Loss of chemist contract a blow to listed pharma

TIM BOREHAM

Sigma Healthcare (SIG), 47c

The drug distributor has put a brave face on the loss of a Chemist Warehouse supply contract that accounts for about 40 per cent of its revenue, arguing that there wasn't much point refreshing the deal if it wasn't going to make a decent margin out of it.

Unconvinced, investors marked down Sigma stock by a symmetrical 40 per cent on the news, with the contract loss overshadowing other issues in a sector that is heavily contested by a handful of full-line wholesale distributors.

Sigma said it failed to come to amenable terms with the fast growing Chemist Warehouse and its sister company MyChemist, with the contract ultimately won by the New Zealand-based, dual-listed Ebos Group from June next year.

Broker Morgans bluntly dubbed the switch as a "major contract for Ebos and a major loss for Sigma".

Sigma CEO Mark Hooper points out the non-contract also frees up $300 million of working capital and ensures a "clearer future". Given the company is seen as undergeared, that enhances the prospect of some kind of acquisition.

Sigma continues to supply the chemist "banner groups" Amcal, Guardian and PharmaSave (it also distributes to hospitals).

If it were merely the case of Sigma losing a big but low-margin contract, perhaps the market could have reacted better. In truth, the drug distribution game is becoming increasingly unpalatable as the federal government tries to rein in the cost of subsidising prescription drugs. Under the Community Service Obligation scheme, the distributors are required to provide any listed drug to anywhere in Australia within 24 hours. In return, they get the benefit of a funding from a taxpayer funded CSO pool. Under a related mechanism, the price of drugs subsidised by the Pharmaceutical Benefits Scheme are agreed on and frequently renegotiated.

In its accompanying trading update, Sigma reported that the latest agreed round of PBS price cuts (in June) had hit harder than expected; and that trading in May and June had been "particularly weak". Even before the contract loss becomes effective, Sigma has adjusted expected current year EBIT (for the 12 months to January 31 2019) to $75m, from an expected $90m previously. The company expects 2019-20 earnings of $50m — half the 2017-18 tally.

Morgan Stanley pencils in only $35m. "Overall trading conditions have deteriorated and we see potential for material risk beyond the Chemist Warehouse agreement not being renewed," it says.

Australian Pharmaceutical Industries (API), $1.50

API is Sigma's arch rival and supplies chemists including Priceline and Soul Pattinson. It has reported soft retail conditions, with 2017-18 results still expected to be marginally above the previous year's numbers.

Performance-wise API could also do with a vitamin pill, although it managed to confine its half-year performance (to February 28 2018) to an 8 per cent earnings decline (to $26.8m on steady revenue of $2 billion).

In the longer term, the chemists (and thus the distributors) face a shake-up if new entrants such as Amazon or logistic group DHL get serious about the pharmacy sector.

In the US, chemist stocks were whacked recently after the online giant said it would acquire an online pharmacy called PillPack. Locally, chemists are protected against competitors such as supermarkets because of restrictive ownership rules.

Last year AstraZeneca said it would distribute some of its higher-value drugs directly to pharmacies, using DHL.

In Britain, a mob called Med-Express experimented with an emergency delivery of Viagra and the morning after pill (presumably in that order).

Sagely Sigma and API have sought to reinvent chemists from being pill dispensers to providers of beauty care and front-of-the shop wellness products.

Reflecting the trend, API last month said it would fork out $61m for Clearskin Clinics, which has 44 mainly franchised outlets in Australia and NZ.

Tim Boreham edits The New Criterion.

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Now the super caps kick in

The new rules are confusing but it's important to comply

WILL HAMILTON

As investors prepare to do their taxes the reality of the biggest change to superannuation we have seen in a generation will hit home.

The financial year just ended was the first in which the transfer balance cap of $1.6 million became applicable to all superannuants. The cap is the cumulative maximum a super fund member may transfer into retirement phase (tax-free pension) over their lifetime. It has been well-publicised in the industry and the media; at our own firm our clients were fully briefed about the cap and its implications before its introduction. Yet there still appear to be many questions about it — or understanding of planning opportunities and indeed, added complexities.

Despite all this attention, when I mentioned the transfer balance cap for superannuation to a prospective client at a meeting this month, there was little to no understanding of what it was. Investors have to get a grip on these new rules — here's a guide.

