Australian Shareholders' Association

Australian Shareholders' Association Limited
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David eats Goliath, or is it vice-versa?

Company/ASX Code	Sigma Healthcare/SIG
AGM time and date	Thursday, 30 May 2024 at 2pm
Location	25 Collins St Melbourne, Sofitel, and online
Registry	Link Market Services
Type of meeting	Hybrid
Monitor	Mike Robey
Pre-AGM Meeting	With the Chairman Mr Michael Sammells and Investor Relations Executive Gary Woodford

Monitor Shareholding: the individual involved in the preparation of this voting intention has no shareholding in this company.

1. How we intend to vote

No.	Resolution description	
2	Financial Statements and Reports	No vote required
3	Remuneration report	Against
4.1	Re-election of Mr Michael Sammells as Director	For
4.2	Re-election of Dr. Christopher Roberts as Director	Undecided
5.1	Item 5.1 – Grant of rights to Managing Director and Chief Executive Officer under new 2024 Long Term Incentive Plan (LTIP)	Against
5.2	Grant of rights to Managing Director and Chief Executive Officer Rights under the Company's Short Term Incentive Deferral Rights Plan (STIP)	Against
5.3	Potential retirement benefits to Managing Director and Chief Executive Officer	Against

2. Summary of Issues and Voting Intentions for AGM/EGM

- Sigma announced in December 2023 an intention to merge with the private Chemist Warehouse Group (CWG). This was an unusual structure in which Sigma would acquire CWG for $700m in cash and 85.75% of shares in the merged company, subject to regulatory approval. If it goes ahead this merger will take Sigma from a market capitalisation of about $800m to about $9bn. Its effectively a way for CWG to go public, without using an IPO by folding into a listed pharmaceutical supplier. They had a successful capital raising of $400m concurrent with this announcement, underwritten by Sigma's largest shareholder (@19.1%) HMC Capital Ltd. Underwriting by the largest shareholder also denied the brokers the opportunity for the usual fat fees charged for such deals; a bonus for shareholders. The capital raising was not the preferred renounceable type we strongly prefer, which led to a significant number of retail shareholders being diluted. The new shares issued amounted to 54.1% of the existing share count. The equity raising was needed to fund stock for a new 5-year supply contract with CWG and for future growth initiatives. The share price went from $0.68 to $1.04 (53% increase) after the announcement and has tracked up to $1.22 at the time of writing. It had traded between $0.50 and $0.70 for the prior 5 years. The pharmacy guild has objected to the merger.

- This merger has cast the spotlight onto the multi-fold increase in Sigma and is subject to regulatory approval. Interest in the company is now mostly directed towards if and how it will operate in the greatly expanded new structure, where retail shareholders account for only 14.25% of the stock.

- Sigma has not been fully monitored by the ASA in the past 2 years as its market value declined, taking shareholder interest with it. The CWG acquisition propels it to the largest Chemist chain in the country, which will attract much larger retail interest. It was also included this month in the S & P/ASX 200 index. We have had no issues with Sigma Healthcare but note the irony of the current CWG deal. In 2017, Sigma commenced legal proceeding against CWG over a supply contract breach, which left Sigma with excess warehouse stock. This led to a reduction in EBIT of $5 to $10m in that year and to a sour taste in the mouth of Sigma shareholders. It was a salutary lesson in having a single dominant customer with apparent scant regard for contract responsibilities.

See ASA Voting guidelines and Investment Glossary for definitions.

3. Matters Considered

Accounts and reports

Financial performance

(As at FYE)	**2024**	**2023**	**2022**	**2021**	**2020**
NPAT ($m)	4.51	1.81	(7.24)	59.76	(12.33)
UPAT ($m)				29.09	12.45
Share price ($)	0.963	0.607	0.468	0.684	0.586
Dividend (cents)	1.0	1.0	1.5	2.0	0.0
Simple TSR (%)	70.3	45.0	(29.5)	10.0	17.3
EPS (cents)	0.40	0.20	(0.7)	6.1	(1.3)
CEO total remuneration, actual ($m)	3.384	3.150	1.440	3.893	3.911

Simple TSR is calculated by dividing (change in share price plus dividend paid during the year, excluding franking, by the share price at the start of the year.

