

Creating Value for Coventry Group Limited Shareholders

A fellow shareholder's presentation of issues to consider

3 November 2014

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About Sandon Capital

An investment firm with a proven track record for unlocking value for shareholders

- Sandon Capital Pty Ltd is an Australian investment management and advisory firm established in 2008
- Funds managed by Sandon Capital have been shareholders of Coventry since 2011.
- We invest in companies we consider are undervalued and seek to encourage changes to unlock value.
- Our flagship fund, Sandon Capital Activist Fund, established in 2009, has delivered compound annual returns since inception of 15.8% per annum, net of all fees and expenses.
- Successful activist roles for Sandon Capital include:
 - RHG Limited
 - Alesco Group Limited
 - Australia Infrastructure Fund
 - Signature Capital Investments Limited
 - India Equities Limited (now Mercantile Investment Company Limited)
 - Wallace Absolute Return Limited (now Armidale Investment Corporation Limited)

About Coventry Group Limited (ASX:CYG)

An ASX-listed company that has serially disappointed shareholders

➤ After divesting some businesses, Coventry Group Limited reports that it now operates in 5 segments:

Fasteners	Cabinet Hardware	Fluids	Gaskets	IT Services
<i>Konnect / Boltshop</i>	<i>Artia</i>	<i>Cooper Fluids</i>	<i>AA Gaskets NZ Gaskets</i>	<i>Managed System Services</i>

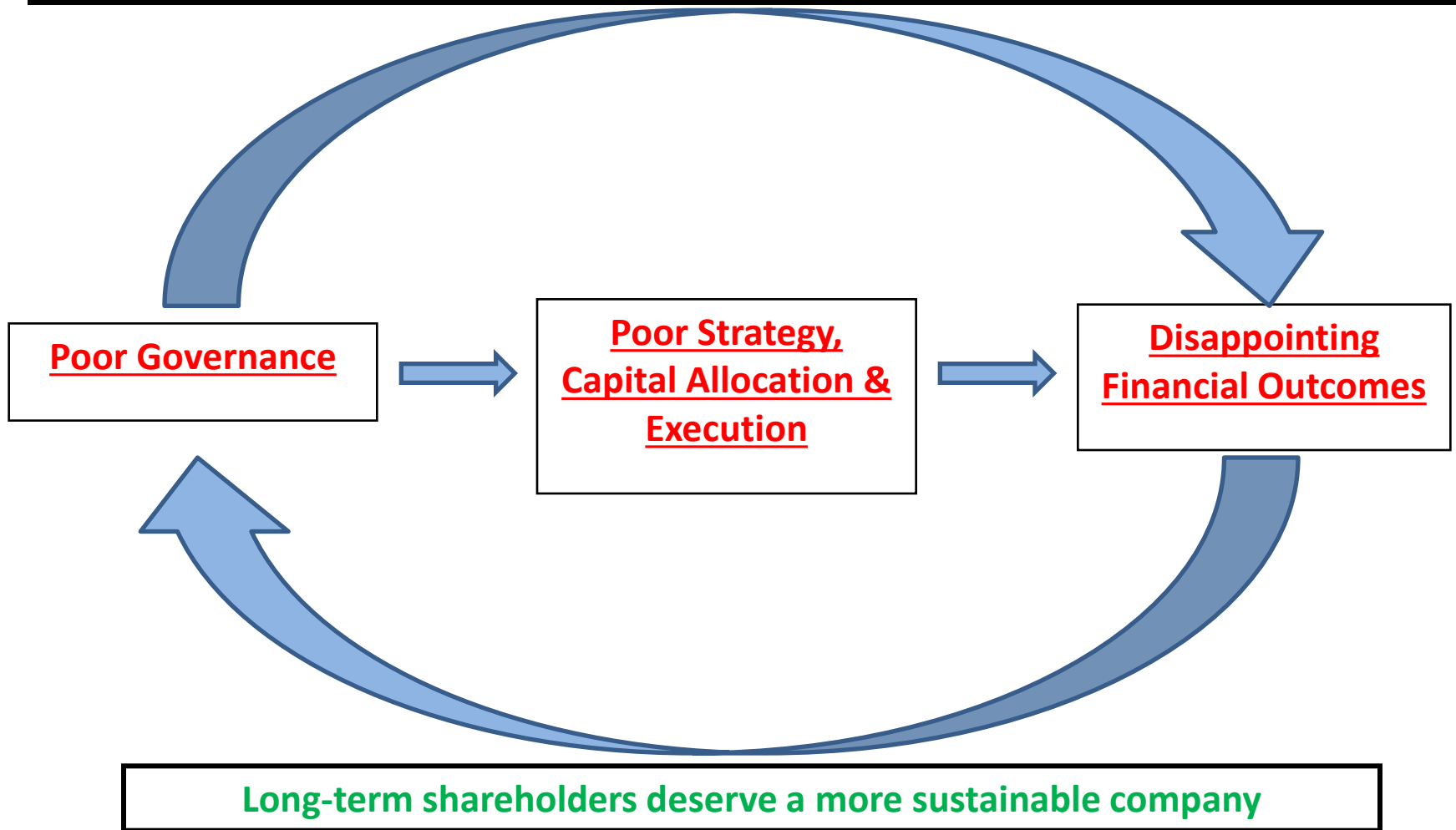
➤ Revenues have fallen from \$468.3M in 2007 to \$210.6M in 2013

