CPH Group expands in Asia and achieves an operating profit for 2016

Peter Schaub (left) and Peter Schildknecht

Dear shareholder, dear reader

CPH continues to consistently pursue its business strategy

The current corporate strategy of the CPH Group is based on three key thrusts:

- With several production facilities in Switzerland, the Group incurs much of its costs in Swiss francs. But its main markets are in the rest of Europe, and its sales are largely in euros. This imbalance, and the resulting exposure to currency exchange rate trends, should be reduced by expanding capacities outside Switzerland.
- The Paper Division accounts for more than half of total group sales. This makes CPH heavily dependent on paper market trends. To reduce this dependence and achieve a better balance among the Group's three divisions in sales terms, business should be expanded in the Chemistry and Packaging divisions.
- The Group is currently strongly focused on European markets. By investing in expansion in the growing Asian markets, CPH should further tap the potential offered by this emerging market region. The present Annual Report puts a particular focus (from Page 10 onwards) on CPH's Asian expansion activities.

The CPH Group continued to pursue its adopted business strategy throughout 2016. The Chemistry Division repositioned itself in the course of the year. After almost 200 years of production on its original premises in Uetikon beside Lake Zurich, CPH sold the 65 000-square-metre site to Canton Zurich, which plans to use it to build a new cantonal high school. The sale price amounted to CHF 52 million. Under the terms of the sale, CPH will also pay 80% of the costs of the work required to clean up the adjacent lake bed, a legacy of local production practices in much earlier times. Canton Zurich is retaining CHF 32 million of the sale price to this end. CPH has also leased the Uetikon site back from the canton for a further two years, to ensure a smooth transfer of its present production to new locations.

The transfer of the production of standard molecular sieves to the Group's China-based Jiangsu ALSIO Technology subsidiary has largely been completed. Three further product lines will be manufactured in Bosnia and Herzegovina from the end of 2017. To this end, CPH has founded the new Zeochem d.o.o. and acquired a suitable site in Zvornik, very close to its raw materials supplier, on which a new production facility will be constructed in the course of 2017. The production of deuterated solvents and high-value GMP gels will resume at a new Swiss location in Rüti from mid-2017. The new Rüti site will also be home to the Chemistry Division's management and service functions. The manufacture of fertilizers will cease in mid-2017.

Following its strategic realignment, the Chemistry Division now has production facilities in Switzerland, Bosnia, the USA and China, enabling it to substantially enhance its competitive credentials. The purchase of ALSIO has also prompted a reorganization of the division's Asian sales organization, including the opening of new sales offices in Shanghai and Singapore.

CPH has largely disposed of any real estate not required for its business operations over the past few years. The sale of the Uetikon site has significantly reduced the strategic importance of the Group's real-estate assets; and in view of this, its real estate management and development were outsourced to UBV Immobilien Treuhand Perlen AG in mid-2016.

The Packaging Division also continued with its Asian growth strategy. The new coating plant in China commenced operations as planned in the course of the year and delivered its first film products to pharmaceuticals customers in the Asia region. The operation has already earned the certifications required for international markets. Approval to serve the Chinese market has not yet been secured, however, and may still take some time.

Market environment remains challenging

According to World Bank estimates, the global economy saw even more modest growth in 2016 than it had the previous year, with GDP rising by just 2.3%. The worldwide efforts of the central banks to boost economic growth via very low interest rates have shown few results to date; and with hardly any inflation in sight, there is little prospect of interest rates returning to more normal levels any time soon. On the positive side – from the Swiss perspective, at least – the currency markets have stabilized somewhat. The euro, the most important foreign currency for the CPH Group, rose from an average exchange rate of CHF 1.068 for 2015 to CHF 1.090 for 2016, while the US dollar also strengthened minimally from CHF 0.963 to CHF 0.985.

