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## A year to forget

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|---|---|
| **Company/ASX Code** | Sigma Healthcare/SIG |
| **AGM date** | 11am Wednesday 15 May 2019 |
| **Time and location** | The Event Centre, 727 Collins St Melbourne |
| **Registry** | Link Market Services |
| **Webcast** | TBA |
| **Poll or show of hands** | Poll on all items |
| **Monitor** | Mike Robey |
| **Pre AGM Meeting?** | Yes, with Chair Brian Jamieson, Corporate Affairs Manager Gary Woodford, and Non Executive Director David Bayes. |

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| **Item 1** | **Chairman's Address and Presentation by the Managing Director and Chief Executive Officer** |
| **ASA Vote** | No vote required |

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|---|---|
| **Item 2** | **Financial Statements and reports** |
| **ASA Vote** | No vote required |

**Summary of ASA Position**

This year has been extremely challenging for Sigma, whose main business is the distribution of pharmaceuticals to chemist practices throughout Australia. They confirmed that they will part ways with their largest customer, MyChemist/Chemist Warehouse (MC/CW), after a very public legal case for breach of contract. They also rejected a bid for control of their business received in December 2018 from a competitor, Australian Pharmaceutical Industries Ltd. Concurrent with this has been an attempt to poach their top talent. The share price as a consequence sits near historical lows. The reason Sigma gives for rejecting the API bid is that it significantly undervalues the $100m in savings they have in their plan, which come largely from the consolidation of their warehousing into new purpose built state-of-the-art Distribution Centres in QLD, WA, NSW and SA. This project, called project Pivot, completes in fourth quarter 2019. The Chemist Warehouse contract finishes in June 2019, after settlement of a legal case brought by Sigma, so the revenue in the coming Financial Year will fall considerably. In effect Sigma is a smaller business, with a short-term large increase in debt, in order to service their capital program, and now requires even fewer staff. Sigma had already started along a path of diversification, to reduce its dependence upon the Government PBS drug margins, which continue to be squeezed. In 2017 they purchased a drug dosing company called MPS which reliably packages all the daily drug needs for a range of aged care and community pharmacy customers, which is progressing well. In addition they have direct to hospital services. Sales revenue was down 2.9% to $3.98b and reported earnings before interest, tax, depreciation and amortisation (EBITDA) was down 17.5% (underlying down 15.6%) on the prior period, to $76.5m and reported net profit after tax (NPAT) down 33.7% (underlying 22.7%) to $36.5m. These underlying numbers account for both the increased costs of running both the new and soon to be redundant warehouses side-by-side, as well as restructuring costs, so the underlying financials (as shown above in brackets) are not as bleak.

**Summary**

| (As at FYE) | **2019** | **2018** | **2017** | **2016** | **2015** |
|---|---|---|---|---|---|
| NPAT ($m) | 36.5 | 55.0 | 60.8 | 59.2 | 53.0 |
| UPAT ($m) | 46.3 | 55.0 | 60.8 | 59.2 | 53.0 |
| Share price ($) | 0.577 | 0.904 | 1.246 | 0.819 | 0.765 |
| Dividend (cents) | 4.0 | 5.5 | 5.5 | 5.0 | 2.0 |
| TSR (%) | (35.9) | (21.2) | 61.7 | 16.4 | 26.2 |
| EPS (cents) | 4.6 | 5.7 | 6.1 | 5.4 | 4.8 |
| CEO total remuneration actual ($m) [1] | 1.327 | 1.347 | 2.325 | 2.394 | 2.483 |
| CEO total remuneration ($m) [2] | 2.244 | 2.496 | 3.327 | 3.459 | 2.502 |

[1]excludes unexercised vested shares

[2] includes value of share based options

For 2019 the CEO's total remuneration was **26** times the Australian Full time Adult Average Weekly Total Earnings based on November 2018 ABS data.

| **Item 3** | **Remuneration Report** |
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| **ASA Vote** | **For** |