Understand the cap

Essentially, the transfer balance account acts as a lifetime ledger, tracking transfers in and out of pension phase to identify when the transfer balance cap is reached. This is a very complex part of the new arrangements.

Notably, the transfer balance cap may be indexed in future years in increments of $100,000 to the consumer price index. If a person has not triggered a credit against their transfer balance cap they will benefit from the full increase of any indexation. The extent to which an individual benefits from indexation depends on whether that person has triggered a credit (or assessment) against their own transfer balance cap.

In addition, superannuants who have already commenced an income stream in pension phase but have not fully used the cap will have indexation applied only to the proportion of the unused transfer balance cap. Indexation is not available for those who have completely used their transfer balance cap.

This means that some superannuants will now need to track an additional two lifetime super amounts — the transfer balance cap and the transfer balance account effective from July 1, 2017.

The application of the transfer balance cap can also vary depending on whether it relates to an account-based pension, a defined benefit pension or a combination of the two. A transition to retirement pension doesn't count towards the transfer balance cap as they no longer receive the earnings tax exemption from last year. Again, if readers believe they are affected with a combination of a defined benefit and account-based pension and are unsure where they stand I suggest they take separate advice.

Accumulation mode

Another incorrect assumption is that many superannuants seem to think that from July 1, 2017, you could only have $1.6 million "in super". You can have more; you just can't have more underpinning a tax-free super income.

While you are in accumulation mode (saving pre-retirement) you can have balances over $1.6m and you are treated at 15 per cent on earnings on the total account balance.

Those in pension mode with amounts above the transfer balance cap have two choices.

They are required to "roll back" the amounts above the transfer balance cap to either the super fund accumulation account, where earnings will be taxed at 15 per cent, while the balance in pension mode is taxed at zero.

The other option is that they withdraw the excess from the super system altogether.

The following example illustrates this scenario.

If you had $2m in a pension account on June 30, 2017, you either had to withdraw $400,000 from both the pension and the super system or commute $400,000 from the tax-free pension back into a taxable super fund accumulation account.

Rolling back is always the preferred option as the excess rolled back is taxed at a maximum of 15 per cent. It is for this reason that superannuants should avoid withdrawing the excess from the fund as accumulation super is still taxed advantageously.

As investors prepare tax returns for the tax year just ended — and find they have exceeded the transfer balance cap — the ATO will issue an excess transfer balance determination. This will come with a default commutation authority effectively requiring the excess amount to be commuted back to accumulation and excess transfer balance tax of 15 per cent be levied on notional earnings upon the excess amount for the first breach. If there are breaches in future years the ATO will levy 30 per cent for second and subsequent breaches.

This is a very new and expensive risk: I recommend the following moves to manage this new transfer balance cap regime.

Do's:

- Know and understand your transfer account balance.
- Ensure you comply with the transfer balance cap for the 2018 financial year.
- Ensure your fund administrator understands the new regime and complies with it.
- If you have an SMSF, remember you — the trustee — are ultimately accountable for all SMSF activity.

Don't:

- Withdraw money above the transfer balance cap from super — this money if left "in super" is still taxed at a maximum of 15 per cent under current legislation.
- Confirm whether you have a transfer balance cap excess.
- Wait to take remedial action if required.

Yes, superannuation has become even more complex. I hadn't fully appreciated just how complicated transfer balance caps had become until I sat down to write this piece. Understanding your obligations and ensuring compliance is vital and if in doubt seek appropriate advice.

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FLOAT WATCH

Hi-tech spin on building materials

Calix

ASX code: CXL
Shares on offer: 15.1 million
Listing price: 53c
Market capitalisation: $65m
Listing date: July 20

SIMON HERRMANN

Demand for cement is forecast to rise over the coming decade, especially in emerging countries with much-needed investments in infrastructure or housing.

The cement industry is the largest non-fossil fuel source of carbon dioxide emissions, accounting for about 5 per cent of total industrial and energy emissions. Most is released as a by-product during the chemical conversion process in the production of clinker, a component of cement.

The effect of excessive CO_2 emissions is well documented and any industry with a high ecological footprint is under pressure to reduce emissions.

Technology and innovation can transform and improve entire industries, but not all new technologies will prove to be successful.

