starrag

Half-year report
2017

Significant improvement in profit – order backlog remains good despite drop in order intake – 10% sales growth

- EBIT margin nearly doubled to 4.0%
- Net profit climbs to CHF 6.4 million or 3.2 percent of sales, plus 133%
- Order intake down 39% to CHF 142 million from prior-year period, 5% decline in local currency over the preceding 12-month period
- Order backlog of CHF 284 million secures capacity utilization for almost one year
- Sales advance 10% to CHF 202 million
- Consistent implementation of strategy

CHF m	**2017** 01.01. – 30.06.	2016 01.01. – 30.06.	Change
Order intake	141.7	231.2	-38.7%
Sales revenue	202.3	183.4	10.3%
Operating result EBIT	8.0	4.4	80.8%
Net profit	6.4	2.8	133.0%
Earnings per share (in CHF)	1.89	0.78	143.2%
EBIT as % of sales revenue	4.0%	2.4%	63.8%
Net profit as percentage of sales revenue	3.2%	1.5%	111.1%
Return on equity ROE	8.0%	3.4%	131.3%
Cash flow from operating activities	-5.8	6.6	n.a.
Capital expenditure	7.0	9.6	-27.4%
Free cash flow	-12.8	-3.0	n.a.
Employees (average number of FTEs during the reporting period)	1’505	1’535	-2.0%

CHF m	**30.06.2017**	31.12.2016	Change
Order backlog	284.4	348.3	-18.3%
Total assets	327.9	316.3	3.7%
Net debt	36.2	18.7	93.2%
Shareholders’ equity	168.1	161.4	4.2%
Equity ratio	51.3%	51.0%	n.a.

Consolidated accounts have been prepared in accordance with Swiss GAAP FER since 1 January 2017. The figures reported in the comparable year-ago period have been restated accordingly.

Dear shareholders

Good order backlog

Starrag Group's order backlog for new machines amounted to CHF 284 million at the end of June 2017, virtually unchanged from the level reported a year ago. The 18% decline compared to the end of 2016 can be viewed as a normalization of the order backlog. Orders currently on hand are sufficient to maintain an appropriate level of capacity utilization for almost one year, especially since the new machine business always entails substantial additional customers services and support.

Volatile order intake

After an exceptional surge in new orders during the first half of 2016, order intake during the first six months of 2017 declined by 39% to CHF 142 million (-38% in local currency). As always, orders intake for half-year periods can vary considerably, depending on the timing of customers' decisions to go ahead with major projects. Extending the order intake period to the past twelve months (July 2016 to June 2017) to take into account the longterm nature of Starrag Group's capital goods business, new orders amounted to CHF 391 million, which corresponds to a 5% decrease in local currency versus the preceding twelve-month period.

Orders by region and customer industry

Viewed by region, there was a sharp downturn in orders from European and especially Asian customers, whereas order activity in North America remained steady. With respect to the four customer industries, Aerospace and Energy took in fewer orders y-o-y. Orders in the Industrial customer segment were likewise lower, although orders from luxury goods manufacturers were better than in the year-ago period. Transportation managed to hold the year-ago level.

Strong sales growth

As a result of the exceptionally high order backlog from 2016 and the high order backlog at the beginning of the year, sales for the first six months of the year reached CHF 202 million and topped the prior-year figure by 10% (+11% in local currency).

Significantly better profitability

The multitude of measures taken to enhance profitability and achieve operational excellence, along with the strategic focus on fast-growing and high-margin market segments and regions, had a pleasing impact on operating results in the first half of the year. The operating result EBIT nearly doubled, rising by 81% to CHF 8.0 million, which lifted the operating margin to 4.0% (2.4%). Net profit for the period rose by 133% to CHF 6.4 million (prior-year period: CHF 2.8 million), which corresponds to 3.2 (1.5) percent of sales. The bottom line was positively impacted by a one-off tax credit of CHF 0.8 million from earlier reporting periods. Earnings per share amounted to CHF 1.89 (prior-year period: CHF 0.78).

