Gabriel®

General meeting of Gabriel Holding A/S on 12 December 2019

Report of the Board of Directors

by Jørgen Kjær Jacobsen, Chairman

Gabriel is still thriving! The company is growing on all markets, delivers solid bottom line results and has ambition for more. Almost the same introduction as last year. It is worth repeating.

Every year I look forward to providing Gabriel's report. The 2018/19 financial year was yet another year with growth in both revenue and earnings.

At Gabriel we have the realistic ambition that the company should grow, both organically and through acquisitions that can add new potential to our core business. The ambition is realistic because we know that our major, strategic customers benefit greatly from working with Gabriel and we know that the same customers continue to offer great potential.

We acquired revenue in the year, but we are still pleased about healthy organic revenue growth of 11%! The positive development we have seen every year since the financial crisis ten years ago continues. Previously we had to start over every five years on average due to some kind of international economic crisis. A minor decline can perhaps be detected on selected markets in Gabriel's segment but our corporate model and strong organisation have the strength to ensure continued growth.

At Gabriel we dare believe this because we create our own growth. The formula is simple: Year by year, Gabriel increases its sales activities and the number of new products, enters new geographical markets and makes acquisitions where this makes sense in relation to our strategy. We apply the formula accurately and systematically, and it is working because Gabriel has a strong organisation with very able leaders and employees who execute the planned strategy.

Gabriel's strategy is twofold:

- Firstly: to be the leading supplier of furniture fabrics to the world's 70 (60) or so biggest manufacturers and distributors of contract furniture. We thereby ensure that we are growing with the largest customers, those with the greatest potential and the most financial muscle to buy others.

- Secondly: to ensure that our supplies also cover the links in the value chain from furniture fabrics onwards. Today this embraces cutting, sewing, upholstering and assembly of furniture components and sound-absorbing screen solutions.

We carry out the strategy and it is working.

At the end of the 2017/18 financial year, we had expectations that we could achieve growth in revenue of the order of 10-20% and an equivalent increase in profit before tax in the 2018/19 financial year, now closed.

However, our expected earnings were exceeded in the first six months of the financial year, and in the interim report we therefore adjusted expectations for revenue and profit before tax to the upper end of the mentioned interval. Perhaps we should have left out "the upper end", as we mentioned in the same interim report that two acquisitions would result in lower financial ratios in the second half-year.

However, earnings in the fourth quarter were negatively affected by both acquisition and structural costs as well as shifts in the product mix. The year therefore ended with total realised revenue growth of as much as 18%, to DKK 708.2 million, and an increase of 12% to DKK 62.9 million in profit before tax.

Operating profit (EBIT) increased by 13% to DKK 61.9 million, and the operating margin was 8.7% (9.2%).

Profit after tax increased by 11% to DKK 49.0 million.

The Board of Directors finds the development for the year in both revenue and operating earnings satisfactory, considering the acquisition of a textile manufacturer in Lithuania and an upholstery business in Mexico in the 2018/19 financial year, and that the establishment and development of the organisation continues in the USA where, as expected, no profit has yet been earned from operations.

The Group's initiatives and investments in a number of key areas increased again in 2018/19.

We are maintaining our growth formula and strategy of continuously increasing our initiatives. Doing more of what is working. I make special mention of the following:

1. In October 2018, all of Gabriel's global sales units participated in Europe's largest contract furniture fair, Orgatec, in Cologne. New products were introduced and it remains an established fact that Gabriel continues to have a strong brand and influence on the international market for contract furniture.

2. In 2018/19, DKK 17.7 million (15.0) was invested in product development. Ten new fabrics were launched and two existing products updated. FurnMaster and Screen Solutions developed and produced new products directly for, and in partnership with, strategic customers.

3. Considerations relating to generational change in our long-standing Lithuanian weaving partner BTC and Gabriel's desire to ensure continued high quality, high reliability of supply and constant competitiveness led to the signing of an agreement in February for the acquisition of the entire share capital of BTC. The acquisition of BTC, including the weaving mill and production of samples, contributed external revenue of EUR 2 million and profit of around EUR 0.2 million. The price for the shares was EUR 4 million.

