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Another annus horribilis

Company/ASX Code	Mayne Pharma/MYX
AGM date	22 November 2019
Time and location	10.00am Intercontinental Melbourne The Rialto 495 Collins Street Melbourne
Registry	Computershare Investor Services
Webcast	No
Poll or show of hands	Poll on all items
Monitor	Henry Stephens assisted by Mike Robey
Pre AGM Meeting?	Yes, with Chair Roger Corbett and Vice President Investor Relations and Communications Lisa Pendlebury

	Consideration of accounts and reports
ASA Vote	No vote required

Summary of ASA Position

Governance and culture

Non-executive director (NED) Phil Hodges retired from the Board of Directors following the previous years' AGM on 29 November 2018. A new NED has not been appointed. The company also announced on 21 October 2019 that Ron Best, another NED, will be retiring after the upcoming AGM.

Financial performance

Financial years 2018 and 2019 (FY18 and FY19) have been very challenging years for Mayne Pharma (MYX). In 2018, the company reported a substantially negative profit after tax of $133.9m due to severe price deflation in the US generics industry caused by massive consolidation of the wholesalers. This resulted in significant asset impairments ($184m), stock write-offs and restructuring expenses. Reported profit after tax declined 89% to a loss of $134m.

In May 2019 the company issued a profit downgrade highlighting competitive price pressures in the generics market, which affected key products including liothyronine (a thyroid treatment) and dofetilide (an antiarrhythmic agent used to restore a normal heart rhythm). In addition, the impact was exacerbated by wholesaler destocking, one-off failure-to-supply penalties largely emanating from third party manufacturers and shelf stock adjustments resulting from lower prices on some products. As a result, reported FY19 revenues declined 1% to $525.2m, reported earnings before interest, taxes, depreciation and amortisation (EBITDA) declined 4% to $111.6m and reported net loss was substantially worse by 110% at $281m. The net loss included a large asset impairment charge of $357m which is discussed below. Underlying EBITDA slumped 20% to $131m.

On the positive side, the company's other divisions, although smaller than generics, all performed very well in FY19. Specialty Brands (SBD) revenues increased 105% to $92m and gross profit rose 113%. All products increased sales benefiting from the expansion of the dermatology sales team in 2018 with Fabior (for acne) up 54% and Doryx family (an antibiotic) up 153% in US$ terms.

Metrics Contract Services (MCS, a contract manufacturing service) sales increased 14% to $72m and gross profit was up 6%. MCS has benefited from a growing pipeline of manufacturing revenues from clients who are transferring their business into the newly built drug manufacturing facility at Greenville, USA. Metrics has added three new manufacturing clients up from one in the prior period and has gained Japanese approval to develop and manufacture a product at Greenville, the first international drug approval for the site. Mayne Pharma International sales rose 10% and gross profit increased 25% due to growing sales of Suba-itraconazole and Kapanol globally and new third-party contract development revenues.

Key events

In response to the changes within the US generics industry – the industry has consolidated from 30 wholesalers down to 3 in only two years and prices have fallen considerably - the board undertook a major analysis of the company's intangible assets after reviewing the future of the generics industry and wrote off $352m of intangible generic assets (in line with US peers). The company has streamlined its generic development activities, starting to rely less on generics for its business by abandoning non-viable projects and focusing on hard-to-copy product development opportunities in dermatology, women's health and infectious disease. It is now offering complementary branded and generic products in each of these categories. In the future, the board expects that generics will contribute significantly less than the current 60% of revenues.

Revenues for the generic products division declined 17% to $321m and gross profit declined 7% to A$165m (US$ down 14%) resulting from competitive pressure on key products. Dofetilide sales declined more than 80% to US$13m driven by new competitors entering the market which led to pricing pressure; market share loss and shelf stock adjustments.

MYX's women's health portfolio covers about 50% of the gynaecologist's prescription needs in the oral contraception and the pipeline includes the largest contraceptive product sold in the US – generic Nuvaring (a plastic vaginal ring with slow release female hormones) which is pending with the US Food and Drug Administration (FDA). The company is strongly focused on lowering its women's health cost base and approximately US$15 million of annual cost savings are expected to be realised with the majority of these savings expected in FY21. In terms of dermatology, the launch of Lexette in early 2019 is expected to be a key growth driver in the US$600 million corticosteroid market which is the cornerstone treatment for plaque psoriasis patients. In the infectious disease space, the company launched Tolsura (an anti-fungal treatment) in February and expects sales to grow strongly in FY20 and beyond.