Solid balance sheet

Total assets of CHF 328 million as per 30 June 2017 are CHF 12 million higher than at the end of 2016. Net debt increased by CHF 17.5 million from the end of 2016 to CHF 36.2 million due to input costs incurred to process orders on hand. At 51.3% (year-end 2016: 51.0%), Starrag Group's equity ratio remains solid.

Accounting standards switched to Swiss GAAP FER

As announced earlier, the interim results for 2017 were presented for the first time in accordance with Swiss GAAP FER accounting standards. The figures for 2016 were therefore restated. The new accounting standards will reduce accounting complexity, which is increasing under IFRS, and reduce costs as well. Swiss GAAP FER is an internationally recognized accounting standard based on the concept of "true and fair". It meets all the accounting needs of Starrag Group and provides an accurate, comprehensive view of the company's financial situation.

Consistent implementation of strategy continued

Steadfast progress was made with the implementation of the "Strategy 2020" during the period under review. On the innovation front, Starrag Group sets itself apart from the competition through its superior application expertise, which will again be prominently displayed at the next EMO trade show in Hannover this September. New applications for the "Starrag Integrated Production System", the manufacturing system developed to address "Industry 4.0", will be presented along with system-specific automation concepts as well as a new generation of machine tools. The "Technology Days Precision Engineering" event held in Immendingen in February was devoted to Starrag Group's new precision machinery for manufacturers of medical technology devices and micromechanics components.

Geographically, the priority markets for expansion are in the US and China and expansion efforts have been focused on the Aerospace, Industrial and Energy industries. Moreover, the Group has systematically expanded and strengthened its dealer networks in key markets.

Further improvement in operational excellence will be focused on ramping up the performance of customer service division. Examples here include the new "Service Plus" product that was introduced during the period under review and showcased at this year's "Turbine Technology Days" in Rorschach in June, where it attracted considerable interest. Service Plus guarantees a high level of service readiness for a fixed price and helps to simplify a customer's cost control. The introduction of the one-brand strategy clearly simplified "go to market" throughout the Group. During the ongoing implementation of the one-brand strategy, care is being taken to ensure that all customer ties with the former standalone brands remain intact while being gradually transitioned to the "Starrag" brand.

New factory in Vuadens offers numerous advantages

The transfer of production activities and machinery from the Geneva and Sâles sites to the new factory in Vuadens has been completed. High-precision machine tools for producing top-quality components will be manufactured at the new production facilities, which have a "zero carbon footprint" and therefore meet the strictest of energy standards. Ultra-modern manufacturing workflows will yield substantial productivity gains. In conformity with a long-term planning horizon, the capacity of the new plant was deliberately designed to provide ample scope for future growth, which is why some of the existing floor space will be leased to other firms until further notice. Efforts to sell the former factory in Sâles have commenced. Together with the absence of the infrastructure-related costs at the Geneva plant, Starrag Group now has significantly more production space at the new site, whereas the overall cost base is unchanged.

Outlook

Uncertainty continues to cloud the economic and political stage, prices are generally still under pressure, and customer order patterns remain volatile. With the aforementioned implementation of the strategic sales-side measures, Starrag Group has created the necessary structures for sustained, profitable growth that will ensure the attainment of its medium-term profitability goals. The full payback will, of course, not be achieved overnight, but the interim results presented today indicate that considerable progress has already been made.

For 2017 as a whole, Starrag Group basically confirms its guidance given in March. Order intake (in local currency) is expected to be significantly higher in the second half compared to the figure reported for the first half. Nevertheless, full-year order intake is likely to be well below the figure for 2016. Sales (in local currency), however, are forecast to be significantly higher y-o-y. Thanks to the abovementioned strategic and operational measures and not least to the improvement on the margin front from the first half of 2017, which should continue in the second half, the operating margin for 2017 is expected to be much higher than the 2016 margin.

