Press Conference on the Integration of the STI Holding AG into AFG Arbonia-Forster-Holding AG

talk given by
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at AFG Arbonia-Forster-Holding AG
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The spoken text is considered definitive.

Presentation by Dr. Edgar Oehler, Chairman of the Board of Directors of AFG Arbonia-Forster-Holding AG, on the integration of STI Surface Technologies International

Welcome to today's press conference. I would like to apologize once again for the short notice, but as you know, stock exchange legislation makes this inevitable in acquisition deals. I hope that I can – as on previous occasions - make up for the inconvenience by providing you with sufficiently interesting information.

Integration has been under discussion since September 2003

When I stood before you on September 16, 2003, I was already having to field questions about the integration of STI Surface Technologies International Holding AG. As you know I am the sole owner, Chairman of the Board of Directors and CEO of this successful technology company. I have repeatedly been asked the same question ever since, at public events and at our worldwide roadshows. And today I am here to announce and explain the acquisition of STI and its integration into AFG.

As early as on 12 November 2005 there was a report in a Swiss business newspaper saying that "Hartchrom/STI is AFG's fifth division". However, the decision which made this speculation a reality was only taken by the AFG Board of Directors last Monday, with retrospective effect from January 1, 2007.

Decision quickly followed by execution

This brings an end to more than three years of intense debate and discussion – within the company as well as with interested potential industrial purchasers – about the best new owner for STI. The decision to incorporate STI into the AFG Group marks the start of a new era within a new operating environment. In 2007 Hartchrom AG celebrates its 50th anniversary, and I will turn 65. Reason enough for both of us to take stock and think abut the future.

Once upon a time in Steinach

Ten years ago, on December 1, 1996, I took over as Managing Director of what was then Hartchrom AG, which at the time was not in great shape. Management methods were out of date, the technology was stagnating, client care left a lot to be desired, the managers were too old, and so on. But still I could see that the company had a lot of potential. Which is why, when the owner asked me whether I was interested in buying, I said yes.

Between its creation by Theo Keel in 1957 and his unexpected death in fall 2006, Hartchrom AG had enjoyed some golden times.

Significant change in direction - internationalization

Following the acquisition in 1998, the company embarked on a significant change in direction. We invested more in research and development and in our markets, built a new technology centre in Steinach, bought and set up companies in Germany, France and the USA, expanded our coating activities for the aviation and automotive industry, and entered into technology partnerships with existing and new customers. Over the last eight years we have developed Hartchrom AG Steinach into the world's leading company within the industry.

Our "STI goes global, acts local" strategy has brought us a worldwide presence and a worldwide client base. The STI Group currently comprises 12 companies operating in 6 production locations. We employ 635 people around the world, 425 of these in Steinach. Sales of CHF 25 million in 1996 when I took over the company have grown to about CHF 90 million over the last ten years. Profitability has kept pace with volume growth, with the EBIT margin – excluding Hartchrom Schoch GmbH – running at about 14 percent over the years, which is excellent for a company in our industry.

Widest range of products and proven technologies

In recent years we have also become technology and market leader in many areas. STI now enjoys an outstanding position in

- Paper manufacturing (all types of quality) and paper usage
- Printing of newspapers, magazines and books
- Banknote manufacture
- The packaging industry (cartons, drinks containers, packaging material, films and foils)
- The groceries industry (drinks, chocolate, powdered milk, soups, potato puree, etc)
- The textiles industry (manufacture of natural fibers, polyester fibers, gluing of layers)
- Large engines, pistons and piston rings
- Mould making and coating for deep-drawing dies in the automotive industry
- Post-it notes
- Internal coating of gun barrels
- Pipeline construction (globe valves)
- The chemicals industry (cooling coil)
- Aviation (landing gear for the Airbus and other components)
- etc.

The big difference 1

Mechanical treatment

The big difference 2

Only functional coatings

The big difference 3

We operate at the micro and nano level (Nanochrom).

The big difference 4

Within our industry we are the only total provider of mechanically treated parts combined with surface coating.

To summarize I would say that STI is extremely well prepared for the future and thus for the market and technological challenges that it faces. These challenges lie on the one hand in the introduction of thermal spray-coating technology, which will open up substantial additional market potential for STI. On the other, the move into Asian markets, especially China, is opening up an extremely important market of the future. We will develop this market independently but in cooperation with out customers. This approach allows us to expand in a financially advantageous way while at the same time reducing the associated risks.

High degree of customer loyalty

Our customers are extremely loyal to us. This means that it is extraordinarily difficult for our competitors to lure customers away from us. The printing and paper, aviation, defense technology, groceries, large engine and body making industries all provide good examples of this.

All of our coatings are always functional. This means that whether they are on rollers or cylinders for the production of paper, or on printing presses, or on rollers for the manufacture of foodstuffs such as chocolate, powdered milk and stock cubes, or used in the construction of landing gear for all Airbus aircraft, or used in the production of keep-fresh papers and bags, etc. they enable shorter down-times or longer manufacturing runs for the customer. The advantages of this to the customer are clear and measurable.

Action plan expanded and continued with the second 2007-2011 Business Plan

Initially, however, this growth requires significant investment. Within the next five years, according to our business plan, we will be investing about CHF 55 million in building up our current market position, creating new plant (buildings and real estate), opening up new markets and introducing new and forward-looking technologies. In this way we are laying the foundations for further above-average growth, which in 5 years will take STI to CHF 135 million in sales – a 60% increase on today's figure. We accept that this high level of investment in the future of the company will mean that the EBIT margin will not be as good for the next three years.