➤ We believe Coventry has failed its shareholders as a result of:

- **Poor corporate governance** CYG's Board, with an executive chairman, has failed to adjust to clear signals its strategy has been failing.
- **A flawed strategic direction** CYG operates in five business segments not related to each other, with few, if any, discernible synergies or other benefits.
- **Disappointing capital allocation** In 2011, CYG could have paid a special fully franked dividend which shareholders could have then deployed elsewhere. For example, the S&P/ASX 200 Accumulation Index delivered a return of more than 56%¹.
- **Poor operational performance** Revenues, margins and profits have been falling and are volatile.

Why is new leadership required?

The current direction of Coventry is unsustainable and has led to a vicious cycle of disappointment and underperformance

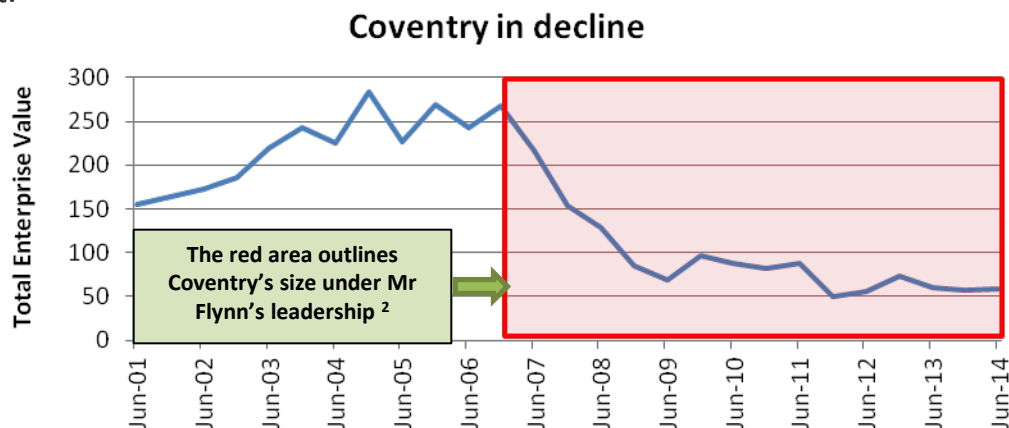


Why is Sandon Capital taking action now?

The directors of Coventry have persistently let us down as shareholders in the company

Prior to the appointment of two new directors, the former cohort of directors of Coventry had an average tenure of ~9 years.

- The former cohort of directors had presided over significant value destruction for Coventry shareholders. Enterprise value of Coventry has fallen from \$217 million in FY2007 to ~\$53 million in 2014¹.
- The share-market holds a poor view of Coventry's future under current management, evidenced by the fact that it values each \$1.00 of capital retained by Coventry at less than \$0.75 – clearly the market is anticipating further value destruction.
- Great businesses require great management and corporate governance practices in place.
- Shareholders are the owners of the company and therefore should hold poor boards and management teams to account.