Thank you

The Board of Directors and the Executive Board truly appreciate the tremendous efforts of all employees and we are grateful for the strong 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 2017

Financial commentary

Order situation

The order backlog for new machinery remains high at CHF 284 million. Down 18% compared to the end of 2016, the order backlog has normalized and is now back at the level reported at mid-year mark in 2016. These unfilled orders for new machinery ensure a solid rate of capacity utilization for a period of almost one year as they always entail substantial additional customer services and support.

Order intake is characterized by considerable fluctuations. Orders received during the first six months of the year amounted to CHF 142 million, which is 39% less than in the same period of the previous year. At constant exchange rates, order intake declined by 38%. Extending the order intake period to the past twelve months (July 2016 to June 2017) to take into account the long-term nature of Starrag Group's capital goods business, new orders amounted to CHF 391 million, which corresponds to a 5% decrease in local currency versus the preceding twelve-month period.

Income statement

Sales revenue for the first half of the year amounted to CHF 202 million, an increase of 10.3% year-on-year. Sales revenue grew by an even faster rate of 11.3% in local currency. This growth was fueled by the record-high 2016 order backlog, which raised the order backlog to a very high level early in the year.

Gross profit (sales revenue minus cost of materials plus/minus change in inventory) amounted to CHF 110 million, or 54.6% of sales revenue. Gross profit was CHF 9.0 million higher than in the year-ago period, although the gross profit margin was 0.7 percentage points lower y-o-y. A shift in the product mix towards higher margins, a reduction in sourcing costs and the absence of negative effects associated with the revaluation of individual projects had a positive effect on the gross margin. The lower percentage of completion of orders in process, which meant a higher consumption of materials, was a negative factor to the gross margin in the period under review.

Personnel expenses were positively affected by the absence of the restructuring costs of CHF 1.0 million charged to the year-ago period and the reduction in headcount from 1'535 to 1'505 FTEs, whereas increased unit labor costs primarily due to industry-wide wage increases in Germany, had a negative impact on personnel expenses. Thanks not least to the higher sales volume, personnel expenses as a percent of sales declined from 37.2% to 34.5%. Operating expenses rose from 13.3% to 13.8% of sales revenue due to higher order-related costs.

Operating profit EBIT rose by CHF 4.4 million from the same period in the previous year to CHF 8.0 million, which lifted the corresponding margin from 2.4% to 4.0%. This margin expansion is largely attributed to the increased sales volume and resulting gross profit growth.

The net financial result was stable at CHF -0.7 million. The tax rate for the period declined to a low 12.6% (25.7% in the previous year), which reflects the positive effect of a one-time tax credit of CHF 0.8 million from earlier reporting periods. Consequently, net profit showed a comparatively stronger increase from CHF 2.8 million to CHF 6.4 million and earnings per share rose from CHF 0.78 to CHF 1.89.

Balance Sheet

Total assets as of 30 June 2017 amounted to CHF 328 million, an increase of CHF 12 million from the end of 2016. Current assets rose by CHF 10.1 million due to upfront payments for the higher level of work in progress. Fixed assets increased by CHF 1.4 million, which primarily reflects expansion-related investments in the company's new factory in Vaudens, Switzerland.

The higher level of capital employed was financed via an increase in liabilities, which rose by CHF 4.9 million during the period. Operating liabilities declined by CHF 8.3 million, while financial liabilities rose by CHF 13.2 million. As cash and cash equivalents also declined by CHF 4.3 million, the net debt position rose by CHF 17.5 million to CHF 36.2 million. This increase is largely attributable to the increase in work in progress and input costs incurred to process orders on hand, while the level of funding for orders in progress decreased slightly to 81.0%.

Shareholders' equity rose by CHF 6.7 million from the end of 2016. Net profit of CHF 6.4 million and the remeasurement of cash flow hedges (CHF 3.4 million) contributed to this increase, while the dividend payout of CHF 3.4 million had a negative effect. The equity ratio rose by 0.3 percentage points to 51.3% compared to the end of 2016, a level that is still consistent with an above-average degree of financial flexibility.

Cash flow

Cash flow (before changes in net current assets) amounted to CHF 9.7 million (prior-year period: CHF 7.8 million). Operating cash flow after changes in non-cash net working capital amounted to a negative CHF 5.8 million (prior-year period: CHF +6.6 million). This is largely due to input costs associated with the higher backlog of orders in process.

