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Sigma Healthcare

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ASX Release

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Business Transformation on track as Sigma announces strong ongoing revenue growth

- Business Transformation program on track to deliver $100+ million per annum efficiency gains, with action already taken on over $33 million of annualised benefit
- Underlying EBITDA# $31.9 million which was in line with expectations
- Ongoing Revenue* Growth of 6.9%
- Sigma's Pharmacy brands achieved like-for-like growth of 7.8%
- Sigma Hospitals achieved 23% revenue growth (ex Hep-C) for the six months
- Investment cycle well advanced with QLD and WA Distribution Centres (DCs) fully operational, and our SA and NSW DCs to come online in 2H20 and 1Q21 respectively

*** Ongoing Revenue relates to the Sigma business excluding Hep-C and sales to Chemist Warehouse (CW).**
 # Refer to Notes for a Reconciliation of Reported to Underlying

Overview

Sigma Healthcare (Sigma) today announced Reported EBITDA of $25.3 million for 1H20, down 19.8% on 1H19, reflecting the net impact of one-off restructuring costs, offset by a favourable litigation settlement and changes to the lease accounting standard. Underlying EBITDA of $31.9 million was down 21.7%.

The company has again maintained its high dividend payout ratio to deliver an interim dividend of 1.0 cents per share payable on 4 October 2019 with a Record Date of 20 September 2019 and an Ex-Dividend Date of 19 September 2019. This equates to a payout ratio of 95% of Underlying NPAT.

Sigma CEO and Managing Director Mark Hooper commented: "These results are in line with our expectations. Sigma's fundamentals remain in strong shape as we continue to implement the changes to deliver sustainable benefits for our business medium to longer term. We have made good progress on our business transformation program, and we are on track to deliver the $100+ million efficiency gains in line with previous guidance."

Mr Hooper continued "The 1H20 Reported EBITDA results include sales to the CW group for only five months, and even less for some products, whilst also bearing some of the one-off restructuring costs from the commencement of our Project Pivot transformation program, the benefits of which will flow in 2H20 and into FY21."

Excluding CW and Hep-C, revenue from our ongoing business was up 6.9%. Total Sales Revenue excluding Hep-C was down 0.5% for the six months to $1.81 billion, with customer growth across the business largely overcoming the impact of one less month's sales to CW and the ongoing impact of PBS price disclosure adjustments.

Other Revenue of $46.4 million was down $1.5 million compared to the same period last year, largely reflecting a reduction in wholesale supplier rebates due to the loss of CW volumes. Operating costs, including warehousing and delivery, sales and marketing and administration, were down 2.7% to $148.4 million against a back drop of volumes decreasing 10.0%.

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Business Transformation

Sigma has made significant progress in implementing the program of work to deliver the $100+ million efficiency gains. The changes implemented to date occurred towards the back end of 1H20, and therefore there is minimal benefit realised in the 1H20 results. However, the actions taken have resulted in over $33 million of annualised costs being removed from the business, the benefit of which will flow through in 2H20 and beyond. Actions to date largely reflect the removal of around 75% of the 300 full time roles and 200 agency roles previously identified, with progress also being made on organisational realignment and improved integration.

At the time of announcing the transformation program, one-off costs of delivering Project Pivot were expected to be around $30-$35 million, including consultancy costs, redundancies, and outplacement services. For the 1H20, $17.3 million has been incurred, with total one-off costs to deliver Project Pivot now expected to be around $33 million for FY20 and reach a total of $35-$40 million by the completion of the program. A further $5-$10 million in one-off costs relating to the opening of new DCs are likely to be separately incurred.

“We are also very aware of the personal impact such a transformation can have on our people and customers. We have implemented a number of communication and change management programs to support those who are unfortunately impacted, and to ensure focus and resilience to drive our business,” Mr Hooper commented

Mr Hooper continued: “We highlighted in March that around 60% of the efficiency gains to be achieved related to costs to service CW. Significant progress has been made on realising those benefits and the total efficiency gains that can be achieved remain on track.”

Whilst the delivery of Scheduled medicines for CW transitioned as planned, the transition of FMCG supply was delayed as a result of issues with the new service provider. As a result, Sigma has continued to supply some FMCG products to CW, which is expected to continue until October this year, with revenue covering costs but delaying the achievement of some of the efficiency gains by several months.

Operational Comments

“As we progress through our transformation, it is especially pleasing to see positive trends in our customer key performance indicators over the last 12 months, such as a significant improvement in Net Promoter Score. This is a reflection of the great work our teams have been doing to support our customers to run better businesses,” Mr Hooper said

Sigma’s pharmacy brands performed ahead of the market on a like-for-like basis, with sales across our brands up 7.8% (excluding Hep-C), benefitting from our ongoing commitment to help our customers build better businesses. Member numbers have remained steady for the half however a strong pipeline of prospective members brings greater optimism for growth for the next 12 months and beyond.

