Sigma Healthcare

Sigma Healthcare Limited
ABN 15 088 417 403
ASX code: SIG
3 Myer Place Rowville Victoria 3178
T +61 (03) 9215 9215
F +61 (03) 9215 9188
sigmahealthcare.com.au

Chairman Address

Brian Jamieson, Chairman
Sigma Healthcare Limited, Annual General Meeting
Wednesday 15 May 2019 in Melbourne, Australia

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My intention today is to give you:

1. A quick overview of our Annual Financial Results
2. Discuss our important business transformation program
3. Address the merger proposal put forward by API
4. Highlight our strategy and future direction
5. Provide some comments about our efforts in the community

Let me state from the outset that we are very confident we are on the path to setting Sigma up for a stronger future following our actions on the challenges of the past twelve months. Significant steps have already been taken, which we will outline for you shortly.

First to our results for the year which were slightly above our revised guidance, but did not reach our own expectations at the start of the year.

Total Revenue was $3.97 billion, down 2.9% mainly reflecting the reduction in high value but low margin Hepatitis C product. Excluding that impact, Sales Revenue was up 2.9% to $3.75 billion.

Underlying Net Profit after Tax was down 13.7% to $46.3 million, which was impacted by additional rebates and higher interest expense and depreciation relating to our significant investment in new Distribution Centres.

We also announced during the year a new $500 million debt facility provided by Westpac. The Board thanks Westpac for their show of confidence in our future.

Mark will give more detail on the business in his report.

Importantly for shareholders, we maintained a high dividend payout ratio, with over 80% of Underlying Net Profit after Tax or 116% of Reported Net Profit after Tax, paid as a dividend. The Board has continued its commitment to maintaining a high dividend payout ratio for the foreseeable future.

This has been a defining year for Sigma. We have taken very important and significant decisions over the past 12-months that we are confident will set us on a path to a strong and sustainable future.

There were two major events during the year that are worthy of further discussion.

First was the decision announced in July 2018 that we would not renew our supply contract with the Chemist Warehouse Group. Let me make this clear – we have taken this decision not to renew the contract, because the terms that Chemist Warehouse were looking for meant it was a bad commercial decision for Sigma. Whilst we would have retained close to $1.8 billion in sales, it would have been for virtually no financial return, and we would still have $300 million plus in working capital tied up to support their business. The terms being sought made no commercial sense for Sigma and would have led quickly to diminished shareholder returns and a constrained future.

It also became clear that Sigma could still be a more robust standalone business with a strong and sustainable future. This decision was unanimously supported by the Board, Management and our advisors as being in the best medium-term interest of shareholders and has set in train actions to transform our business, which Mark will address shortly.

The second major event during the year was the merger proposal put forward by Australian Pharmaceutical Industries, or API. As we announced in February this year, we have declined the indicative non-binding offer put forward by API as we and our advisors Goldman Sachs, formed the view that it does not represent fair value and was not in the best interests of shareholders.

Just to re-cap – in October 2018 we became aware that API had acquired just under 5% of Sigma shares, and subsequently moved to 12.95% in December 2018. During this time, API approached management with the concept of merging the two entities on indicative and non-binding terms.

Remember, this approach was not long after we had announced the Chemist Warehouse decision, so from a share market perspective, it was somewhat opportunistic with Sigma at its most vulnerable.

Our response to the proposal remained consistent all the way through this period. We were interested in participating in the discussions which saw both parties undertake high level due diligence. However, we needed to complete our own assessment of what the Sigma business would look like on a standalone basis post Chemist Warehouse so that we had a valid benchmark to compare any offer.

We completed a detailed assessment of the Sigma business post the Chemist Warehouse decision in conjunction with Accenture. This provided a clear roadmap of how we could transform Sigma, the level of efficiency gains we could extract, the operational improvements we can achieve, and the growth opportunities we can pursue. This analysis reinforced our view of the future and has given us greater confidence that Sigma can be a strong standalone business with appropriate growth opportunities. This analysis was paramount in our decision to decline the merger proposal.