The CHF 7.0 million of investment in non-current assets reflects expenditures on the new factory in Vaudens, Switzerland; improvements to existing production sites; and IT upgrades. Also because of the capacity expansion expenditure in Vaudens, Switzerland, free cash flow for the first half was a negative CHF -12.8 million (prior-year period: CHF -3.0 million).

Cash flow from financing activities amounted to CHF 8.6 million, which largely reflects the CHF 12.4 million increase in financing liabilities minus the withholding tax-free dividend of CHF 3.4 million paid out of capital contribution reserves in May 2017 for fiscal year 2016.

Income statement

CHF 1'000	**2017** 01.01. – 30.06.	2016 01.01. – 30.06.	2016 01.01. – 31.12.
Sales revenue	202'339	183'374	371'611
Other operating income	703	682	1'445
Change in inventory of finished and unfinished goods	-3'782	2'096	-3'125
Cost of materials and components	-88'161	-84'069	-163'416
Personnnel expenses	-69'814	-68'173	-134'116
Other operating expenses	-27'893	-24'387	-52'640
Earnings before interest, taxes, depreciation and amortization EBITDA	**13'392**	9'523	19'759
Depreciation on tangible fixed assets	-4'303	-4'048	-8'217
Depreciation on intangible assets	-1'069	-1'038	-2'195
Operating result EBIT	**8'020**	4'437	9'347
Financial result	-663	-720	-1'443
Profit before taxes	**7'357**	3'717	7'904
Income taxes	-925	-956	-1'836
Net profit	**6'432**	2'761	6'068
Thereof:			
‣ Shareholders of the company	6'365	2'617	5'944
‣ Minority shareholders	67	144	124
Earnings per share in CHF	1.89	0.78	1.77
Diluted earnings per share in CHF	1.89	0.78	1.77

Consolidated accounts have been prepared in accordance with Swiss GAAP FER since 1 January 2017.
The figures reported in the comparable year-ago period have been restated accordingly.

Balance sheet

CHF 1'000	**30.06.2017**	30.06.2016	31.12.2016
Cash and cash equivalents	9'753	11'451	14'028
Receivables from goods and services	107'686	100'947	90'050
Other short-term receivables	5'334	5'714	3'346
Inventories	88'490	93'633	96'396
Prepayments and deferred income	5'701	1'938	3'017
Total current assets	**216'964**	213'683	206'837
Tangible fixed assets	104'618	101'733	103'782
Intangible assets	6'322	5'524	5'718
Total non-current assets	**110'940**	107'257	109'500
Total assets	**327'904**	320'940	316'337

CHF 1'000	**30.06.2017**	30.06.2016	31.12.2016
Financial liabilities	42'251	30'924	28'972
Payables form goods and services	27'513	34'249	31'406
Other liabilities	6'734	6'538	9'132
Provisions	4'624	5'272	4'788
Accured liabilities and deferred income	51'496	57'735	54'142
Total current liabilities	132'618	134'718	128'440
Financial liabilities	3'739	3'942	3'786
Provisions	23'479	22'350	22'752
Total non-current liabilities	27'218	26'292	26'538
Total liabilities	**159'836**	161'010	154'978
Share capital	28'560	28'560	28'560
Additional paid-in capital	60'284	63'644	63'644
Retained earnings	79'113	66'772	68'328
Total shareholders' equity of the company	**167'957**	158'976	160'532
Minority shareholders	111	954	827
Total shareholders' equity	**168'068**	159'930	161'359
Total liabilities	**327'904**	320'940	316'337

Consolidated accounts have been prepared in accordance with Swiss GAAP FER since 1 January 2017.
The figures reported in the comparable year-ago period have been restated accordingly.