**Summary of ASA Position**

Once again this year the key management personnel (KMPs) forwent the bulk of any short-term incentives (STI), due to the MC/CW litigation, so the remuneration outcomes were well below the target level. The former long-term incentive (LTI) plan comprised loan funded shares granted during the year calculated using fair value, which was one of the reasons we opposed the remuneration report last year. Only 2.5% of the STI was paid this year to the CEO, for achieving the safety targets and none to the other KMP. The LTI loan funded share structure was 50:50 return on invested capital (ROIC) and total shareholder return (TSR), and due to the negative TSR, 50% was forfeited. The ROIC reached 15.4% against a target of 15%, so this portion of the LTI was granted. We do not oppose the granting of these shares, since they fall under the legacy plan.

Sigma has signalled changes to both the STI and LTI plans for the future two years, in part to exit the fair value structure but mostly in order to retain key executives who have foregone target STIs in the past two years, due to the business disruption. Sigma explained that key senior executives have been targeted by competitors, and they propose an augmented short term STI structure which rewards them if the Project Pivot savings are achieved and if they remain employed. It will be as follows:

**STI FY2019 (proposal, applies in next two financial years)**

1. An additional performance rights equity plan, 50% vesting in 2019/2020, with the remaining 50% vesting in 2020/2021. The maximum reward is 60% of fixed remuneration for the CEO and 40% for CFO. This is contingent upon reaching the Pivot plan savings outcomes.
2. A cash payment, subject to continued employment, split 50:50 over the same two years. Quantum 100% fixed remuneration for CEO and 75% for CFO.
3. An at-risk component as per prior years (which has not vested for 2 years now)

The additional STI component is against the ASA guidelines, since it is a form of retention payment. We had been advised by the Chair that there had been direct poaching attempts on a number of the senior executives in the wake of the failed takeover bid by API, so retention of key staff is a pressing issue for this company at this stage of its transformation. In addition, we understand that the CEO, who is a large stock holder was all in favour of rejecting the API bid, despite the significant reduction in share price (and thus approx $3m reduction in value his equity), since like the Board, he believed it had not accounted for the savings from Project Pivot. Given the drought in STIs for two years, despite delivering in large part on the business efficiency outcomes for transformation of the warehousing, we will make an exception to this guideline and support these one-off and unusual incentives. Sigma needs to focus on delivering the savings from Project Pivot.

In summary, we support the remuneration report.

| **Item 4.1** | **Re-election of Mr Brian Jamieson as a Director** |
|---|---|
| **ASA Vote** | **For** |

**Summary of ASA Position**

Mr Jamieson has been a Director of Sigma since 2006 and Chair since 2010, so by ASA guidelines can no longer be considered independent since he has already served more than 12 years as a Director. He has advised that he wishes to be reappointed and will possibly stand down before the three year term is completed, but after the company has stabilised from the recent challenges. He has already recently stood down from the Chair role at Mesoblast Ltd, but retains directorships at Highfield Resources Ltd and The Bionics Institute. We support his reappointment on the grounds of maintaining stability and, as part of an orderly succession plan, expect him to announce a lead independent Director in the near future. Mr Jamieson owns 866,000 shares in Sigma, so has adequate skin in the game.

| Item 4.2 | Re-election of Mr David Manuel as a Director |
|---|---|
| **ASA Vote** | **For** |

**Summary of ASA Position**

Mr Manuel has been a Sigma Board member since 2009 and is a Director of Black Swan Healthcare Ltd, a Perth based health services company. He brings a strong background in community Pharmacy and is currently the WA representative of Amcal Guardian Council. Whilst his association with Amcal Guardian makes him a customer of Sigma, the terms of the trade in services from Sigma have always been under normal commercial arrangements. We consider the benefits of having an experienced pharmacist on the Board to be of value to Sigma and do not see any conflict of interest in his re-election. He owns 240,000 shares in Sigma, so has adequate skin in the game.

Sigma has a board which broadly follows the ASA guidelines for diversity with 2 women of 7 Directors

The individual (or their associates) involved in the preparation of this voting intention has no shareholding in this company.