VAT reports stable full-year 2018 results thanks to flexible business model

VAT Group reported stable results in 2018 despite a softening business environment in the second half of the year. Net sales grew significantly in the first six months, reflecting the strong market demand and customer capacity increases. Orders and sales moderated in the second half as some customers, mainly in the semiconductor-related business, postponed further capacity expansion plans. Nevertheless, VAT could build on its leading technology and market position to expand market share from 46% to 49% and report slightly higher revenues, leading to another record for net sales. At the same time, the company's ability to quickly adjust capacity across its global footprint also allowed it to maintain profitability at the same level as 2017.

Mixed market conditions in 2018 after two years of record growth

VAT's markets showed a mixed picture in 2018, with steady to higher demand in some sectors but a marked second-half slowdown in semiconductors, the company's largest end market. The semiconductor space has been characterized in recent years by intense capital spending to build new production capacity, especially for memory chips used to store data. This contributed to very strong sales growth for VAT in 2016 and 2017, increases of 24% and 36%, respectively, as well as an 18% rise in net sales in the first half of 2018. This new capacity, however, together with higher production yields in existing manufacturing facilities, led to a slight oversupply in the second half of the year. In response, semiconductor manufacturers postponed a number of capex initiatives, resulting in lower orders for new vacuum equipment.

At the same time, demand remained strong in other parts of VAT's end markets, such as logic chips used for data processing, and solar photovoltaic equipment. Technology innovations made during the last two to three years that resulted in specification wins – when customers choose VAT valve designs for their future projects – began to generate revenues in 2018. In addition, VAT continued to successfully build its general vacuum and service businesses. All of these factors allowed the company to again increase its market share and offset the second-half demand slowdown to generate slightly higher net sales for the full year.

Higher revenues in two out of three segments

Total order intake in 2018 amounted to CHF 648 million, down 12% from the previous year. The order backlog at year-end stood at CHF 114 million, a decrease of 31% compared to the end of 2017. The lower backlog reflects not only a decrease in orders but also improved customer delivery times. Net sales grew slightly, up 1% compared with 2017, to reach CHF 698 million, a new record. Currency movements had no material impact on the change in net sales.

Two out of three business segments contributed to the growth in net sales. Global Service reported a 7% year-on-year increase in net sales to CHF 106 million as a result of the successful execution of a focused service strategy. Net sales in the Industry segment rose 5% to CHF 41 million, driven by edge-welded bellows used in the semiconductor market as well as higher revenues in mechanical components and assemblies manufacturing.

Net sales in the Valves segment were impacted by lower demand in the second half of 2018 and ended the year marginally below the 2017 level at CHF 551 million.

EBITDA profitability maintained on rapid implementation of cost adjustments

Gross profit, measured as net sales minus cost of materials plus (minus) changes in inventories of finished goods and work in progress declined 3% compared with 2017 to CHF 420 million, mainly reflecting changes in inventories. As a result, the gross margin declined by about two percentage points to 60%.

Personnel expenses reflect adjustments to the slower demand in the second half of 2018, including a reduction in the number of temporary employees and a short-time work program initiated during the fourth quarter for about 400 production employees in Haag, Switzerland. At the end of 2018, VAT employed 1,712 people worldwide, a decrease of 234, or 12%, compared with the end of 2017.

EBITDA for the year improved by 1% to CHF 215 million. For the purpose of comparison, when the 2017 result is adjusted for the impact of bonus costs associated with the company's Initial Public Offering (see the "Summary of reconciliation" on page 31), VAT's EBITDA remained unchanged (as of 2018, these costs are no longer being incurred and no adjustment has been made to the 2018 result).

The EBITDA margin also rose slightly, to 30.8% from 30.6%. Compared with the adjusted 2017 EBITDA margin of 31.1%, the 2018 EBITDA margin is slightly lower.

VAT's EBIT also grew marginally to CHF 180 million, leading to an EBIT margin of 25.7%, 0.1 percentage point lower than 2017.

Below the EBIT line, VAT incurred slightly higher finance costs. Adjusted for the 2017 non-cash costs of unwinding the financing structure set up by the former private equity owners, VAT's finance costs increased from minus CHF 6 million in 2017 to minus CHF 14 million in 2018. The main reason for this increase are negative Fx effects of CHF 7 million. Reported finance net for 2018 was minus CHF 14 million, compared to minus CHF 44 million in 2017.

Net sales
in CHF million

698.1

2017 **692.4**

As a result of the substantially lower reported finance net result, earnings before taxes (EBT) increased by 24% to CHF 167 million. Income tax expenses increased in 2018, resulting in an effective tax rate of 18.5%, within the Group's expected target range of between 18% to 20%.

As a result of the positive development of operating results, lower finance net and a slightly higher effective tax rate, VAT realized net income attributable to shareholders in 2018 of CHF 136 million, an increase of 17%.

On December 31, 2018, VAT's net debt amounted to CHF 148 million, representing a leverage ratio expressed as net debt to EBITDA of 0.7 times. The equity ratio at year-end amounted to 58.3%.

Strong free cash flow improvement driven by higher cash from operating activities

One of VAT's key performance indicators is free cash flow, which in 2018 amounted to CHF 124 million, an increase of 14% compared with the previous year. This is primarily the result of a 10% increase in cash flow from operating activities. Capital expenditures of CHF 48 million were essentially unchanged compared with 2017 and included the capacity expansion in Malaysia, which was concluded on schedule and on budget. Capital expenditures in 2018 represented 6.9% of Group net sales, the same level as in 2017.

Net trade working capital increased by approximately 13% compared with 2017 and now represents about 23% of net sales. VAT aims to reduce this closer to the target level of 20% of net sales in 2019.

As a result, the free cash flow margin as a percentage of net sales was 18% and the free cash flow conversion rate was 58% of EBITDA.

At its Annual General Meeting on May 16, 2019, VAT's Board of Directors is proposing a dividend for the fiscal year ending December 31, 2018, of CHF 4.00 per share to be paid out of reserves from capital contributions. That amounts to a total dividend amount of CHF 120 million, or 100% of VAT's free cash flow to equity. This is in line with the stated dividend policy of paying up to 100% of free cash flow to equity to shareholders and reflects the company's confidence in its cash generation capabilities based on expectations of future business development and an improvement in the free cash flow conversion rate.

Summary of reconciliation

In CHF million	2018	2017	Change
Net income attributable to owners of the Company	**135.7**	**115.7**	**+17.3%**
Income tax expenses	30.8	19.0	+62.1%
Finance costs	13.6	44.5	–69.5%
Finance income	–0.4	–0.5	–18.9%
Amortization	17.7	17.1	+3.5%
Depreciation	17.9	16.4	+9.1%
EBITDA	**215.2**	**212.2**	**+1.4%**
Adjustments			
Personnel expenses[1]	–	2.9	
Adjusted EBITDA[2]	–	**215.1**	

1 IPO bonus costs. The last payments under this program were made in 2017 and therefore no corresponding adjustment has been made to the 2018 result.
2 Adjusted EBITDA is calculated as earnings before interest, taxes, depreciation and amortization excluding items that we do not consider to form part of the ongoing business of the Group. Adjusted EBITDA is not a measure of financial performance calculated in accordance with IFRS and should be viewed as a supplement to, not a substitute for, our results of operations presented in accordance with IFRS. As of 2018, VAT will no longer report an adjusted EBITDA.