Cash flow statement

CHF 1'000	**2017** 01.01. – 30.06.	2016 01.01. – 30.06.	2016 01.01. – 31.12.
Net profit	6'432	2'761	6'068
Depreciation of tangible fixed assets	5'372	5'086	10'412
Change in non-current provisions	-916	-51	984
Other non-cash items	-1'104	53	617
Change in			
‣ Receivables from goods and services	-15'736	-206	9'575
‣ Inventories	8'770	-3'776	-7'125
‣ Other receivables and deferred expenses	491	-782	-1'332
‣ Payables from goods and services	-3'493	8'348	7'809
‣ Other liabilitiies and accured expenses and deferred income	-5'597	-4'831	-5'823
Cash flow from operating activities, net	**-5'781**	6'602	21'185
Capital expenditure for:			
‣ Tangible fixed assets	-5'399	-9'225	-17'706
‣ Intangible assets	-1'611	-582	-1'971
Disposals of fixed assets	30	195	259
Cash flow from investing activities, net	**-6'980**	-9'612	-19'418
Change in current financial liabilitites	12'649	9'548	7'682
Repayment of non-current financial liabilities	-218	-134	-254
Dividend payment	-3'360	-4'051	-4'122
Purchase of interest in subsidiary	-424	-	-
Cash flow from financing activities, net	**8'647**	5'363	3'306
Currency translation	-161	-329	-472
Net change in cash and cash equivalents	-4'275	2'024	4'601
Cash and cash equivalents at beginning of period	14'028	9'427	9'427
Cash and cash equivalents at end of period	**9'753**	11'451	14'028

Consolidated accounts have been prepared in accordance with Swiss GAAP FER since 1 January 2017.
The figures reported in the comparable year-ago period have been restated accordingly.

Statement of shareholders'equity

CHF 1'000	Share capital	Additional paid-in capital	Retained earnings	Shareholders' equity of the company	Minority share holders	Total share holders' equity
01.01.2016 (according to IFRS)	28'560	67'676	88'921	185'157	909	186'066
Restatement Swiss GAAP FER	-	-	-24'934	-24'934	-	-24'934
01.01.2016 (according to Swiss GAAP FER)	28'560	67'676	63'987	160'223	909	161'132
Net profit	-	-	2'617	2'617	144	2'761
Cash flow hedges	-	-	477	477	-	477
Currency translation	-	-	-309	-309	-80	-389
Dividend payment	-	-4'032	-	-4'032	-19	-4'051
30.06.2016	28'560	63'644	66'772	158'976	954	159'930
31.12.2016	28'560	63'644	68'328	160'532	827	161'359
Net profit	-	-	6'365	6'365	67	6'432
Cash flow hedges	-	-	3'386	3'386	-	3'386
Currency translation	-	-	619	619	56	675
Purchase of interest in subsidiary	-	-	415	415	-839	-424
Dividend payment	-	-3'360	-	-3'360	-	-3'360
30.06.2017	**28'560**	**60'284**	**79'113**	**167'957**	**111**	**168'068**

Consolidated accounts have been prepared in accordance with Swiss GAAP FER since 1 January 2017.
The figures reported in the comparable year-ago period have been restated accordingly.

Notes to the interim consolidated financial statements

1. Accounting principles

The unaudited interim consolidated financial statements for 2017 were prepared in accordance with Swiss GAAP FER (Swiss accounting and reporting recommendations). This is a condensed interim report pursuant to Swiss GAAP FER 31 “Additional recommendations for listed companies”.

The consolidated interim financial statements do not contain all of the information found in the consolidated annual financial statements and should therefore be read together with the financial statements for the 2016 fiscal year. Starrag Group prepared its interim and annual accounts in accordance with IFRS (International Financial Reporting Standards) until 31 December 2016. The current accounting standards are nevertheless congruent with the accounting standards used to prepare the 2016 financial statements (refer to pages 96 to 99 of the 2016 Annual Report), unless stated otherwise in the following section.