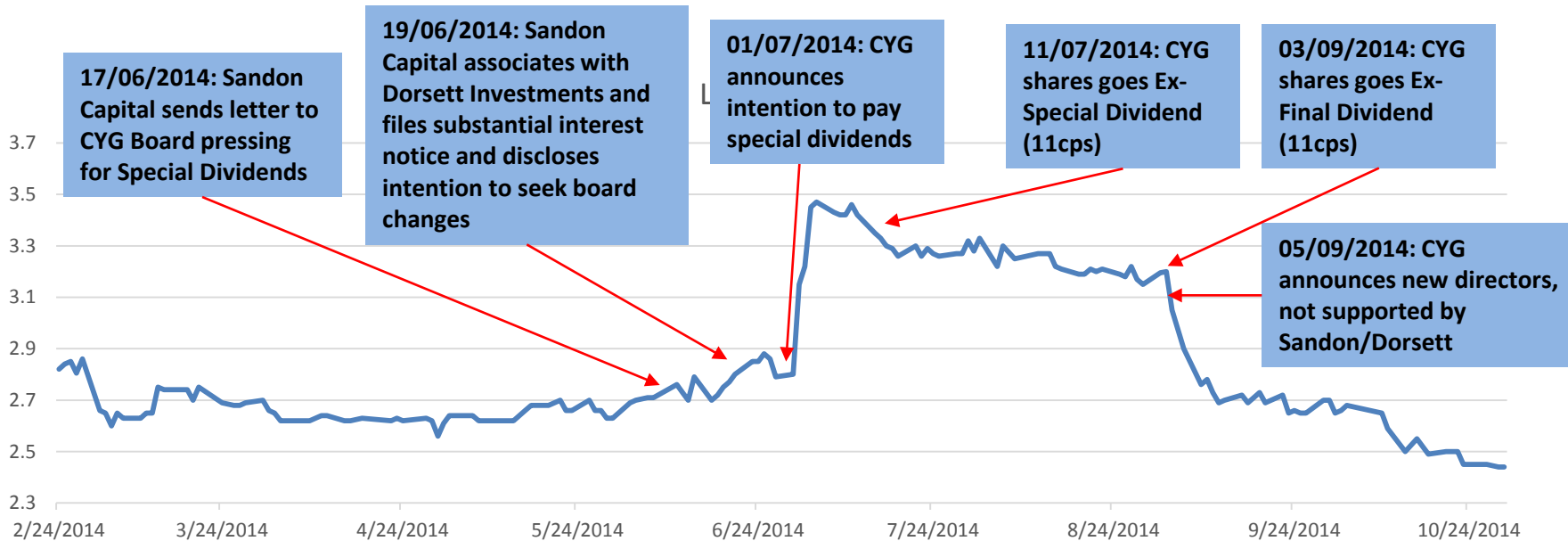
Sources: Capital IQ, Company Reports, Sandon Capital analysis

1. Enterprise value is equal to the market capitalisation plus debt less cash. 2014 EV is estimated using market capitalisation as at 30 October 2014, 30 June 2014 balance sheet data, adjusting for 22cps of dividends recently paid.

2. Mr Flynn became Chairman on 7 November 2006 and assumed the role of executive chairman on 11 April 2007

What have we achieved so far

Initially, the market reacted positively to prospects for change, then reality set in...



Our efforts thus far have received the attention and approval of many fellow shareholders and commentators:

The Sydney Morning Herald
BusinessDay

News Markets Quotes Portfolio Money Property Focus Small Business Executive Style
Today's News & Views Comment & Analysis World Business Mining & Resources Banking & Finance

You are here: Home > BusinessDay > Mining and Resources

Coventry Group shares jump as dividend plan revealed

July 1, 2014
Sally Rose

The West Australian | thewest.com.au
Wednesday, July 2, 2014
WEST BUSINESS 3

COVENTRY'S SPECIAL DIVIDEND

Payouts fail to calm dissidents

By Sean Smith

Coventry Group's special dividend appears unlikely to halt disgruntled shareholders enforcing demands for board changes at the WA industrial group.

Sandon Capital said it was evaluating its next move but managing director Gabriel Radzyninski admitted to being "underwhelmed" by Coventry's plan to pay two special dividends totalling 22¢ a share over the next year.