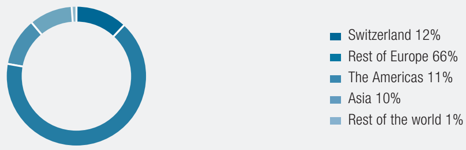
Economic growth in the Eurozone, CPH's most important prime sales market, slowed in 2016, with GDP growth for the year at a mere 1.6%. The Chinese economy, long a prime mover for global economic growth, also struggled to maintain its momentum, posting 6.7% growth for the year (compared with 6.9% in 2015). Those emerging economies which are dependent on revenues from the sale of oil and natural gas suffered as a result of the current low energy prices.

Energy prices were at their lowest – below USD 30 per barrel, in the case of crude oil – at the beginning of 2016. They recovered somewhat in the course of the year; but at USD 55 per barrel, oil prices were still far below their previous highs (of over USD 110 in 2014) at year-end. The energy sector remained correspondingly reluctant to invest; and this dampened demand accordingly for the Chemistry Division, whose molecular sieves are used (among other things) in the production of ethanol and natural gas. The chemicals and pharmaceuticals sectors, by contrast, displayed stronger demand, particularly for the division's higher-value products.

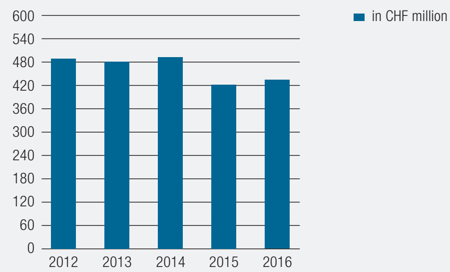
The Paper Division operates largely in an environment that is experiencing a structural decline in demand. Newspaper circulations have been falling in Europe for years, as media consumption habits change and advertising volumes show parallel declines. This structural shift has led to overcapacity in the newsprint and magazine paper markets. Demand for both fell further in 2016. But overcapacities were only withdrawn from the newsprint market: magazine paper production capacities remained unchanged. As a result, the price of newsprint held up better than magazine paper prices over the course of the year.

CPH Group net sales by division

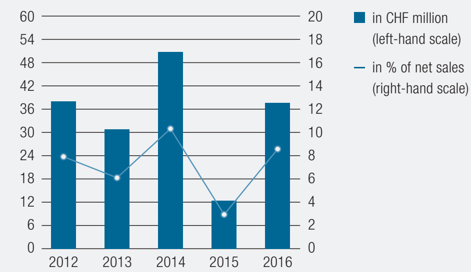
CPH Group net sales by region



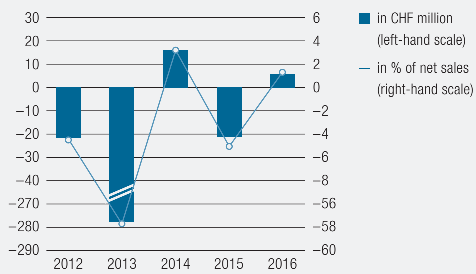
CPH Group net sales trends



CPH Group EBITDA trends



CPH Group EBIT trends



The pharmaceuticals sector showed global growth of 5-7% in 2016, with a corresponding further increase in the demand for blister pack films. The Packaging Division is a leader in the high-barrier-film packaging segment; and as such it benefited from the trend within the pharmaceuticals industry to develop ever-more-complex substances that make sizeable demands of their packaging's barrier credentials.

Chemistry and Packaging report increased sales

Net sales for the CPH Group amounted to CHF 434.8 million in 2016, a 3.5% improvement on the previous year. While the Chemistry and Packaging divisions saw substantial increases in their net sales, those for the Paper Division remained broadly at prior-year levels. The organic growth was accompanied in the Chemistry Division by the net sales of ALSIO, which were consolidated from March 2016 onwards.