Governance and culture

Sigma is a well-managed company with no governance issues of note.

Key events

The key event of the proposed merger occurred just before then end of their financial year and is mentioned above. In a business context, Sigma has struggled to grow for a number of years now, despite early optimism. The business is largely that of national wholesale supply of pharmaceuticals under the Federal Government Pharmaceutical benefits scheme (PBS) to a wide range of community pharmacies. These contracts are controlled by government and have been squeezed to low margin over the years. The national distribution requirements of 24hr delivery have been efficiently met by the establishment of automated large distribution hubs outside major cities. EBIT margin in 2024 was a mere 0.7% and gross margin 6.6%.

A new 5-year supply contract was struck with CWG, for supply of both fast-moving consumer goods (FMCG) and PBS pharmaceuticals, which is a significant increase in the total volume delivered by Sigma and is worth about $3B in revenue in the first year of sales (from July 2024). It will also make better use of the nine newly built distribution centres. Consideration for the contract included CWG acquiring 10.7% of the shares of Sigma.

In contrast, CWG derives about 70% of its business from the US-style drug store model, selling a range of FMCG from its stores, making it much less dependent upon prescription drug sales. As part of the marketing communications associated with this merger, CWG reported its financial performance to the market; pre-tax profit of $321m, a rise 28.6% to Dec 31 and sales increase of 9% on a per store basis, making it a power retailer in the Australian retail market.

Key board or senior management changes

There has been substantial board renewal this year, with three Director departures and two appointments.

Gerard Manuel resigned from the board mid-year. This departure triggered a late lodgement "please explain" from the ASX concerning Directors trading in shares in the company for which they work. This was apparently a timing issue and was accepted by the ASX.

Christine Bartlett resigned in Dec 2023, having been appointed in 2016.

Dr Chris Roberts was appointed Director in October 2023 and will stand for re-election at this board meeting.

Mr Neville Mitchell was appointed to the board in February 2023, and comes with a strong healthcare background.

Ms Annette Carey was appointed in April, bringing a strong background in law and logistics.

Mark Conway replaced Nigel Simonsz as CFO, who took on a role in an International private equity company.

This has left the board with only 6 Directors, of which 2 are women, but the proposed merger will add an additional two board members from CWG, as we understand it. Sigma has signed up to the 40:40:20 diversity target for its board, so we await the merged board structure with interest.

Sustainability/ESG

Sigma produces a comprehensive annual sustainability report and a mandatory modern slavery report. They state that the highly regulated nature of their business significantly reduces the chances of modern slavery issues, but we imagine that the reverse takeover by CWG will raise the likelihood of such events.

Two of the highlights of their report include the growth of women in both senior management positions (from 27 to 40%) roles executive roles (from 28 to 37.5%), the continued reduction in non-renewable energy (from 11.45 to 9.25MW p.a.) and growth in renewable energy (from 2.0 to 2.8MW p.a)

ASA focus issues (not discussed above or under remuneration report or re-election of directors)

Sigma held a capital raising during the year in order to fund the large new supply contract with CWG. This was a large non-renounceable offer and didn’t follow the ASA guideline for fairness to retail shareholders. Those who didn’t participate suffered substantial dilution.

4. Rationale for Voting Intentions

Resolution 3 - Remuneration report

The remuneration structure for future years has a clause, which states that the board will have discretion, in the event of a change of control (i.e. the planned CWG event), to determine just how much of the Long-Term Incentive (LTI) and Short-Term Incentive (STI) will vest. We have asked for clarification of these statements. ASA believes that these awards should be pro-rated given the uncertainties surrounding the merger proposal, with a process to determine if they are tracking satisfactorily against the targets.