Sandon believes the payout is well below what Coventry can support and noted the fasteners and gaskets maker's announcement yesterday failed to address the dissidents' concerns about strategy and the board.

"We will let the company and the market know of our intentions when we are ready," Mr Radzyninski said.

Two weeks ago, Sydney-based Sandon combined with Bunbury's Dorsett family to warn it would call a shareholders' meeting to replace some of Coventry's four-person board.

The move reflected long-held dissatisfaction in some quarters with the company, which culminated in a first strike against its remuneration report at last year's annual meeting.

Criticising Coventry's failure to land a major acquisition, Sandon had agitated for a big slab of the company's \$50 million of cash — the legacy of the sale of its car parts businesses — to be returned to shareholders via a near 3¢ one-off special dividend.

Instead, Coventry said yesterday it would return \$8.4 million in two 11¢-a-share payments, one later this month and the other in July 2015. It also provided short-term certainty around its regular dividends by committing to continue to pay out 11¢ each half year until at least 2015-16, increasing its proposed return over the next 13 months to 5¢, all fully franked.

Coventry executive chairman Roger Flynn said the decision to pay a special dividend was unrelated to shareholder pressure but instead reflected the board's regular discussions around capital management.

"While working to restore profitability in some of our underperforming businesses, Coventry has simultaneously been actively looking for opportunities to deploy this cash in the shareholders' interest, including by acquisition of other businesses," Mr Flynn said.

"Several small acquisitions have been made but we have not so far found a substantial acquisition which had suitable risks and rewards."

Coventry shares yesterday jumped 35¢ to \$3.15.

Despite already unlocking some value in Coventry Group Limited, Sandon Capital believes the company can be dramatically improved to release significant further value for all long-term shareholders.

But change is needed.

Where can Coventry improve?

We still believe that significant long-term value can be created for Coventry shareholders if a few key areas of concern are addressed by a new leadership team

As long-term shareholders, we continue to be let down by Coventry's:

- 1. Corporate Governance**
- 2. Poorly Executed Corporate Strategy**
- 3. Disappointing Financial Performance**

1. Coventry's questionable corporate governance

The current board has allowed compensation to grow out of proportion to Coventry's size and financial performance

- A key role of a well-functioning board is setting of appropriate executive remuneration and incentive hurdles.
- The directors have awarded themselves significant fee increases since 2007.

	2007	2014	% change
NED base fee	\$58,000	\$86,000	+48%
Interstate NED base fee	\$69,000	\$89,000	+29%
Committee fees (payable in addition to base fees)			
Chairman of Audit & Risk Committee	\$11,000	\$15,000	+36%
Chairman & Member of Rem & Nomination	\$8,300 ¹	\$5,000 ¹	-40%