   In the years 1998 to 2003, Gabriel relocated machinery and equipment from the weaving mill in Aalborg, which was subsequently closed. The lack of specialised labour in Denmark, lower operating costs in Lithuania and the strategy of concentrating and expanding our own initiatives in sales and product development were the reasons for the decision at the time.

   The weaving mill Baltijos Tekstilė (BTC) became our good strategic partner. This co-operation proved so successful that we also saw advantages in outsourcing the production of samples and sales materials in the SampleMaster business unit from Aalborg to BTC.

4. Acquisition of the Mexican furniture manufacturer Grupo RYL followed in April this year. The acquisition was the result of an active search for a Mexican production partner who will primarily be serving Gabriel's big American industrial customers, who number most of the world's biggest manufacturers of contract furniture.

RYL is a well-established upholstery factory with revenue of USD 8 million in 2018 and a loss before tax of USD 1.2 million. The company was taken over for USD 0.8 million, and debts to the previous owners of USD 3 million were taken over. In Gabriel's interim report in May, management expected revenue of approximately DKK 20 million and a loss before tax of DKK 2 million from RYL, which on the whole proved to be the outcome.

Management considers the acquisition of RYL an important element in the effort to increase our competitiveness, growth and future earnings on the North American market.

5. In February this year, Gabriel participated in the Scandinavian furniture fair in Stockholm and introduced new products – including products from the acquired company Screen Solutions. The response was definite and positive.

6. During the year, sales offices were opened in Barcelona in Spain and in Milan in Italy. In addition, sales activities increased in the sales offices in Aalborg, Beijing, Singapore, Bangkok, Grand Rapids, Stockholm, Paris, London and Bingen near Frankfurt.

7. An average of 117 employees were employed in sales and product development as against 102 in the previous year. Sales and development employees account for 69% of total staff costs, as against 66% last year.

8. Gabriel's distribution centres in England, Detroit and Shanghai are continuously expanding to offer a selection of Gabriel's product range targeted to the individual markets.

9. Events shortly after the end of the financial year on 30.09.2019 which may in due course have an impact on our continued growth include the signing in November of an interim share purchase agreement on the acquisition of the share capital of the German manufacturer of textile solutions, Visiotex. Visiotex GmbH is recognised in the furniture industry for its innovative textile solutions. The patented Wovenit technology makes it possible to design and produce textile solutions with built-in functionality in one process, without any subsequent cutting and sewing. More information will be provided on this acquisition if and when the transaction is completed.

Thus there should be good reason to believe that Gabriel will continue to deliver revenue and earnings growth in the future. The Group has the structure, skills and capital required to maintain high growth, and the necessary efforts are made every year.

Gabriel's core processes and self-improving management processes are being maintained.
The management and Board of Directors have specific strategic goals and indicators that show whether their set strategy is being achieved. The approach is systematic and keeps the management up to date on whether planned strategic activities are being performed – with ever-increasing productivity.

The development in revenue potential for Gabriel's 70 or so strategic global customers who use and need contract furniture fabrics, upholstery processes, final assembly of large batches of contract furniture, and sound-absorbing screens and room dividers is also monitored. The potential has been increasing in the financial year, mainly as a result of a strengthened position on the European market and continued development in the potential in the USA and Asia.

We focus below on the financial results we achieved in 2018/19.

Gabriel published its annual report on 14 November 2019, when it was also published on the company's website. The printed version is now also available.

- Annual Report 2018/19
- The CSR Report 2018/19, which is also interesting reading this year, is available at www.gabriel.dk.

Gabriel's CSR report is interesting reading. Among other things, readers can see how many years' efforts have resulted in Gabriel becoming CO_2 neutral and how we work with the UN's Sustainable Development Goals. More information about this can be obtained after our general meeting when we meet in Gabriel's showroom.