The easy decision was to agree to the proposal. This would however have meant handing over control in the knowledge that $300 million plus in working capital is about to be released and knowing efficiency gains are only beginning to be realised from over $220 million already invested in our Distribution Centre assets along with other important actions. To agree to proceed may have been the easy decision, but our detailed analysis supported our view that it was not the right decision for mid to long-term shareholder value.

So where to now for Sigma.

Management has sharpened the focus on our strategy with the full support of the Board. Our core strategy has not changed – it has been and continues to be focused on our core business whilst continuing our progress on diversifying our earnings base, to provide us with a stronger more sustainable growth profile. We will target specific opportunities to diversify our earnings and leverage our core infrastructure.

We are moving closer to finalising our significant capital expenditure program. This has been an intense period of investment in critical infrastructure that will significantly contribute to our business transformation.

We announced a major transformation program – Project Pivot – which has identified over $100 million of efficiency gains to be achieved over the next two years. This is a significant program of work and Mark will provide more detail shortly.

On a personal note, I would like to offer my thoughts for those team members who are impacted as we progress through this transformation. I want to personally thank them for everything they have done for our business while they have been with us and wish them well in their future endeavours.

Finally, I will just touch on our efforts during the year on the broad topic of Corporate Social Responsibility.

Sigma is committed to ensuring we maintain a balanced and diverse work force. This is evidenced in our Workplace Gender Equality Report submitted to government May 2019. This report highlights the composition of Sigma from a gender perspective, with one-third of our Board females, 34% of Senior Managers, and 57% of our total work force.

Safety remains a key directive of management and the Board and is one of the first agenda items discussed at each Board meeting. Our Lost Time Injury Frequency Rate for the year was 4.76, an improvement from the 5.18 last year.

We continue to seek our employee feedback on culture and engagement. Our employee engagement pulse check was conducted in November 2018, where 68% of the organisation who completed the survey agreed that Sigma is truly a great place to work. This survey was the first time all the Sigma subsidies were included, and is a good result given it was undertaken at a time of significant uncertainty. It is also pleasing to see that 60% of our employees are shareholders in Sigma.

Meanwhile, our support for the community has remained strong. Our Guardian Angel program has been running for over 25 years, harnessing community support to provide knitted garments for the homeless in conjunction with the St Vinnies. We have provided financial support to The Summer Foundation to help find solutions for young people with acquired disability other than living in aged care facilities, and Carers Australia who support the unpaid carers in the community. Amcal is also the proud sponsor of the Mother's Day Classic which was held last weekend in support of breast cancer awareness.

Through Discount Drug Stores we have supported Assistance Dogs, who provide services to people with disabilities, and "Free To Be", a charity that protects children in vulnerable communities.

In terms of our environmental footprint, we upgraded our lighting at our Rowville facility to LED lighting which is reducing energy consumption by over 70% and have built in environmentally friendly initiatives as part of the design of our new DC infrastructure, including solar power, recycled water, efficient lighting and temperature control. We continued our efforts to recycle and divert wastage, resulting in over two thirds of our waste being diverted from landfill. We also adjusted our packaging, reducing our requirement for plastic seals on containers by over 231,000 units, and totally eliminating the need for 17,000 lineal meters of plastic bubble wrap.

Ladies and gentlemen, we are embarking on an exciting and transformational program with many challenges and opportunities ahead. The Board has complete confidence that the outcomes we have outlined from this program will be delivered. I would like to personally thank all our team members for their collective commitment to delivering the outcomes we have outlined. I thank my fellow Directors for their contribution and support. And finally, I thank our shareholders and other stakeholders for your ongoing commitment to Sigma. We understand the last 18 months have been a difficult period, however we have a clear strategy and strong resolve to return Sigma to a position of strength that we will all be proud of.

I will now hand over to Mark.

Thank you.

Brian Jamieson
Chairman, Sigma Healthcare Limited
15 May 2019