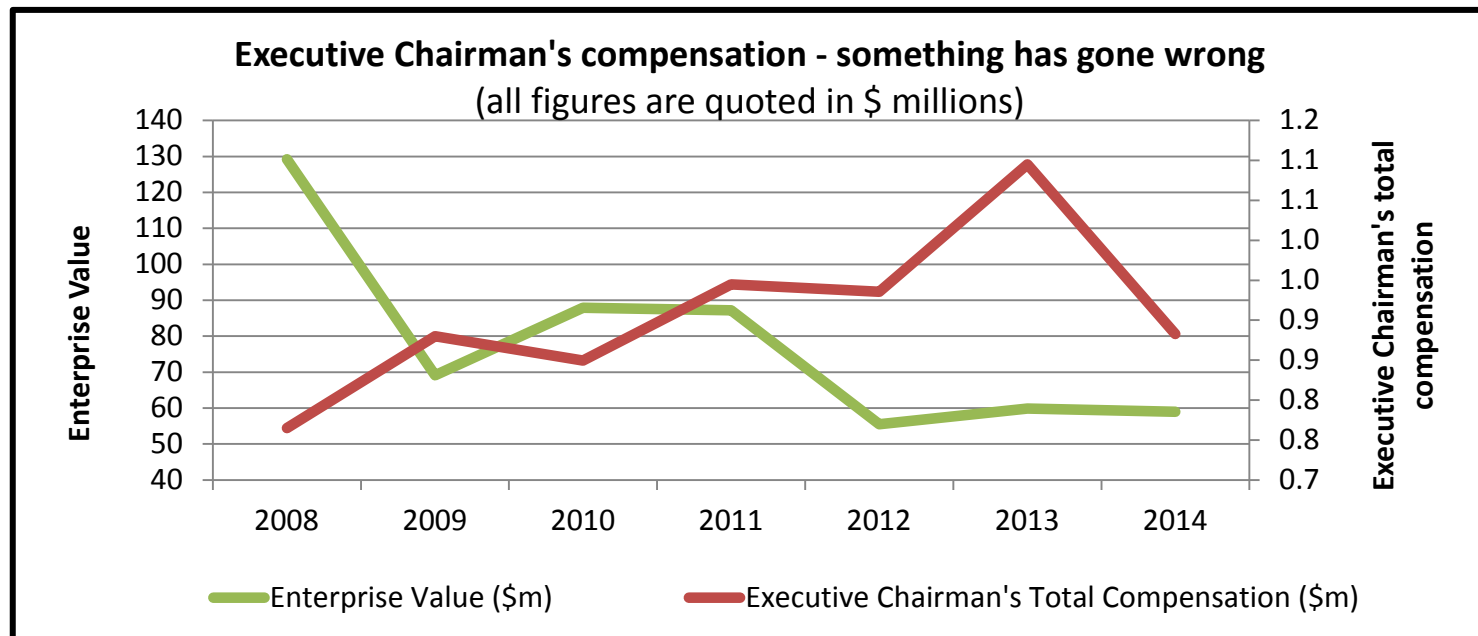
1. In 2007, the fee was only payable to the Chairman of the committee whereas by 2013 the fee was payable to all members of the committee (ie 3 x \$5000 = \$15,000).

Sources: Annual Reports

1. Coventry's questionable corporate governance (cont'd)

The current board has allowed compensation to grow out of proportion to Coventry's size and financial performance

- The executive chairman's remuneration has increased despite Coventry becoming a significantly smaller company
- Since assuming the role, the Executive Chairman has received a total of \$6.4 million as enterprise value has fallen from \$217 million to \$53 million¹.



Sources: Capital IQ, Company Reports

1. EV figures are for June 2007 and are estimated using market capitalisation as at 30 October 2014, adjusting for 22cps of dividends recently paid. Mr Flynn became Chairman on 7 November 2006 and assumed the role of executive chairman on 11 April 2007.

1. Coventry's questionable corporate governance (cont'd)

Shareholders have sent clear messages to the Board about remuneration by consistently voting against the Remuneration Report, but these concerns have been ignored

- Shareholders have expressed their view of Coventry's remuneration practices.
- In 2012, Chairman exercised his right to put the adoption of the remuneration report resolution to a "show of hands", meaning the significant number of proxies cast against the adoption of the remuneration report had no effect on the result.
- At the last AGM (2013) the remuneration report was voted down by a poll
- Had a poll on the adoption of the remuneration report been held in 2012, Coventry would have already had "**two strikes**" and would have already faced a "**spill meeting**".
- The table below shows the results of the voting on adoption of the remuneration report at the 2012 and 2013 Annual General Meetings:

Voting on adoption of remuneration report							
	Proxies received			Poll Result			
	For	Against	Proxies Against	For	Against	Vote Against	
2013	14,002,781	8,457,584	38%	14,220,588	7,822,212	35%	"First strike"
2012	14,306,701	5,840,800	29%	Passed on a show of hands		unknown	

1. After 2012's result, Sandon Capital and other investors requested the Chairman call for a poll on all future remuneration reports.