Productivity

Our efforts to effect constant improvements in productivity, measured as the relationship between gross profit and costs, are central to the way in which the company is developing.

As indicated in the slide shown, the key figure for staff costs remained unchanged compared to last year at DKK 2.5. The Group employed an average of 855 employees during the year against 518 last year. At the end of the year, the number was 1,126 (550), 879 of whom work in production, 155 in sales and development and 92 in the administration.

The key figure for other external costs was, as expected, affected negatively by acquisition costs in connection with the acquisition of BTC and RYL. The relative value added in 2018/19 via staff costs was unchanged. The increase in staff costs was precisely the same as that of the total gross profit, 19%. On the other hand, other external costs increased by 26%, and the figures were primarily affected by the acquisition costs of the two acquisitions – as was the EBIT margin, which was 8.7% (9.2%). A negative effect on financial ratios is to be expected in connection with investments and acquisitions which are intended to strengthen our competitiveness and growth potential in the longer term.

We maintain our goal of an increasing EBIT margin as one of the Group's overall financial goals. This goal was not achieved in 2018/19. Gross margin increased from 39.5% to 40.1%, and gross profit increased by 19%, so with two acquisitions we are not complaining that the increase in operating profit was "only" 13%.

Our vulnerable point is the increase in the working capital. The main reason is that the activities of FurnMaster also increased considerably in 2018/19. This affected our working capital, which increased by 23% to DKK 166.3 million. The corporate model in FurnMaster activities means that Gabriel takes over parts of the customers' inventories. The financial ratio for gross profit relative to working capital was DKK 1.7 per DKK 1 in working capital, against DKK 1.8 last year. We are working constantly to improve this situation.

Sales promotion

Key Account Management (KAM) is a core process at Gabriel. Investments in the KAM process have a clear payback period and they increase the potential in all business units.

The KAM team initiatives are accurately measured relative to the performance indicators – also referred to as KPI goals – specified for the area. Once again, an excellent, targeted effort was made with an increasing and fine fulfilment of the goals in 2017/18. Again, there was a productivity rise in sales promotion.

The sales manager is constantly attempting to find new ways of improving the impact of the initiatives, both directly in relation to selected strategic customers and indirectly in relation to their branches, dealers and specifying levels. The year's growth in revenue, which comes from all markets and all product areas, shows that the KAM process is being executed effectively in close and systematic interaction with Gabriel's other core processes, i.e. the logistics process and the process and production innovation processes.

A continued increase in the sales organisation on different markets is planned for the 2019/20 financial year.

Product development

Gabriel launched ten new main products on the world market in 2018/19. There are constantly new products in the various development phases, which are primarily coordinated and aligned with strategic customers. This increases the accuracy and the speed at which new products are launched. The penetration time for new products and components in the market is quite long, as we are faced with different requirements for documentation and no less with habits. But the advantage is that a well-distributed furniture fabric for contract furniture generates a good continuous and long-term return. We used to say that it was like placing money in the bank at negative interest rates. We have stopped saying that.

At the general meeting in 2018 we mentioned that a global patent had been obtained in the category "product innovation with longer development times". The patent is for a technical fibre material for use as insulation and sound-proofing. It has been on the way for many years and was developed in partnership with another Danish company supplying markets other than Gabriel's. Unfortunately, the product failed the final and conclusive tests. The capitalised development costs have been amortised and have been taken out of our portfolio in the pipeline. That was that. The possibility of substantial gains usually goes hand in hand with a high risk of loss.

Our own requirement for the product portfolio is that over 30% of revenue should derive from products younger than five years. New products accounted for 20% in 2018/19. The failure to reach our target is primarily due to the fact that two of the Group's main product series crossed the age limit for "new" products and that new products launched in the period have not fully taken over a big share of revenue. This is not a sign that dangers are lurking in the short term, but it is a yellow flashing light that requires a constant and systematic effort and the management's full attention.