Summary

(As at FYE)	2019	2018	2017	2016	2015
NPAT ($m)	(280.8)	(133.9)	88.6	37.4	7.7
UPAT ($m)	14.1	58.7			
Share price ($)	0.51	0.87	1.08	1.90	0.98
Dividend (cents)	0	0	0	0	0
TSR (%)	(41%)				
EPS (cents)	(19.04)	(9.16)	6.18	4.77	1.18
CEO total remuneration, actual ($m)	$1.47*	$1.17*			

*Excludes LTI (the LTI had no value due to the decline in the stock price and at 52 cents was not in the money)

For FY19 the CEO's total actual remuneration was **16.7 times** the Australian Full time Adult Average Weekly Total Earnings (based on May 2019 data from the Australian Bureau of Statistics).

Note - For May 2019, the Full-time adult average weekly total earnings (annualised) was $88,145 (http://www.abs.gov.au/ausstats/abs@.nsf/mf/6302.0, "Full-time adult average weekly total earnings", Trend(a)).

Resolution 1	**Re-election of Mr Bruce Mathieson as a Director**
ASA Vote	**Against**

Summary of ASA Position

Bruce Mathieson was formerly CEO of the ALH Group, a joint venture between Woolworths and the Mathieson family, and Australia's biggest hotel and pub operator. He is a self-made businessman and owns 25% of ALH. The ALH Group owns 325 hotels and 520 retail outlets across Australia and employs more than 16,000 staff. He is also a founder of Mayne Health and has almost 100m shares equal to a 6.2% of the company's capital and was appointed in 2007.

In our discussions with the Chair, we were advised that Mr Mathieson is a shrewd businessman and always has something relevant to say at board meetings. Although we do not doubt Mr Mathieson's business skills, the ASA believes that we should take this opportunity to further renew, diversify and prod the board to move in line with both the ASA and the Australian Institute of Company Directors target of at least 30% female directors.

Given that MYX also operate in the USA, they have the opportunity to select Directors from both Australia and the USA. Currently the board has only one female board member out of 9 directors. We had alerted MYX of this lack of diversity at last year's AGM and so far, there has been no progress. The ASA also notes that Mr Mathieson has been on the board for 12 years, and therefore, we can no longer regard him as being an independent director. Of the 8 remaining board members after the retirement of Ron Best, two have tenure of ten years or more and one is the Managing Director, so while there is a majority (5) independent board members we consider independent, the next longest director appointment of 2010 means that majority will fade next year. We will vote against Mr Mathieson's re-election on the basis of encouraging board renewal and address the lack of diversity.

Resolution 2	**Re-election of Professor Bruce Robinson, AM as a Director**
ASA Vote	**For**

Summary of ASA Position

Professor Robinson has been an independent director of the company since August 2014. The ASA supports his re-election as he brings to the board valuable medical knowledge; he understands medical research and is the only qualified medical doctor on the board. Professor Robinson is a practising endocrinologist and he has previously led the Cancer Genetics Unit at Sydney's Royal North Shore Hospital. He is a non-executive director of two publicly listed companies: Cochlear Ltd and MYX and one private company QBiotics Group Limited. He is also Chair of the National Health and Medical Research Council and Chair of the Medical Benefits Review Taskforce. Normally the ASA would vote against a director with this many directorships and two chairman roles (note: these chair roles are paid positions); however, we have been advised by the company that Professor Robinson's role at the Medical Benefits Review Taskforce will finish at the end of March 2020 and therefore this should ease his workload. His credentials for this business are top drawer and we support his re-election.

Item 3	**Adoption of Remuneration Report**
ASA Vote	**For**

Summary of ASA Position

MYX has adopted a remuneration scheme with a significant weighting to at-risk and long-term incentives. There is no short-term incentive scheme (STI) for MYX key management personal (KMP) and the long-term incentive (LTI or Executive Share Loan Scheme (ESLS)) is in the form of a share loan scheme over five years that only benefits executives if the share price increases. The LTI program allows the issue of shares to participants based on a percentage of fixed remuneration funded by a limited recourse, interest free loan for the sole purpose of acquiring the shares. The shares are issued annually, and the price is based on the five-day volume weighted average price. The number/proportion of shares that vest is based on the total shareholders return (TSR) over the period; 50% vesting if a TSR compound annual growth rate (CAGR) of 5% rising to 100% vesting for achievement of a TSR CAGR of 10% (see tables in the 2019 Annual Report).