2. Coventry's poorly executed corporate strategy

Comments by the Company and Executive Chairman about the future of the business do not reflect actual outcomes

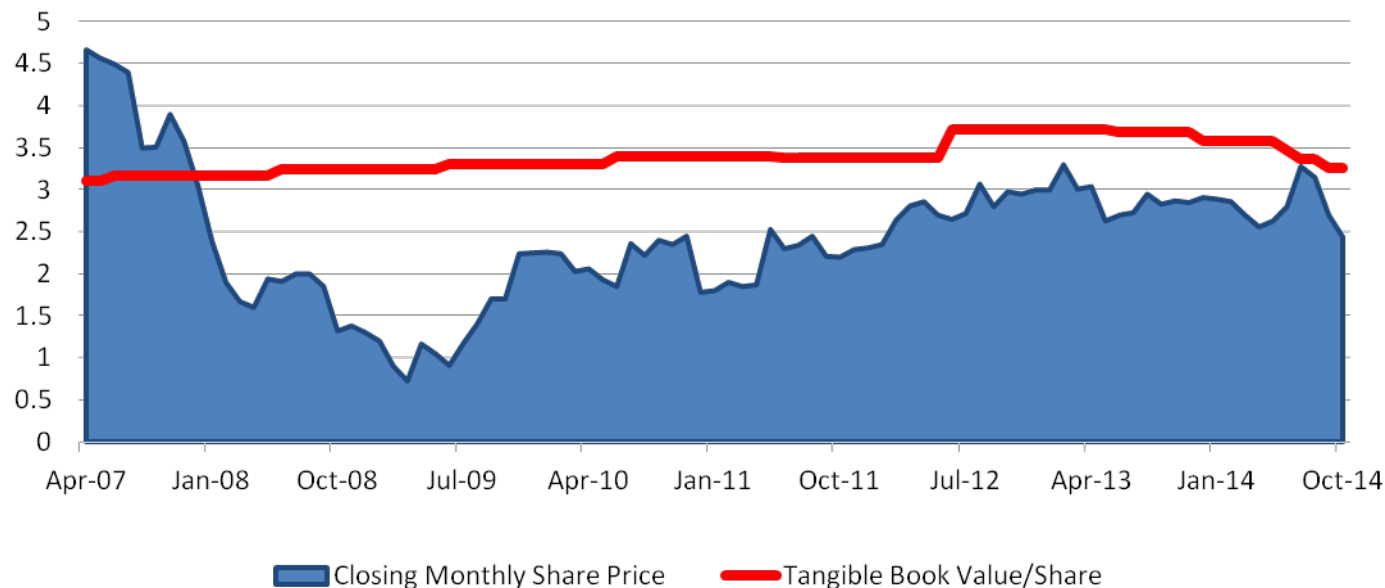
➤ Shareholders should use these statements as a yardstick to measure the board's and management's ability to set realistic and achievable targets. These statements should also demonstrate managements awareness of the environment they operate in.

Source	Management Comment	Outcome
2009 Annual Report, p.1	"Initiatives to improve working capital implemented – reductions in inventory levels and trade and other receivables achieved"	Over the last 5 years, working capital as a % of Revenue has been <i>higher</i> than at the time the comment was made – i.e. sustained improvements in working capital have NOT been achieved.
CYG Results presentation for the half year ended 31 Dec 2009	"increasing importing although much improvement still possible"	Operational Update, June 2014, In reference to "Fasteners Strategy, page 5 "to compete, must be low cost/competitive value, - more imports" The Company identified increasing importing as a key objective in 2009, but this doesn't yet seem to have been achieved.
21 July 2010, in an interview for the West Australian newspaper, 'Coventry back in the black, declares dividend'	"The answer is 'yes'," Mr Flynn said last night when asked whether he felt his turnaround efforts were now complete.	By management's own admission in 2012 (a mere two years later), there were needs to "increase turn around momentum" [p.10 Market Update September2012]. In the June 2014 operational update the company reported "some progress, but lots to do"
2012 Annual Report, p.7	"Management is actively engaged in cost control and moving internal resources to sales and to the expanding areas of the business".	Since this comment, neither costs of goods sold nor SG&A expense margins have changed materially , in fact, operating margins have deteriorated. Further, sales have fallen despite management "moving internal resources to sales"
31 Dec 2013 Half year Results 22 Feb 2013, p.3	"...the Group expects a gradual increase in its continuing operating profit"	The opposite has happened. On 29 April 2014, Coventry issued an earnings warning, anticipating statutory net profit to be in the range of \$1m to \$2m.