The 2024/2025 remuneration structure has standard fixed, short-term and long-term elements, with maximum STI being 100% of fixed, and maximum LTI being 200% of fixed. LTI uses two equally weighted hurdles; earnings per share (EPS) according to a board agreed amount each year of the 3-year term, and TSR compound growth, commencing with partial vesting of 12.5% of the performance shares at 8% growth with full vesting at 12%. We are unable to support an EPS hurdle which is reset each year, since this resolution in effect becomes a blank cheque for shareholders to approve.

There are also two retention payments foreshadowed for the CEO. The first will be a bonus of $1m payable 12 months after a successful merger and the second $500K a further year later. We think these are largely unnecessary, since as the CEO of a much larger capitalised company, the

Remuneration and Nominations committee will certainly review the quantum and structure of the CEO and KMP remuneration.

Resolution 4.1 - Re-election of Mr Michael Sammells as Director

Mr Sammells was appointed in 2020 to the Sigma board and has an extensive background in the healthcare industry, having been CFO at Medicare and Healthscope. His background is tailor made for this business and he has adequate time for this position. He is an independent candidate. We support his re-election.

Resolution 4.2 - Re-election of Dr. Christopher Roberts as Director

Dr. Roberts is a nominee of the largest shareholder HMC Capital, so is not independent. He has excellent qualifications in the healthcare industry, having served as CEO at Cochlear and president of Resmed for a number of years. He has a full workload, and holds directorships at two other listed pharmaceutical companies and four unlisted companies /associations. It is unclear how much time he will be able to spend on Sigma, particularly if the merger gets complicated by regulatory or other stakeholder matters. We will seek clarification on these matters before deciding to vote.

Resolution 5.1 - Grant of rights to Managing Director and Chief Executive Officer under new 2024 Long Term Incentive Plan (LTIP)

The structure and quantum of the LTI plan is conventional; however, 50% of the performance rights will be allocated to an EPS measure, which is set annually by the board, with no shareholder transparency. We will therefore vote against this unless the EPS hurdles are set up-front. In the event of a change of control, we would expect the possibility of a completely changed structure in any event.

Resolution 5.2 - Grant of rights to Managing Director and Chief Executive Officer Rights under the Company's Short Term Incentive Deferral Rights Plan (STIP)

This STI has a maximum 100% of fixed remuneration and a hurdle using an (unstated) Net Profit After Tax (NPAT) hurdle. It comprises 75% cash in the current year and 25% shares in the next year. In the event of a change of control (successful merger) the following year's shares will be issued. This is understandable and sensible in the current circumstances. Much like with the LTIP there is no clarity of what the NPAT hurdle is and we are being asked to support a substantial variable pay component without the means to test the fairness.

Resolution 5.3 - Potential retirement benefits to Managing Director and Chief Executive Officer

This resolution requests permission to pay termination benefits to the MD, which include the accelerated vesting of his LTI. It is unclear in the Notice of Meeting whether the full vesting will occur or a pro-rated amount. We believe this needs to be spelled out, particularly as the intended merger is in full swing. In addition, he will be entitled to a separate termination benefit of the equivalent of 12 months fixed remuneration. Whilst we understand the need to retain and motivate the CEO during the negotiations for the merger, this combined benefit is unreasonably generous.

ASA Disclaimer, commencing

Appendix 1
Remuneration framework detail

Assumes business as usual, and does not include retention or departure payments.

CEO rem. Framework for FY25	Target* $m	% of Total	Max. Opportunity $m	% of Total
Fixed Remuneration $m	1.490		1.490	25%
STI – Cash $m	No target		1.120	18.8%
STI – Equity $m	No target		0.370	6.3%
LTI $m	No Target		2.980	50%
Total $m			5.960	100%

The amounts in the table above are the amounts that are envisaged in the design of the remuneration plan. *Target remuneration is sometimes called budgeted remuneration and is what the company expects to award the CEO in an ordinary year, with deferred amounts subject to hurdles in subsequent years before vesting. Some remuneration framework set a maximum opportunity amount, but not all.