



### Cursed by Chemist Warehouse. Blessed by COVID-19?

<b>Company/ASX Code</b>	Sigma Healthcare/ SIG
<b>AGM date</b>	11 May 2020
<b>Time and location</b>	Virtual, based in Melbourne
<b>Registry</b>	Link
<b>Webcast</b>	Yes
<b>Poll or show of hands</b>	Poll on all items
<b>Monitor</b>	Mike Robey assisted by Frank Thompson
<b>Pre AGM Meeting?</b>	Yes with Chair Brian Jamieson, Chair of Remuneration, David Bayes and Corporate Affairs exec Gary Woodford

Frank Thompson who was involved in the preparation of this voting intention has a shareholding in this company.

<b>Item 2</b>	<b>Consideration of accounts and reports</b>
<b>ASA Vote</b>	No vote required

#### Summary of ASA Position.

Sigma is more than half way through a restructure, called Project Pivot, triggered by the departure of its largest client My Chemist/Chemist Warehouse (MC/CW) in June 2019, which constituted 40% of its business. This involves a wide range of activities, principal of which were the consolidation of its warehousing into larger, best practice new facilities. This was to save about \$100m annually in operating expenses and they report being on target, with \$62m saving in the 2020 Financial Year. Ironically, after the end of the Financial Year they reported they had won back the consumer goods portion of the MC/CW business (but not the pharmaceuticals) so have to had to rapidly restock.

#### Financial performance

Sales were down 18.4%, mainly due to the loss of MC/CW but also affected by the ongoing pressure of margin squeeze in the Federal Government's PBS reform. There were some offsetting increases in sales in non-regulated areas such as its direct sales to hospitals and a Department of Defence supply contract.

All key financial measures are well down year-on-year. NPAT is down from +\$36.5M to (-\$12.3M) (underlying +\$46.3 to +\$12.6M), EBITDA +\$76.5 to +\$24.2M (underlying +\$90.5 to +\$48.1M).

Sigma dividends were also down from 4c to 3c from the prior year.

### **Key events**

Sigma has in recent years morphed into a specialised pharmaceuticals logistics company, from its roots as a producer of simple household potions. As mentioned, Sigma started project Pivot to modernise and consolidate its warehousing, reduce labour and increase efficiency of its logistics business. The target \$100M in annual opex savings seems to be on track, with the expectation that it will be largely complete by the end of the current 2021 FY.

One key event was the win-back of the FMCG portion of the MC/CW business from DHL, after the end of the financial year, and so not affecting the results in the 2020 year. We did question Sigma whether we will see a repeat of the same contract breaches with this new contract that were the cause of their losses last year, particularly in light of the quick churn from the global logistics company DHL. The response was that it is good margin business and they accepted it with eyes open. Time will tell but the commercial behaviour of MC/CW is an ongoing concern.

### **Key Board or senior management changes**

The Chairman Brian Jamieson has announced he will retire at the AGM, handing over to Mr Ray Gunston, a long serving Board member for Sigma and CFO at Tatts Group when Jamieson was a Director there. Mr Gunston will step past the 12 years Directorship during his first term as Chairman, and hence become non-independent, so we see this as a sub-optimal appointment. We mentioned our concerns to the Chairman here and asked about the process of selection, whether they had a skills matrix and whether it followed an external search and were advised that they preferred an internal candidate for Chair. Given that Mr Gunston's other principal experience is with sporting clubs, Tatts and Hotel Investments, we are not convinced that this is the correct appointment to a super logistics company Chairmanship and has the hallmarks of preferential treatment.

A new Director with refreshingly relevant experience was appointed during the year and is up for election at the AGM. Mr Sammels has a background in both Healthscope and Medibank Private, so has deep experience in the industry.

### **ASA focus issues**

Sigma has two women on its Board, so nearly meets the criteria of 30% but in the near future will have both a Chairman and other Director with service over 12 years. In the absence of recruiting a new Director they will not meet the requirement of having a majority of independent Directors. We were advised that the other long serving Director Mr Bayes who is standing for re-election this year will step down during the course of this 3 year tenure.

## Summary

(As at FYE)	2020	2019	2018	2017	2016	2015
NPAT (\$m)	(12.3)	36.5	55.0	60.8	59.2	53.0
UPAT (\$m)	12.6	46.3	55.0	60.8	59.2	53.0
Share price (\$)	0.60	0.577	0.904	1.246	0.819	0.765
Dividend (cents)	3.0	4.0	5.5	5.5	5.0	2.0
TSR (%)	9.0	(35.9)	(21.2)	61.7	16.4	26.2
EPS (cents)	1.0	4.6	5.7	6.1	5.4	4.8
CEO total remuneration, actual (\$m)	3.911	2.244	2.496	3.327	3.459	2.502

For 2020 the CEO's total actual remuneration was **33 times** the Australian Full time Adult Average Weekly Total Earnings (based on November 2019 data from the Australian Bureau of Statistics).