2. Coventry's poorly executed corporate strategy (cont.)

A poorly articulated and executed corporate strategy has led investors to persistently ascribe *negative* value to the company's future

- CYG's share price reflects the fact that the market ascribes \$0.75 of value for every \$1.00 retained by the company, indicative, we believe, that the market is anticipating further value destruction.
- Under current leadership, CYG persistently trades below its tangible assets



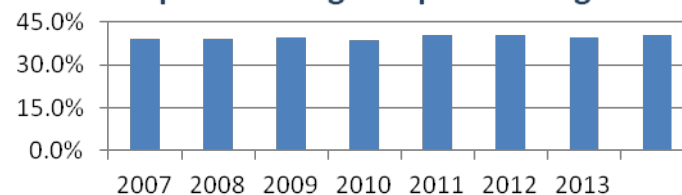
Source: Capital IQ, Bloomberg

3. Coventry's inconsistent financial performance

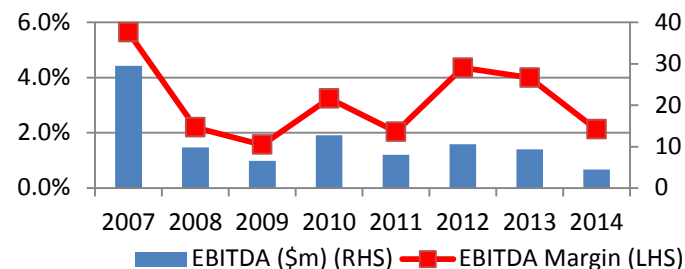
Coventry has failed to deliver any consistent, reliable financial performance under the stewardship of Mr Flynn

- We see gross profit margins as indicative of the “raw ingredients” given to all participants in an industry. We believe the translation of gross profits to net profits is driven by management skill.
- Despite stable gross profits, Coventry has failed to deliver predictable or consistent financial performance
- Management's stated attempts to improve profitability has yielded almost no change in outcomes.
- For example, management's supposed “cost-cutting” initiatives since the sale of the automotive parts in 2011 division has not delivered any sustained improvement in margins

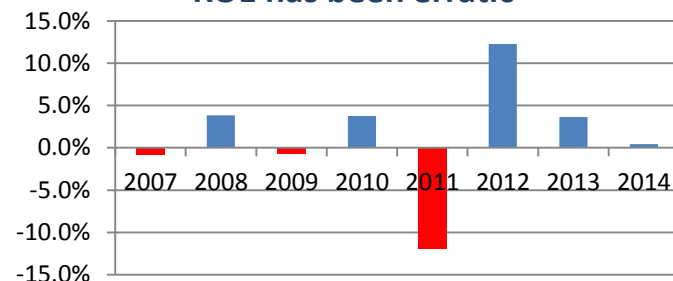
Despite stable gross profit margin



EBITDA and EBITDA Margins have been volatile and in decline



ROE has been erratic



3. Coventry's inconsistent financial performance (cont.)

This unpredictable and disappointing financial performance has caused all analysts in the market to shun the stock

- Predictable and stable financial performance is the bedrock for sustained increases in shareholder value
- Coventry's financial performance, on the other hand, has presented great uncertainty to investors when evaluating the future of the company
- As of March 2014, all major brokerage houses that once covered CYG have terminated coverage:

Brokerage Firm	Coverage Termination Date	Reason for Termination of Coverage*
Goldman Sachs	March 7, 2014	<ul style="list-style-type: none">➤ "...we think uncertainty persists on the turnaround in CYG's underperforming Hardware business and recovery in Fluids profits as well as utilisation of surplus cash"➤ "NPAT was below our expectations"
Macquarie Equities Research	May 18, 2011	<ul style="list-style-type: none">➤ "The key risks following settlement will be... how the cash is spent"➤ "The best and most sensible outcome in our view is to return the cash to shareholders utilising excess franking credits"

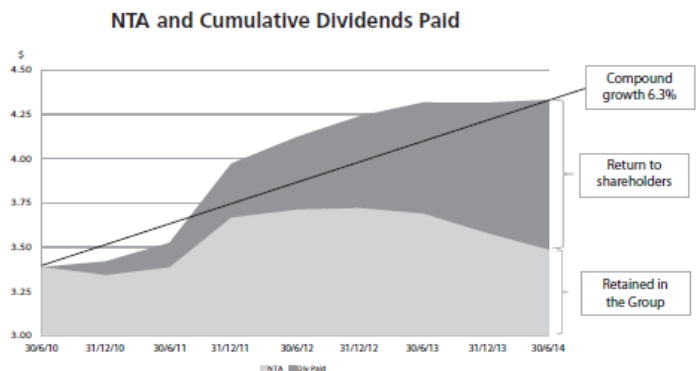
*Sources: Goldman Sachs, Macquarie Equities Research, S&P

3. Coventry's inconsistent financial performance

The Board reports glowing returns, yet ignores the reality for long-term shareholders: Total Shareholder Returns since 2007 are negative¹

What Is Reported?

