

Sonic off Covid highs returning to pre-pandemic trajectory.

Company/ASX Code	Sonic Healthcare/SHL
AGM time and date	10 AM Thursday, 16 November 2023
Location	Acacia Room, InterContinental Sydney Hotel, 117 Macquarie Street, Sydney
Registry	Computershare
Type of meeting	Hybrid
Monitors	Michael Batchelor, Robert MacMahon
Pre-AGM Meeting	Yes, Mark Compton Chairman, Kate Spargo Chair Remuneration Committee, Paul Alexander Company Secretary

Monitor Shareholding: The individuals (or their associates) involved in the preparation of this voting intention have shareholdings in this company.

1. Summary of Issues

ASA intends to vote “for” all resolutions but raised questions with Sonic regarding:

- An almost 25% downturn in Europe but continuing to fund acquisitions.
- Whether share buybacks are the best use of cash.
- The issuing of options.
- The clarity of the Remuneration Report.
- The apparent ease of achieving some of the key performance indicators detailed in the Remuneration Report.
- CEO succession.

2. How we intend to vote

No.	Resolution description	Vote
1	Re-election of Directors - Professor Mark Compton	For
2	Re-election of Directors – Mr Neville Mitchell	For
3	Re-election of Directors – Professor Suzanne Crowe	For
4	Re -election of Directors – Mr Chris Wilks	For
5	Remuneration Report	For
6&7	Approval of the issue of securities as an exception to ASX Listing Rule 7.1	For
8&9	Approval of long-term incentives – Dr Colin Goldschmidt and Mr Chris Wilks	For
10	Renewal of Proportional Takeover Bid Approval Provisions	For

3. Matters Considered

Accounts and reports

The strong message from Sonic is that it was now transitioning from the high volume COVID-19 testing environment to business as usual. Sonic reported base business revenue growing at 7% from FY 22 results. The net result was a fall in profit from \$1,461M to \$685M.

Sonic presented FY24 EBITDA guidance of A\$1.7-\$1.8B which is a 5% EBITDA increase on FY23.

Behind the scenes Sonic was busy managing costs across its business particularly in the wake of COVID reductions and extracting synergies from recent acquisitions including new acquisitions in Germany. Sonic reinforced the continuing relevance and competitive advantage of its medical leadership model and saw significant scope for acquisitive growth in Europe.

Regarding ASA questions:

- Sonic advised that prices paid for European acquisitions did not include COVID 19 throughput. Lab capacity was important in terms of understanding scope for synergies but doctor referral base, underlying business revenue and profit were the main drivers of acquisition valuation.
- Sonic considered that it had excess cash and share buybacks were an attractive way of providing returns to shareholders. The acquisition activity was not expected to slow down.
- Regarding the use of options, Sonic pointed out that options were issued right through the organisation and had been its practice for some time. It thought that changing the way it awarded shares to staff would cause some concern to staff. ASA is concerned that this dilutes shareholders holdings.
- Sonic took on board our feedback regarding clarity of the Remuneration Report.
- Sonic felt that the 100% achievement of the strategic component of the STI awarded over the last 6 years did not reflect soft targets but rather very successful execution of the key performance requirements.
- Sonic advised that it did have CEO succession options. Dr Colin Goldschmidt is a strong CEO and has been successful in this role for 30 years.

Financial performance

(As at FYE)	2023	2022	2021	2020	2019
NPAT (\$m)	685	1,461	1,315	528	550
UP(EBIT) (\$m)	1,067	930	874.6	799.4	803.7
Share price (A\$)	35.57	33.01	38.4	30.43	27.1
Dividend (A\$ cents)	1.04	1.00	0.91	0.85	0.84
TSR (%) ¹	10.9	-10.8	29.1	15.6	14.1
EPS (\$ cents)	145	303	273	110	122
CEO total remuneration, actual (\$m)	5.969	7.685	6.733	4.494	6.281

Notes.

1. Simple TSR is calculated by dividing (change in share price plus dividend paid during the year, excluding franking, by the share price at the start of the year.

Remuneration Report

4. Rationale for Voting Intentions

Resolution 1, 2, 3 & 4 Re-election of Directors

ASA noted the unusual board inclusion of the CFO, Mr Chris Wilks. Sonic noted that his role is broader than a typical CFO and his inclusion (and re-election) as a Director is valuable to Sonic.

ASA will vote For the re-election of the Directors namely Mr Mark Compton, Mr Neville Mitchell and Professor Suzanne Crow as well as Mr Chris Wilks.

Resolution 5 - Remuneration Report FOR

The Remuneration Report forms a part of the Directors' Report and is found from pages 31 to 51 in the Annual Report (AR). In the pre AGM meeting the point was made that the Remuneration Report (RR) is complex, difficult to read and interpret. Kate Spargo (Chair Remuneration and Nomination Committee) indicated that others had provided similar feedback and that they were examining ways to improve the RR.