Strategic factors also led to our decision in fall 2004 to buy, restructure and expand what was then our biggest competitor, Gebr. Schoch GmbH, which was founded in 1925 and based in Stuttgart–Feuerbach. The new plant was opened on 17 November 2006 after investment in the years 2005 and 2006 of about CHF 23 million. It was important for us to have a suitably large and very modern manufacturing site in one of the most important – if not the most important – economic regions in Germany. I made the decision deliberately and used one-time write-offs of several million francs to avoid a net income of several million francs and a corresponding EBIT loss. The consequences of this decision will be apparent in the 2006 and 2007 annual results and to some extent in 2008 as well.
However, we believe that this entrepreneurial risk will pay off. There are already major synergies between the two plants in Steinach and Sternenfels-Diefenbach. We assume that by the end of the current 5-year planning period – in 2011 – the EBIT margin will be back at the 14% that STI has achieved in the past.

The AFG Board's considerations when buying this high-tech company

So what were the factors that prompted AFG's board of directors to buy STI – a high-tech company that has nothing to do with AFG's core business as Europe's leading construction supplier?

From my **perspective as the owner and CEO of STI**, I would like to reaffirm the following point:

As I have repeatedly mentioned, my idea of responsible entrepreneurship includes sorting out one's own successor in good time, and in the interests of the company, its employees and its customers. If STI is to develop successfully and build on its market successes, the group needs a new owner. As the sole shareholder of STI and operational director of the STI Group I have therefore decided to give up both of these responsibilities at the same time and thus clear the way for a new, long-term solution.

It was also clear to me that STI should not be sold to a private equity company or to a direct competitor. Both options would have been feasible, but I do not believe that either would have been in the best interests of STI. The company is in a position from which it can make another substantial leap in growth. However, as I have said, this requires a long-term business commitment. In any event, I wanted to avoid STI falling into the hands of anyone that saw the company mainly as a means to a short-term profit, or as a pawn in some other overriding strategy. Neither of these approaches would have been good for jobs or for the local economies concerned. As I mentioned at the beginning, I wanted to make a decision about STI's future now, so an IPO was also out of the question. I do not believe that STI would be ready for such a step yet.

From AFG's perspective there is a whole other set of positive prospects, for both AFG and STI:

1. Alongside the three divisions that focus on the building trade – Heating Technology and Sanitary Equipment, Kitchens and Refrigeration, and Windows and Doors – AFG is already present in the mainly technology and process-driven metals business through its Steel Technology Division. Strengthening this business by purchasing a high-tech company in the same sector is obviously a good, strategically astute move.

2. As we know from the Steel Technology Division, technology-driven activities are significantly more profitable than traditional building supplies activities. STI not only helps to increase the volume of high-tech work done by the AFG Group, but it also pushes the Group's average EBIT margin upwards.

3. The Steel Technology Division, combined with the new Surface Technologies Division will start by generating about 20 to 25% of AFG Group's consolidated sales. This will considerably reduce AFG's dependence on the performance of the construction industry. This will make AFG more attractive to investors.

4. Because STI, like AFG, generates most of its sales outside Switzerland, AFG will continue to enjoy in full the advantageous risk profile created by its geographical diversification.

5. In terms of regional policy it is important that STI's decision-making center remains in Steinach, thus ensuring that jobs are kept in the region.

6. There are no negative synergy effects (job reductions), but plenty of positive synergies can be expected in the areas of product development, procurement and further development of international markets. However, no substantial cost savings will result from the integration of STI, either at STI itself or at AFG. STI has a very lean organization, but there will be some savings from joint purchasing of energy and transportation services, as well as in IT and certain areas of procurement.

On the basis of these considerations, AFG's Board of Directors decided that the acquisition of STI and its integration into the AFG Group would be in the best interests of Arbonia-Forster-Holding as well as of STI. The acquisition is also in my personal interests precisely because the criteria that I formulated with regard to the new owner of STI have been met in full. At the same time, the Board of Directors of AFG has made it clear that this Group focus on the traditional construction supply business on the one hand an on high-tech products on the other will continue. We want to maintain and strengthen this focus.

Owing to the special circumstances created by my position as majority shareholder and CEO of both companies involved, the Board of Directors has taken special measures to ensure that decisions could be taken about the transaction without any conflicts of interest arising. As you have already heard from Board member Paul Witschi, a special committee was set up to take care of the preparation and execution of the transaction on behalf of the AFG Board of Directors.

A performance related maximum price of CHF 86.8 million has been agreed for the purchase of STI's entire share capital by AFG. I have agreed to make a substantial portion of this – CHF 24.75 million – dependent on reaching the objectives for 2011, so the guaranteed purchase price subject to the fulfillment of extensive obligations by the vendor is CHF 62 million.

The acquisition of STI by AFG is taking place with retrospective effect from January 1, 2007.

From my personal position as the seller of STI, I can confirm that this pricing structure gives due consideration to my wish to secure the future of STI as well as to my financial expectations. I believe that this solution ensures that both parties to this transaction, but also everyone else concerned - especially on the STI side – can count themselves winners.

The AFG Board has decided to fund the transaction though a temporary credit facility. The Board has not yet decided on the form of the long-term financing that will replace this.

And that brings me to the end of my presentation. The newspaper I mentioned earlier wrote a few weeks ago that "by taking over STI, AFG would be acquiring a real pearl". I - now speaking as someone with a stake in STI only though my AFG shareholding – can support this view wholeheartedly. I believe that this expansion of its technology-based business puts AFG in a much stronger position to succeed in the future.