- The chart below is from the 2014 Annual Report extolling the growth and distribution of assets per share and Total Shareholder Returns (TSR). The Company chooses a favourable time period to report:



4 Year Total Shareholder Return (TSR) Calculation		\$
Share price at 30/06/10		1.81
Share price at 30/06/14		2.80
Cumulative dividends over 4 years (Interim + Final paid in period)		0.85

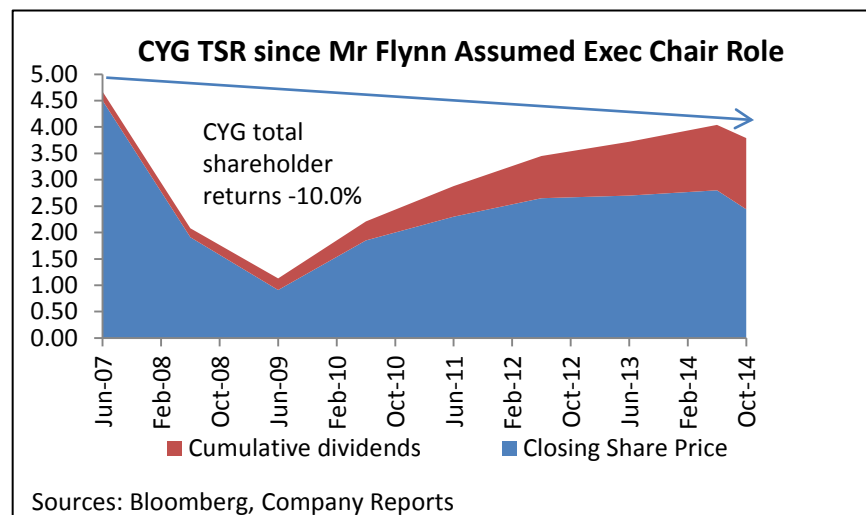
Calculation of TSR based on the above data:

Gain in share price	0.99
Share dividends	0.85
	<hr/>
	1.84

Gain in percentage terms	101.7%
Implied annual compound growth	19.2%

What is the Reality?

- In contrast, TSR since Mr Flynn assumed the role of executive chairman paints a very different picture¹:



1. Since Mr Flynn's appointment as executive chairman on 11 April 2007 to 30 October 2014. The closing share price as at 11 April 2007 was \$4.22 and as at 30 October 2014 was \$2.44. Cumulative dividends of \$1.35 were paid during that period. TSR from 11 April 2007 to 30 June 2014, including dividends paid during the period, with share price as at 30 June 2014 is -4.3%

Sources: Company Reports, Bloomberg

We think it is time to end Coventry's current unsustainable path. We believe that this change can only occur through fresh leadership and renewed corporate vision.

The Board changes proposed from within do not go far enough.

How to vote at the AGM

➤ If you want to see positive change at Coventry, send a message to the Board at the AGM, vote as follows:

AGM Resolutions	How to vote	Why?
1. Election of Neil Cathie	AGAINST	Send a message to the Board that shareholders have had enough.
2. Election of Nick Willis	AGAINST	Send a message to the Board that shareholders have had enough.
3. Adoption of Remuneration Report	AGAINST	Remuneration has grown despite company performance deteriorating.
4. Spill Meeting Resolution	FOR	All incumbent directors must be held accountable before shareholders.
5. Renewal of proportional takeover restrictions	AGAINST	An underperforming Board should not be given protection from corporate activity that could benefit shareholders

Contact details

- Gabriel Radzyninski
- Tel: 02 8014 1188 / 0408 936 357
- gabriel@sandoncapital.com.au
- www.sandoncapital.com.au

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