<b>Item 3</b>	<b>Adoption of Remuneration Report</b>
<b>ASA Vote</b>	<b>Against</b>

### Summary of ASA Position

The CEO was last year awarded a retention bonus split over two years on top of the usual STI and LTI, mainly to ensure he remained leading the Pivot project, and in order to compensate for having foregone STIs for two years running. We reluctantly voted for this last year, since Sigma was in a very difficult position and subject to predation by its main competitor API, both for talent and the whole company via a takeover. The second half of this was paid this year.

The STI payment was substantial this year, and was subject to an undisclosed NPAT hurdle, which they maintain was reached. The statutory NPAT however was, as shown in the table under item 2, negative and even after adjusting for considerable depreciation and amortisation for the new warehouses was still very low. In addition 70% of the STI was awarded on non financial measures for which we have no yardsticks. The ASA guideline is a minimum of 50% financials. So in total, the STI award was completely opaque to shareholders, in that the NPAT target was very low and not published and the other measures not transparent. In addition it was made in the year of the COVID-19 virus, when Sigma found itself in that small cohort of healthcare companies which did not suffer much at all and possibly benefited from the virus.

A further concern is that our benchmarking of both the Chairman's salary and the CEO's fixed remuneration showed them to be well over the 75<sup>th</sup> percentile for companies in their band of market capitalisation (in which they sit in the 25<sup>th</sup> percentile). They have not chosen to benchmark their remuneration, despite the company falling by roughly half in market capitalisation since 2017. Moreover the share price drop is as a consequence of the permanent loss of a significant source of revenue due to the MC/CW defection, so is not likely to bounce back soon. We will ask when they had last benchmarked both the CEO and Chair salaries and attempt to get a commitment that they intend to do so during the first term of a new Chairman.

For these reasons we will not support the remuneration report this year.

The remuneration framework for the CEO is shown in the table below. The framework does not include a target level of remuneration, and as mentioned above, a one-off retention payment was made which is additional to the amounts considered by the framework.

	Max. Opportunity \$m	% of Total
Fixed Remuneration	1.4	38.5
STI - Cash	1.4	38.5
STI - Equity	nil	nil
LTI	0.8	23.0
Total	3.6	100

<b>Item 4.1</b>	<b>Re-election of Mr Michael Sammells as a Director</b>
<b>ASA Vote</b>	<b>For</b>

#### Summary of ASA Position

Mr Sammells has been appointed recently to the Board of AMP (post Banking Royal Commission!) and has long experience in Finance, risk in the Healthcare industry, at Healthscope and Medibank Private. He is a good fit to the Sigma Board

<b>Item 4.2</b>	<b>Re-election of Mr David Bayes as a Director</b>
<b>ASA Vote</b>	<b>For</b>

#### Summary of ASA Position

Mr Bayes has been a Director at Sigma for 12 years and so is being put up for re-election, by our guidelines, as a non-independent Director. He has adequate skin in the game and is Chair of the Remuneration committee and member of the Audit and risk committee. His broad experience in the food industry, which while not immediately pertinent to the Pharmaceutical supply industry, gives him useful exposure to retail franchise issues, and with that an understanding of Sigma customers.

The ASA supports his re-election, but has made it clear to Sigma we no longer see him as an independent Director. Mr Bayes has also made it clear that he will most likely not stay on for the full 3 year term.

<b>Item 4.1</b>	<b>Re-election of Mr Ray Gunston as a Director</b>
<b>ASA Vote</b>	<b>Against</b>

### Summary of ASA Position

This re-appointment presents us with a problem. As mentioned above Mr Gunston has already been announced as the incoming Chair, when Mr Jamieson retires at the AGM this year. Since Mr Gunston was first appointed in 2010, the re-election will see him spend a portion of his chairmanship as non-independent. On these grounds in part, and in part because of the observations above under key Management changes in Item 2, we do not support his re-election. We also saw the retirement of Mr Jamieson as an opportunity (lost) to appoint a fresh face to the Chairmanship role, with direct experience in what will be needed in Sigma post the Pivot transformation project.

<b>Item 5</b>	<b>Renewal of proportional takeover provisions</b>
<b>ASA Vote</b>	<b>For</b>

### Summary of ASA Position

This is a routine renewal of a standard provision which we support

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