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. Adjustments owing to the change in accounting standards

The accounting standards used to prepare and present the consolidated interim financial statements for 2017 differ from the consolidated financial statements 2016 prepared under IFRS in the following material respects:

1. Intangible assets from acquisitions

Goodwill from acquisitions and acquired brands, customer relationships and technology is deducted directly from balance sheet reserves as of the date of acquisition, in accordance with Swiss GAAP FER 30 “Consolidated Financial Statements”. Under IFRS, goodwill was capitalized and subsequently tested for impairment on an annual basis. Brand names, customer relationships and technology were capitalized separately under IFRS depending on the cost of acquisition and then amortized over the estimated useful life of the item. Under Swiss GAAP FER, transaction costs incurred with acquisitions are treated as part of the acquisition cost. Under IFRS, transaction costs were recognized in the income statement.

2. Pension plans

Pursuant to Swiss GAAP FER 16 "Pension benefit obligations", the economic obligations and / or benefits of Swiss pension plans are determined on the basis of the accounts drawn up in accordance with Swiss GAAP FER 26 “Accounting of pension plans”. The economic benefit of pension plans at foreign subsidiaries is determined in accordance with the respective local valuation methods. Employer's contribution reserves and similar items are capitalized pursuant to Swiss GAAP FER 16. Under IFRS, the service cost of defined-benefit plans was calculated using the projected unit credit method and recognized in the balance sheet in accordance with IAS 19.

3. Deferred income taxes

The aforementioned valuation adjustments and changes in balance sheet presentation have an impact on the deferred income taxes reported in the balance sheet and income statement.

4. Exchange differences

With the adoption of Swiss GAAP FER, cumulative exchange differences were reset to zero by offsetting them against reserves.

5. Presentation and structure

Presentation and structure of the income statement, balance sheet, cash flow statement and statement of changes in equity were adjusted to comply with Swiss GAAP FER.

Prior periods were restated accordingly to ensure comparability with the period under review. The effects of the aforementioned adjustments on Starrag Group's equity and the income statements are summarized in the table below:

CHF m	**01.01.2016**	**30.06.2016**	**31.12.2016**
Shareholders' equity in accordance with IFRS	186.1	181.2	186.8
Goodwill from acquisitions	-17.4	-17.4	-17.2
Adjustment of depreciation of purchased brands, customer relationships and technologies	-17.9	-17.1	-16.0
Adjustment of the pension benefit obligation	6.4	10.2	3.8
Deferred income tax	3.9	3.0	4.0
Shareholders'equity in accordance with Swiss GAAP FER	**161.1**	159.9	161.4

CHF m	**2016** 01.01. – 30.06	**2016** 01.01. – 31.12
Net profit in accordance with IFRS	2.0	4.6
Adjustment of depreciation of purchased brands, customer relationships and technologies	0.9	1.8
Adjustment of the pension benefit obligation	0.1	0.2
Deferred income tax	-0.3	-0.6
Net profit in accordance with Swiss GAAP FER	**2.8**	**6.1**

3. Purchase of remaining shares in a subsidiary

On 11 May 2017 Starrag Group Holding AG acquired an additional 15% stake in Toolroom Technology Limited at a cost of CHF 0.4 million. Starrag Group now owns 100% of Toolroom Technology's Limited's capital stock. At the time of acquisition the carrying amount of the corresponding minority shares was CHF 0.8 million. This amount was derecognized in the equity attributed to noncontrolling interests and the CHF 0.4 million difference to the acquisition cost was recognized in the retained earnings of the company.

4. 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.

5. Approval of interim consolidated report

No events have occurred after 30 June 2017 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 2017.

Engineering precisely what you value

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 and Industrial sectors. In addition to its portfolio of machine tools, Starrag Group provides integrated technology and maintenance services that significantly enhance customer productivity.

The products are marketed under the brand Starrag and include the product ranges Berthiez, Bumotec, Dörries, Droop+Rein, Heckert, Scharmann, SIP, Starrag and TTL. 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 the most important customer countries.

Starrag Group Holding AG is listed on the SIX Swiss Exchange.

Financial calendar

26 January 2018	Initial information on full-year 2017 results
9 March 2018	Presentation of 2017 results for analysts and the media in Zurich
28 April 2018	Annual general meeting in Rorschach
27 July 2018	Half-year report 2018

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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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