After the general meeting, you are all welcome to see samples of our new products here in Gabriel's showroom.

Income statement and statement of financial position

The company's auditor will discuss the most important items in the accounts under the next point on the agenda.

But, first, we should compare the actual results for the year with Gabriel's general financial targets.

Gabriel aims to achieve

- A return on invested capital (ROIC) of at least 15% (22.7%) before tax
- An increase in operating margin (EBIT margin) – down this year to 8.7% from 9.2%
- An average increase in earnings per share of at least 15% (12.6%), and
- An average increase in revenue of at least 15% (17.8%).

In a year in which we bought two strategically decisive manufacturing businesses in Lithuania and Mexico respectively, the Board of Directors is fully satisfied with the goal achievement in 2018/19.

Property portfolio: The saga continues

As last year's report of the Board of Directors stated, the 2018/19 financial year was only 12 days old when management signed a letter of intent with the pension group PenSam on 12 October 2018. The total sale price was DKK 150 million, from which interest-bearing debt and deferred tax of Gabriel Ejendomme A/S had to be subtracted. The transaction was expected to take place around 1 April 2020 since the deal was conditional on the municipality's approval of a new local plan.

On 7 February 2019, we unfortunately had to announce that PenSam required a price reduction. However, Gabriel's Board of Directors and management found no reason for acceding to this requirement and therefore chose to withdraw from the conditional deal.

The part of the property not being used by Gabriel has a full complement of tenants and operation of the property has almost no effect on earnings.

The Group's operation is developing positively with good cash flows and sufficient capital resources to implement the Group's strategy – even without a capital injection from the sale of the property.

On this basis, management decided to put the sale of the subsidiary Gabriel Ejendomme A/S on hold.

Enough about property for this round, and we cannot guarantee that there will not be a new instalment in this ongoing saga.

Increasing dividends again this year

With an equity ratio of 50%, a continuing satisfactory cash flow and good capital resources, the Board of Directors finds it responsible and appropriate to propose an increase in dividend to DKK 10.50 per share, equivalent to a pay-out ratio of 41% – the same level as in the last few years when there has been strong growth in earnings. The dividend has thus almost doubled in five years.

Gabriel's market price closed at 712 at the end of the financial year, compared to 608 at the same time in the previous year. However, around noon today, Gabriel's share price had increased to 814.

The remuneration of Gabriel's directors and committee members was last adjusted in 2016 with effect for the 2016/17 financial year. It was unchanged in the 2017/18 and 2018/19 financial years and the Board of Directors also proposes that the remuneration of directors and committee members remains unchanged at around DKK 1.1 million for the 2019/20 financial year.

Summary of 2018/19

- Gabriel realised organic revenue growth of 18%.
- Operating profit (EBIT) increased by 13%.
- Gabriel executed its strategy and performed all its planned increases in development and sales activities.
- There was revenue growth on all markets.
- Gabriel's global structure with three axes (America, Europe, Asia) was further expanded and consolidated.
- Dividend increased by 11% to DKK 10.50 per share.
- Gabriel's share price increased by 17% to 712 in the financial year and is now 814.

- In the 2019/20 financial year management expects revenue growth of the order of 15-20% and an increase in earnings of the order of 10-15%.
  It should be noted in this connection that Gabriel's sales are today structured far more as project sales. This always makes it difficult to forecast the future revenue for given periods, i.e. quarters, half-year and full-year periods.

The Gabriel fruit tree has grown and stands firm in good soil and a reasonable climate. It has been cared for with a view to ensuring a good new harvest in the current 2019/20 financial year and the years that follow.

Against this background, I offer a big thank you to all employees, managers and the executive board for their hard work. I would also like to thank my colleagues on the Board of Directors for their fine and constructive teamwork.

With these words I conclude the report of the Board of Directors. Once again I am very pleased with the past year, in which Gabriel again delivered a fine result and invested in the future by increasing its initiatives.