Ongoing Revenue (excluding CW and Hep-C) was up 6.9% for the 1H20 despite the ongoing impact of PBS price disclosure reform.

Sigma Hospitals has continued to grow market share (currently 8%), with sales (excluding Hep-C) for 1H20 up 23%, reflecting strong growth in the Victorian and Western Australian markets.

“The hospital pharmacy market as well as the dose administration services market continue to be focus areas for Sigma. We have invested in capability to expand our service offering and push for national market growth and are committed to bringing value add services to market,” said Mr Hooper.

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With our 40,000 square metre Kemps Creek DC in NSW commencing some services from August 2019, we now have significant capability and capacity to pursue third party and fourth party logistics (3PL/4PL).

"3PL and 4PL business is an important growth avenue for Sigma. We have a highly skilled management team in place to grow this business, with our new DC investments providing the capacity to meet the demand we are very confident exists in the market," said Mr Hooper.

Capital Management

Sigma's investment in critical long-term and efficient infrastructure remains on schedule and under budget.

Our Queensland and Western Australian DCs are fully operational and performing ahead of expectations, with our new South Australian DC due to commence operations in October 2019.

"The next exciting milestone is the commencement of full operations at our Kemps Creek DC in New South Wales. With some 3PL/4PL work already underway at the site, and automation in testing, we expect to begin full operations here in the first quarter of 2020. This brings capacity and efficiency to a whole new level for Sigma, opening up significant new business growth opportunities," Mr Hooper commented.

Sigma Chairman Mr Brian Jamieson commented "Our concentrated investment cycle has seen us appropriately gear our balance sheet into long-term efficient infrastructure to support the business, funded from net debt of $192.3 million at 31 July 2019. Importantly we maintain the capability to execute on our business development opportunities."

Net Debt benefited from the release of approximately $150 million of working capital from CW, partly offset by BAU working capital movements. The balance of working capital return from CW is expected to flow as the CW business exits during 2H20.

Interest expense for 1H20 was $6.5 million, with full year interest expected to be approximately $11.0 million ($4.5 million in 2H20). In line with increased capital investments, Depreciation and Amortisation (D&A) was $7.9 million in 1H20, with D&A expected to total $18.9 million for FY20 ($11.0 million in 2H20) and $25.6 million in FY21, with both Interest and D&A excluding the impact of the adoption of AASB16.

Mr Jamieson commented "We have confidence in the direction the business is heading. We have maintained our high dividend payout ratio at 95% of Underlying NPAT for 1H20 and remain open to investing in our share buy-back program, subject to any other capital investment opportunities."

Outlook

"Sigma is entering a growth phase where we have few business constraints. Our sales and pharmacy banner pipelines are strong, and our investment cycle is delivering an efficient and effective DC network with significant capacity and capability to better service our customers. As a result, we are now well placed to actively pursue further 3PL/4PL opportunities, hospital pharmacy and retail pharmacy customers," said Mr Hooper.

Mr Hooper concluded, "Progress in executing Project Pivot means Sigma remains on track to achieve the $100+ million efficiency gains. A slight timing delay is likely to see Underlying EBITDA for FY20 at the low end of the $55-60 million previous guidance, with FY21 remaining in line with previous expectations with growth of at least 10%."

A results briefing will be held at 10.00am AEST. For webcast details, please visit the Investor Centre located at www.sigmahealthcare.com.au.

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Financial Summary

	Reported	Underlying *
Revenue	$1.88bn, down 4.1%	$1.88bn, down 4.1%
EBITDA	$25.3m, down 19.8%	$31.9m, down 20.8%
NPAT	$2.5m, down 81.2%	$11.2m, down 43.7%
Dividend Payout Ratio	421%	95%

* Refer to Notes

Notes

	31 July 2019 $'000	31 July 2018 $'000
Reported NPAT attributable to owners of the Company	**2,519**	**13,397**
Add: Restructuring and dual operating costs after tax	**13,045**	**6,090**
Add: Litigation and due diligence costs after tax	**(4,367)**	**386**
Add: Impact of AASB16 after tax	**12**	**-**
Underlying NPAT attributable to owners of the Company	**11,209**	**19,873**
Reported EBITDA	**25,294**	**31,519**
Less: Depreciation and amortisation	**12,606**	**6,199**
Reported EBIT	**12,688**	**25,320**
Add: Restructuring and dual operating costs before tax	**18,635**	**8,700**
Add: Litigation and due diligence costs before tax	**(6,238)**	**552**
Add: Impact of Adoption of AASB16 before tax	**(1,109)**	**-**
Less: Non-controlling interests before interest and tax	**(682)**	**(473)**
Underlying EBIT attributable to owners of the Company	**23,294**	**34,099**
Add: Depreciation and amortisation attributable to owners of the Company	**12,606**	**6,199**
Less: Depreciation of right-of-use assets under AASB 16	**(4,658)**	**-**
Underlying EBITDA attributable to owners of the Company	**31,242**	**40,298**