

Saft Groupe SA (05/01/2015)

2% of the fund's capital is invested in Saft Groupe SA (Saft).

The fund bought this position during June and July 2012 at €18.44.

Saft is a French based industrial battery manufacturer with an enterprise value of around €700 million.¹ We do not have a natural affinity towards investing in small cap French or industrial battery companies. However, we were able to get past these biases given Saft's long operating history, strong cash generation and dominant leadership positions in various high end niche industrial battery applications.

Saft has been producing batteries for almost 100 years, beginning with production of nickel-based batteries in 1918. The business was acquired by private equity from Alcatel in 2004, leveraged and then exited through an initial public offering in 2005 at an enterprise value of €830 million.

Saft's primary battery chemistries are Nickel Cadmium, Primary Lithium and more recently Lithium Ion.

We do not expect Saft to build a world-beating, mass market car battery, in fact it would scare us if they were pursuing this goal. We regard these obvious mass market battery applications as a race to the bottom activity that is highly susceptible to commoditisation.²

Since Saft's IPO in 2005 the business has consistently generated a pre interest and tax cash coupon of around €70 million per annum. This amount has ebbed and flowed a bit but has been reasonably stable in the context of the macro environment. While there has been no consistent earnings growth the business has a history of generating strong cashflow. This was initially used to pay down the private equity inspired debt burden and then in the latter years towards funding a new Lithium Ion production facility in Jacksonville, Florida. Saft's cash generation contrasts to a number of other

¹ We have maintained an interest in the economics of the battery space as an adjunct to our focus on the utility sector where batteries are increasingly being used to manage and time shift electricity demand and supply. In 2011 we spent some time sorting through investment opportunities directly in the battery space and this led us to Saft.

² Saft did have a joint venture with Johnson Controls Inc which was established in 2006 with the intention of using Saft's battery IP to develop and manufacture lithium ion batteries for the automotive sector. Saft sold their 49% interest in the JV back to Johnson Controls in September 2011. Saft then spent some further time reviewing the automotive opportunity but at the end of the first half of 2012 they dramatically narrowed the company's focus to limited areas in the space, seemingly being of the view there were niches that were interesting but the risk reward did not line up investing in the broader opportunity. We were encouraged that they would back away from this space given the broad interest from the media and investment community. This discipline reflected well on the company's internal culture.

listed battery companies that seem to be developing technology, selling nothing and burning lots of cash.

We spent considerable time trying to understand the business and what enabled the cash generation. The key characteristics include:

- Intellectual property in the battery chemistry and battery manufacturing / production space;
- Research and development significantly funded by external customers for specific applications;
- Some brand value from delivering a reliable, high quality product. As one customer commented to us, “Saft batteries tend to be more expensive but you get what you pay for”;
- History and reputation pre qualify Saft as a supplier to multinational original equipment manufacturers; and
- Business focused on various niches. The majority of revenue comes from activities where Saft holds the market leadership position and purpose built battery systems that have been designed by Saft.

One of the applications Saft dominates is aircraft batteries. Saft supply 100% of Airbus’ batteries and the majority of Boeing’s batteries. As was evident by the problems Boeing had with the Dreamliner battery system (supplied by GS Yuasa Corp), there are applications where the performance of the battery is vital.

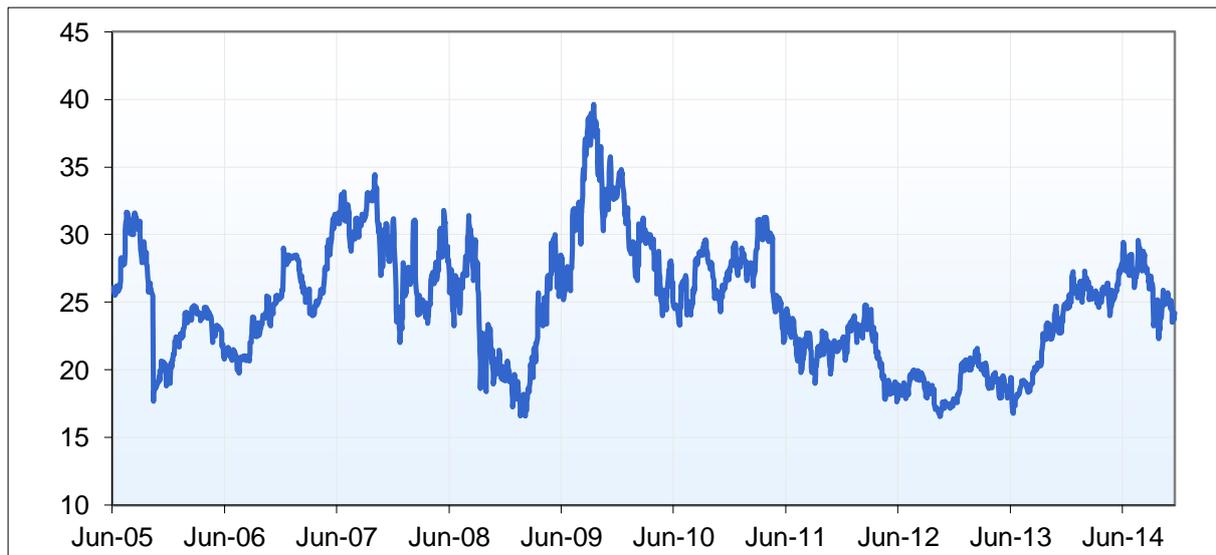
We felt there were some highly attractive characteristics regarding the activities, customer base and positioning of the business. There is reasonable confirmation of these activities in the financial results of the company. There is also confirmation of their IP in the applications and market positions Saft holds across various industries.

In 2010, Saft commenced the construction of a Lithium Ion battery production plant in Jacksonville, Florida. The cost of the plant was approximately US\$200 million, US\$95 million of which was funded by various government grants. The first batteries were produced in 2012 and the majority of the capex was completed by 2013. The sales of Saft lithium ion batteries from the Jacksonville plant are steadily ramping up. While the plant will run at a loss in 2014, management expect volumes will build to achieve a close to breakeven financial result in 2015. Given the nature of the economics of the manufacturing process, incremental sales above the breakeven point are highly cash generative.

In November 2014 Saft held an investor day in Jacksonville to give investors a better sense of the plant and the business more broadly. This provided us the opportunity to access a wide range of management, tour the facility and obtain more detail around some of the newer activities.

Today Saft’s enterprise value is approximately €720 million. We expect Saft’s existing business that currently generates around €70 million in cashflow (including the small loss for Jacksonville) will grow at mid single digits per year. In addition, we expect they will get an adequate economic return from the US\$200 million invested in the Jacksonville plant. Moreover, their reputation, brand and activity in the battery space positions them well to participate in new and growing battery applications. While these contributions will be lumpy and we don’t have any real transparency or expectation regarding the timing, they have the potential to make a meaningful contribution over time.

Below is a chart of Saft's share price since the IPO in 2005.



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