. The interim consolidated report was approved and released for publication by the Board of Directors on 18 July 2016.

Adaptive manufacturing of turbine blades

Starrag has developed a flexible manufacturing system with four machining centres for the safe, customer-specific series production of turbine blades, embodying the core concepts of Industry 4.0.

The new development from Starrag is intended to support the extremely demanding process of finishing precision-forged titanium turbine blades for use in aircraft engines. The manufacturing system represents the state of the art. In order to be able to reliably manufacture up to 40'000 blades a year, Starrag uses the expertise it has gained over its many years of experience to design an overall concept and take the individual machining steps into account. For example, an individual milling program is generated for each blade due to small component differences arising from the process. This makes it possible for the customer to significantly boost their productivity.
Starrag's expertise is clear not only in the machine itself, but also in the machining processes. This is why Starrag uses its very own, specially developed machining software as well as its own milling tools. To handle the high demand for tools in the four machining centres – which operate around the clock – Starrag combines the linked manufacturing system with two tool grinding machines plus auxiliary equipment.

The necessary capacity for equipment is planned in advance by the cell controller. This arrangement makes the production process considerably safer for the customers. Up-to-date information about all the parameters of the production system can be viewed and checked at any time via the company's own software solution, as well as on mobile devices such as tablets and mobiles – all very much in the spirit of Industry 4.0.

High-precision machine tools for greater productivity

Starrag Group is a global technology leader in manufacturing high-precision machine tools for milling, turning, boring and grinding of workpieces made from metallic, composite and ceramic materials. Principal customers are internationally active companies in the Aerospace & Energy, Transportation & Industrial Components and Precision Engineering sectors. In addition to its portfolio of machine tools, Starrag Group provides integrated technology and maintenance services that significantly enhance customer productivity.

Starrag Group products are marketed under the following strategic brands: Berthiez, Bumotec, Dörries, Droop+Rein, Heckert, Scharmann, SIP, Starrag, TTL, WMW. Headquartered in Rorschach, Switzerland, the Starrag Group operates manufacturing plants in Switzerland, Germany, France, the UK and India and has established a network of sales and service subsidiaries in numerous other countries.

Starrag Group is listed on the SIX Swiss Exchange (STGN).

Financial calendar

26 January 2017	Initial information on full-year 2016 results
10 March 2017	Presentation of 2016 results for analysts and the media in Zurich
28 April 2017	Annual general meeting in Rorschach
27 July 2017	Half-year report 2017

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This half-year report is also available in German. In case of any discrepancy between the two versions, the German text shall prevail. The half-year report may also be viewed online on our website: www.starrag.com

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