Vesting occurs on a straight-line basis for performance between these two points. At the end of the vesting period, if the vesting conditions are met the LTI shares will vest and the KMP will then have until the end of the five-year term plus one month to repay the loan.

As a result of volatility in the US generics market, the stock price has declined considerably, and this is reflected in the remuneration outcomes for KMP. Since the introduction of the ESLS in FY15 (which superseded the option scheme as the new LTI), less than 7% of loan shares have vested and only 84,999 loan shares have been exercised. The total cash benefit realised to all employees from the share loan scheme for the period FY15 to FY19 has been only $80,749. Based on a share price of 51 cents at 30 June 2019, no employee's options or loan shares were in the money and could be exercised. Currently there are 102m loan shares and 1.8m options outstanding; representing a theoretical dilution at balance date of 6.6%, but the actual dilution to shareholders is zero.

The ASA requires companies to have a least two hurdles for an LTI scheme and one of them should be based on TSR which the company has adopted. Normally we would recommend, for example, statutory net profit after tax as a second hurdle but in this case, the ASA is prepared to overlook this requirement given that there is a very strong alignment between shareholder returns and remuneration to KMP and this is clearly shown when less than 7% of loan shares have vested since FY15 and currently no employee loan shares or options are in the money.

The current remuneration structure clearly works from the shareholders' perspective and at this stage of their refocus onto branded products we are prepared to overlook the lack of an additional financial target here. Furthermore, the company does not have a STI scheme that could potentially give KMP a bonus – executives rely totally on the LTI scheme for their bonus and this is directly tied to total shareholder interests. It should also be noted that MYX has executives living in the USA and these executives have to be paid a salary and benefits comparable with US citizens in similar positions. As a result, the CEO's annual ESLS participation in FY19 was increased to 200% from 150% in the previous year following a review of CEO remuneration of Australian and US comparable companies by KPMG-3dc.

CEO remuneration framework	Max. Opportunity $m	% of Total
Fixed Remuneration	1.469*	42%
LTI – ESLS (loan) LTI – PROP (performance rights)	0.800** 1.200**	58%
Total	3.469	100%

*Includes all benefits paid to the CEO including re-location (for moving to the US), living away from home allowance, medical benefits and signing on benefits.

**The maximum opportunity shown is the statutory value, whereas actual take home remuneration depends on the stock price at the time.

Resolution 4	**Issue of shares under the ESLS and Performance Rights under the PROP to the Mr Scott Richards**
ASA Vote	**For**

Summary of ASA Position

The company is seeking approval to issue shares under the ESLS and performance rights under the Performance Rights and Option Plan (PROP) employee incentive scheme to the CEO, Mr Scott Richards. It is proposed that the CEO receives an LTI equity interest equal to $2m which is 200% of his fixed annual remuneration. Furthermore, the board has recommended that the Mr Richards LTI interests be allocated between the ESLS and PROP on a 40%/60% basis which would result in an ESLS participation value of $800,000 and a PROP participation value of $1.2m.

Under the ESLS, the company grants a loan equal to 3.02 times the $800,000 participation value and the number of shares granted is determined by dividing the loan amount by the volume weighted average price of shares to be determined 30 days after the AGM (if approved). The shares vest over five years subject to the achievement of hurdles based on increases in shareholder wealth.

Once vested the shares are restricted until the loan is repaid. If the shares are valued less than the outstanding loan balance, they are forfeited in full settlement of the loan balance. Currently the CEO has received 21.4m shares under the ESLS over the last five years and at a current price of 52 cents no shares are in the money (see table in the Notice of Meeting). In other words, the CEO has not made any money to date on his LTI.

If approved, the board intends to issue the CEO with performance rights to the value of $1.2m to be allocated no later than 30 days after the AGM. Currently he does not hold any performance rights issued under the PROP. The rights are eligible for vesting over a five-year period, subject to the achievement of the specified vesting condition hurdles. The number of performance rights is determined in the same manner as the ESLS and the vesting process is the same as well. 50% of the performance rights will vest if the TSR growth rate is 5% and 100% of the rights will vest if the TSR growth rate is 10%.

The ASA supports the issue of shares and performance rights to the CEO because there is a very close relationship between shareholder returns and the remuneration of the CEO.

The individual involved in the preparation of this voting intention has a shareholding in this company.

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