Calix founder Mark Sceats is the inventor of 36 patented inventions and clearly the driving force behind this IPO. The company was founded in 2005 and over $50m plus an additional $36m in grant funding has been invested to develop and research numerous applications of its patent-protected technology.

At the core of Calix vision is the "Calix flash calcination", a novel technology that reinvents the kiln process and produces high-purity raw materials. The products are said to be more cost-effective and less taxing on the environment than cement, lime or other commercial materials. The company targets a number of markets including the waste water infrastructure and sewer in Australia and NZ, with planned expansion into Europe and the US. Further trials are under way to validate the commercial appeal of Calix's technology in aquaculture and agriculture, while ongoing R&D manages future growth opportunities.

Calix owns a raw materials mine in South Australia and a commercial production facility in Victoria capable of producing 25,000 tonnes per year of raw product.

Having achieved a compound average growth rate of over 40 per cent per annum to $3.2 million in revenues, Calix has demonstrated a positive growth trajectory in a short period, but there remains uncertainty about its somewhat unproven business model. Nevertheless, the IPO is well supported by a number of institutional shareholders.

Simon Herrmann is an investment analyst at www.wise-owl.com

Happy new financial year: now for some resolutions to help your SMSF pension

MONICA RULE

It's the first month of a new financial year and if you are running your own SMSF pension it's a good time to review your numbers: if you don't pay yourself the minimum pension you may end up paying more tax.

Self-managed superannuation fund members receiving a retirement pension from their super fund would be aware their SMSF must pay a minimum pension amount each financial year to receive the tax exemption on earnings and capital gains generated from pension assets.

The minimum pension amount is determined by the member's age and the percentage value of the member's retirement pension account, at the commencement day of the pension or at July 1 each financial year.

If a pension starts on a day other than July 1, the minimum pension amount is calculated proportionately to the number of days remaining in the financial year, including the commencement day. If the start day is on or after June 1, no payment is required to be made in that financial year.

It's also worth recapping the key numbers on how pension drawdowns work: the percentage value for members younger than 65 is 4 per cent; from 65-74 it's 5 per cent; from 75-79 it's 6 per cent; from 80-84 it's 7 per cent; from 85-89 it's 9 per cent; from 90-94 it's 11 per cent and for those older than 95 it's 14 per cent.

In relation to a deceased member's pension, if the pension is a reversionary pension, then the minimum amount must continue to be paid from the SMSF in the financial year the original pension recipient dies (that is, based on the original pensioner's age). If it is a non-reversionary pension, there is no requirement to pay the minimum pension in the year of death if the original pension is commuted and paid out as a lump sum death benefit. If, however, a new death-benefit pension is to commence from the SMSF, the minimum amount is calculated based on the dependant recipient's age.

If an SMSF is unable to pay the minimum pension amount as required, then any amount paid from the SMSF during the financial year will be treated as lump-sum superannuation benefits and taxed accordingly in the recipient's hand. This means, tax may be payable if the lump-sum recipient is younger than 60 and the lump sum includes a taxable component. In addition, any income (including capital gains) generated from pension assets in the SMSF will not receive the tax exemption.

If the member's SMSF has plenty of assets but not enough cash to pay the minimum pension amount, the member could consider either partly or fully commuting their pension by using an asset in the SMSF to pay the commutation amount as an in-specie lump-sum benefit. The SMSF still must pay a minimum pro-rata pension amount calculated to the date of commutation, because the lump-sum benefit amount cannot be counted towards the minimum pension amount.

Here's something well worth knowing: if the amount unpaid from an SMSF does not exceed one-twelfth of the annual minimum pension amount, then provided the only rule broken by the SMSF is not paying this amount, and it was unpaid due to an honest mistake or because it was outside the control of the SMSF trustee, the Australian Taxation Office will allow the SMSF to make a catch-up payment for the amount within 28 days of becoming aware of the underpayment. The ATO will allow the SMSF to treat the underpayment amount as being paid in the year it should have been paid. This dispensation is only for the first time an underpayment occurs. If it happens again, the SMSF cannot self-assess it again.

SMSFs trustees need to ensure that when a member commences a pension from their SMSF, they review the investment strategy of the SMSF to ensure minimum pension payments can be made from their SMSF. The last thing you want to do is pay more tax than you need to.

Monica Rule is the author of The Self Managed Super Handbook — Superannuation law for SMSFs in plain English.

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