Chemistry posts black-ink operating result

The Chemistry Division posted net sales for the year of CHF 69.3 million, up 10.9% from their 2015 level. Demand for molecular sieves and gels was particularly strong among higher-value products, and manufacturing facilities remained well utilized. The division also increased its market share in Asia, following the acquisition of ALSIO of China. The impact of the new Chinese subsidiary was felt on the earnings side, too, as the division saw its annual EBIT return to a black-ink result.

Paper substantially enhances profitability

The Paper Division sold more newsprint (356 000 tonnes) but substantially less magazine paper (157 000 tonnes) in 2016 than it had the year before. Magazine paper prices came under pressure in the second half of the year. Industry overcapacities were high, and facility utilization fell accordingly to less-than-satisfactory rates. As a result, the Paper Division only just kept sales at their prior-year level, at CHF 246.2 million. On the procurement side, lower energy prices were offset by higher recovered paper costs. But with sizeable efficiency endeavours (including investments in material cycles) productivity was improved, and the division posted a further clearly positive EBITDA result.

Packaging achieves strong earnings result

The Packaging Division further expanded its share of a slow-growth European pharmaceuticals market. Sales volumes were up on 2015, and net sales were also raised 8.7% to CHF 119.3 million. The new barrier film coating plant in China supplied its first products to the Asian markets. Despite the high expenditure on building the new Chinese plant, EBIT saw an even stronger increase to a new high – thanks largely to the division's greater focus on higher-value products and to further efficiency enhancements.

Chemistry and Packaging both raise shares of group sales

The targeted expansions of the Group's Chemistry and Packaging divisions were reflected in their relative contributions to overall group sales. Chemistry raised its share of group net sales from 15% to 16%, while Packaging's contribution rose from 26% to 27%. The Paper Division remains the biggest source of group sales, however, accounting for 57%. The first fruits of the new strategic thrust were seen in geographical terms, too: Asia's share of total group sales rose from 7% to 10%, and is set to increase further in the years ahead.

Continued group focus on efficiency enhancements

Since it is essentially unable to influence such key business parameters as currency movements and pricing trends in both the sales and the procurement markets, CPH has long put a prime emphasis on enhancing its efficiency. The actions taken here have reduced expenditure by tens of millions of francs. The cost of materials as a percentage of sales remained constant in 2016 at 53%, in spite of rises in the price of recovered paper, CPH's biggest raw material. The greatest relative savings were seen in energy costs, which declined from 15% to 12% of sales. In addition to lower electricity prices, new rates were also agreed for the steam supplies used. The actions taken had a positive overall impact on operating results, and group EBITDA for the year was tripled to CHF 36.9 million, giving an EBITDA margin of 8.5%.

Net result affected by exceptional items

After ordinary depreciation of CHF 31.0 million, the CPH Group reported earnings before interest and taxes (EBIT) of CHF 5.9 million, a CHF 27.7 million improvement on the previous year. The corresponding EBIT margin amounted to 1.4%. The acquisition of ALSIO was financed through a CHF 20 million bank loan, with a resulting rise in interest expense. The sale of the Uetikon site earned the Group CHF 20 million; but this was offset by CHF 24.4 million in expenses for the writeoff of residual values, personnel-related restructuring costs and provisions for the decommissioning of the site's facilities. The net result amounted to CHF –7.7 million, a CHF 25.4 million improvement on the previous year.

Dividend of CHF 0.65 per share proposed

The Board of Directors will recommend to the Ordinary General Meeting of 21 March 2017 that, in line with the company's consistent dividend policy, a dividend of CHF 0.65 per share be distributed for the 2016 business year.

CPH retains a sound balance sheet

The CPH Group is in sound financial health. At the end of 2016 the Group held liquid funds of CHF 70.3 million, while the equity ratio stood at 56.6%. The decline from the 64.5% of the prior year is due largely to a CHF 32 million provision for the clean-up of the lake bed adjacent to the now-sold Uetikon site and to the offsetting with equity of CHF 12.2 million of goodwill deriving from the ALSIO acquisition.