A summary of remuneration framework for the Managing Director (MD) and Finance Director (FD) can be found on page 38 of the AR. The framework is typical of most ASX companies in that it has a Fixed Annual Remuneration (FAR), a Short Term Incentive (STI) and Long Term Incentive (LTI). The changes to the remuneration structure can be found on page 32 of the AR, outlining;

- No changes to the MD's FAR and a ~10% increase to \$1.2M for FD,
- Half of the STI non-financial aspects related to the Companies environmental, governance and sustainability objectives,
- Malus and clawback provisions now apply,
- There are now minimum shareholding levels for MD and FD

Outcomes

STI consists of two components: 80% based on EBITDA and 20% based on Strategic Objectives. At the Target level STI is awarded 60% cash and 40% equity, with equity held for minimum of two years. ASA prefers that this is split 50% / 50%.

- EBITDA
 - This was awarded at 35% compared to 150% in 2022 owing to the significantly lower result (~-40%).
 - At a pre-AGM meeting it was noted that the performance measure changed from year-on-year growth in 2022 to a target level in 2023 with no explanation given for the change in the AR. Also, the target level was unclear as it was based on a 'market expectation' which was also not provided. Kate Spargo indicated that this could have been communicated better.
 - EBITDA STI is provided 50% cash and 50% equity.
- The Strategic component was awarded at 100%. In our pre-AGM meeting the relevance of this measure was discussed as:
 - At least 100% had been awarded for the last six years reviewed.
 - In 2019 the AR stated "the Board was of the view that given the known strengths of the long-serving executives in the qualitative factors, more emphasis should be placed on financial outcomes".

The LTI outcome for 2023 consisted of three components: 45% based on Relative TSR, 33% Aggregate EPS and 22% based on Average Return on Invested Capital (ROIC). For LTI, 50% are granted as Options and 50% as Performance Rights.

For the three-year measurement period to 30 June 2023, 84.3% satisfied the performance conditions compared to 100% for 2022. The break-up of this result was:

- Relative TSR is a measure against S&P ASX 100 excluding banks and resource companies. The result achieved was the 58th percentile, resulting in 64.6% vesting.
- Aggregate EPS is a measure against internal targets which seem soft. Result achieved was 747.7 cents against min and max targets of 366 and 442 cents respectively resulting in 100% vesting
- Average ROIC target is a measure against internal targets which also seems soft. The average result achieved was 14.5% versus a target of 9.7%, resulting in 100% vesting.
- It is worth noting that the only measure that did not achieve 100% vesting was the measure based on market performance.

The ASA intends to vote for the RR, which is a change from 2022, for the following reasons:

- The actual amounts paid to MD and FD (including STI and LTI) are not excessive when compared to other ASX 100 companies.
- Both executives have successfully steered the company through a challenging three years with the company in a very strong position to continue strong growth.
- Simple TSR of +10.9% for 2023 compares to -10.8% for 2022.
- Both the STI EBITDA and LTI TSR components moved appropriately to reflect change in company performance.
- The STI Strategic Component now has a 50% weighting on “Progress with the Company’s environmental, governance and sustainability objectives”.
- The Board says they are making changes to improve the readability of the RR.

Nevertheless, it is noted that:

- The RR remains complex, difficult to read and interpret.
- In reading through AR one cannot get to the total remuneration without doing the maths.
- Changes are made to the STI and LTI from one year to the next without giving an explanation for the change.
- Some targets are not transparent e.g. EBITDA market expectation, or ‘soft’, e.g. STI Strategic measures and LTI Aggregate EPS and Average ROIC.
- At Target the STI award comprises 40% equity, ASA preference is 50%.

Resolutions 6 & 7 - Approval of the issue of securities as an exception to ASX Listing Rule 7.1

The issue of securities under the Sonic Healthcare Limited Performance Rights Plan (the Performance Rights Plan) was last approved by shareholders for the purposes of an exception to ASX Listing Rule 7.1 at the 2020 AGM held on 12 November 2020. The Board is, in effect, now seeking to update that approval. The maximum number of Options issued cannot exceed 5% of the total number of the shares in the Company, and the Performance Rights will not exceed 10% of the shares in the company, over a three-year period.

If this is not approved, grants under the Option Plan and Performance Rights Plan after 16 November will count towards the 15% annual limit that Sonic can issue without shareholder approval.

Resolutions 8 & 9 - Approval of long-term incentives – Dr Colin Goldschmidt and Mr Chris Wilks

Resolutions 8 and 9 seek shareholders' approval to the grant of LTI awards to provide performance incentives through to the 2026 financial year with a maximum value of:

- Dr Goldschmidt: \$3,449,251; and
- Mr Wilks: \$1,447,445,

Resolution 10 - Renewal of Proportional Takeover Bid Approval Provisions

This is an administrative issue and ASA will vote for Resolution 10.

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Appendix 1

2023 CEO Remuneration framework detail

2023	Target \$	%	Max Potential \$	%
FR	2,397,634	31%	2,397,634	27%
STI Cash	1,320,821	17%	1,848,576	21%
STI deferred equity	957,116	12%	1,232,383	14%
LTI	<u>3,087,472</u>	<u>40%</u>	<u>3,450,195</u>	<u>39%</u>
Total	7,758,200	100%	8,928,789	100%

The amounts in the table above are the amounts that are envisaged in the design of the remuneration plan.

*Target remuneration is sometimes called budgeted remuneration and is what the company expects to award the CEO in an ordinary year, with deferred amounts subject to hurdles in subsequent years before vesting. Some remuneration frameworks set a maximum opportunity amount, but not all.