The Group invested CHF 20.7 million in tangible fixed assets in the course of 2016. The majority of this was for the two new Chinese production plants. Further investments were made in improving the efficiency of existing facilities. The Group generated a cash flow for the year of CHF 28.3 million and a free cash flow of CHF 1.9 million.

Change in Group Executive Management

Richard Unterhuber took up his new duties as Chief Financial Officer of the CPH Group on 1 October 2016. He brings more than 20 years of experience in finance and controlling to his new position. Before joining CPH, he had spent the previous ten years serving as CFO of the internationally active Multi-Contact industrial group based in Allschwil, near Basel.

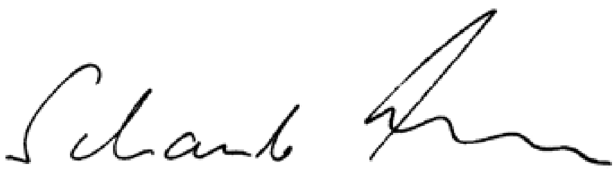
The CPH workforce grew from 858 to 985 employees in the course of 2016. The increase is due to the expansion into Asia of the Chemistry and Packaging divisions. Personnel numbers for the Paper Division showed a slight year-on-year decline.

Outlook for 2017

The economic trends in CPH's prime target markets suggest further positive – albeit fragile – growth. The CPH Group will continue to press to expand its businesses in the faster-growing Asian markets in 2017. The realignment of the Chemistry Division should be completed by the end of the year. The Chemistry and Packaging divisions plan to further extend their present operations. The prospects for the Paper Division are heavily dependent on future market developments, and on the hard-to-predict factors of paper price and Swiss franc/euro exchange rate trends. The division will be seeking to further increase its sales volumes and to post a broadly breakeven earnings result. The current efficiency enhancement endeavours will continue undiminished group-wide, with some CHF 36 million earmarked for corresponding investments in the course of the year. Provided paper prices and currency exchange rates remain largely stable, the CPH Group expects to report higher sales and a slightly-improved operating result for 2017.

Sincere thanks

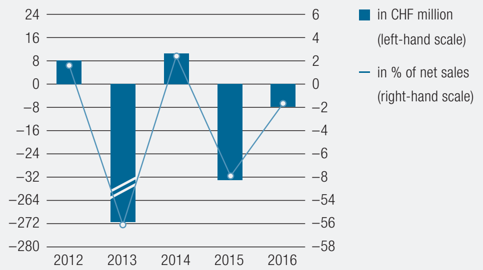
With all their efforts and commitment, CPH's personnel played a crucial role in 2016 in helping the Group to overcome the sudden and unexpected abolition of the Swiss franc/euro minimum exchange rate and return its operations to profit. And we offer them all our deepest thanks for all their energies and endeavours on the Group's behalf. We also thank our customers, our suppliers and particularly our shareholders for all their loyalty, their trust and their confidence in the CPH Group.



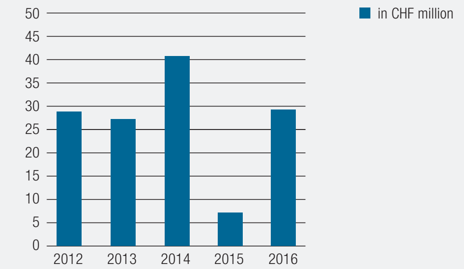
Peter Schaub
Chairman of the Board

Peter Schildknecht
Group CEO

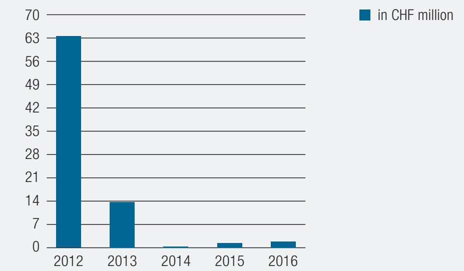
CPH Group net result trends



CPH Group cash flow trends



CPH Group free cash flow trends



Group investments in tangible assets