Ausbil Investment
Management Limited
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AUSBIL ANNUAL ESG REPORT

2021

ausbil
Strength. Wisdom. Agility.

CELEBRATING 25 YEARS IN FUNDS MANAGEMENT

About Us

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About Ausbil

Ausbil Investment Management Limited (Ausbil) is a leading Australian investment manager. Established in April 1997, Ausbil's core business is the management of Australian and global equities for major superannuation funds, institutional investors, master trust and retail clients. As at 31 December 2021, Ausbil manage over AU$16 billion in active Australian and global equity investments. Ausbil is owned by its employees and New York Life Investment Management (NYLIM), a wholly-owned subsidiary of New York Life Insurance Company. NYLIM has more than US$650 billion in assets under management. NYLIM has a number of boutique affiliates including MacKay Shields, Apogem Capital and Candriam Investors Group.

Ausbil chairs the RIAA Human Rights Working Group and has board representation at RIAA. Ausbil is a signatory to the Principles for Responsible Investment (PRI) and has a dedicated environmental, social and governance (ESG) research team who provide an in-house service. ESG research is integrated into Ausbil's investment process. Ausbil believes that a consideration of ESG issues as developed by well-founded ESG research can identify mispriced stocks and assess a company's earnings sustainability. Similarly, engagement on ESG issues can drive long-term value and reduce the risk of value destruction.

Ausbil has monitored and engaged with companies on their corporate governance record and to this extent has historically regarded proxy voting as an important part of its fiduciary duties.

A message from our co-founder: Why ESG matters to us

ESG has become central to how society needs to be thinking, on investments, on policy, and on how we live every day. We believe our actions, through an exhaustive and ongoing program of engagement with listed companies, underscores how much ESG matters in Ausbil's approach to investing, and really, how we approach life. As investors, we know ESG ensures better risk-adjusted returns and less unexpected outcomes. I commend this report to you and thank our ESG team for another stellar year of action, advocacy and leadership as they engage the leaders and boards of Australia's most influential companies.

Paul Xiradis
Co-Founder, Executive Chairman and
Chief Investment Officer of Ausbil Investment Management Limited

Members of

riaa Responsible Investment Association Australasia
Investor Group on Climate Change
IAST APAC
Investor Alliance for Human Rights
PRI Principles for Responsible Investment
Climate Action 100+
Interfaith Center on Corporate Responsibility
Plastic Solutions Investor Alliance

Contents

> “We take ESG very seriously, and we expect the companies we engage to do likewise.”

We believe in ESG

Ausbil is proudly committed, firm-wide, to ESG advocacy, engagement and the integration of ESG issues across our business, in all our investing, in how we function as a business, and in how we seek to lead in the investment community.

We take ESG very seriously, and we expect the companies with which we engage to do likewise. We are not in the business of naming and shaming those that we consider need to improve their performance on ESG measures. Rather, we are in the business of actively engaging listed companies on their ESG performance, and how it can be improved.

We do not invest in all of the firms we measure and engage with on ESG, but we still engage with un-investable firms in our universe because part of our mission is to contribute to bringing all listed companies forward on ESG issues and performance.

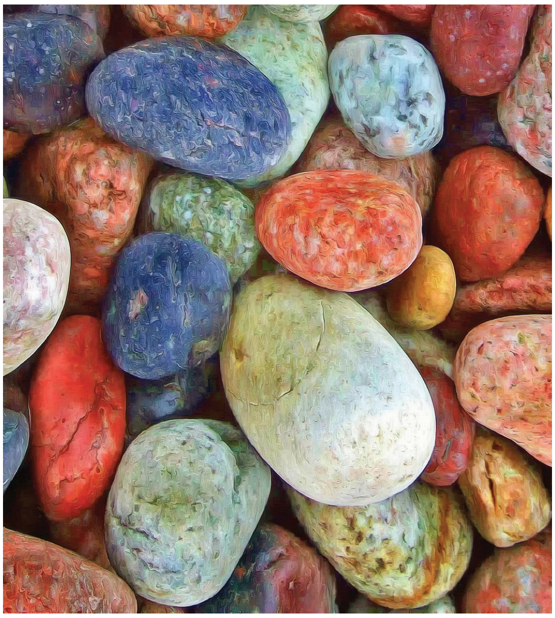
We have been applying ESG principles in our investing for over a decade and we are a signatory to the PRI (Principles of Responsible Investing) having ratified our membership in 2016. Ausbil has a dedicated ESG Research Team, part of the investment team, producing proprietary ESG research on Australian-listed companies and assisting global teams in their ESG integration. Importantly, the ESG Research Team participates in company meetings, leading the ESG engagement activities, alongside financial analysts and portfolio managers, which ensures the engagement occurs at the highest possible level. The vast majority of engagements are carried out this way, with C-suite or board representatives. Only a small proportion of engagements are done with other company representatives.

Finally, we are active investors. We believe ESG is a critical part of our active investment management approach because it can help us avoid many risks that are unquantifiable, and because those companies that adhere to quality ESG approaches tend to be better companies, on performance, longevity, and many other measures of quality, culture, sustainability, environmental and social impact, and financial performance.

We carefully plan and monitor our engagements and are forensic in ensuring we record, score and grade each interaction so we can establish whether companies are progressing, or not. To this end, Ausbil operates with an annual ESG engagement plan that contains a rationale for engagements on each key ESG theme as well as milestone targets and objectives for current and future engagement.

With this in mind, we are delighted to present you with our annual review of the ESG advocacy and engagement we undertook in 2021.

2021 ESG Annual Report

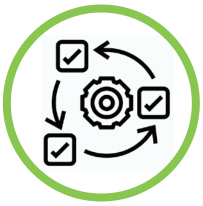


Executive Summary

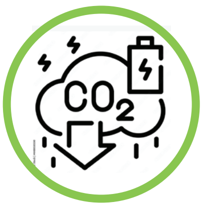
Ausbil's ESG year in a snapshot

Each year, Ausbil's activities across ESG become deeper and more engaged. 2021 was the biggest year yet, covering major issues from modern slavery to global decarbonisation, the rights of indigenous peoples and human rights in the supply chain, the circular economy, corporate culture, and governance across many themes and issues; all with a global pandemic raging. The year can be summarised as follows, though we delve more deeply into these issues later in the report.

Ausbil's ESG team has never been busier, and we are growing to accommodate our surging activity. In 2021, we held 175 engagement meetings with boards and executive leadership, covering a wide range of issues, as illustrated in Chart 1 on page 8. We considered 971 meeting resolutions and exercised 158 proxy votes on behalf of our investors. We also added another full-time member to Ausbil's ESG Research Team, bringing our team to three dedicated researchers and analysts, led by our Head of ESG, Måns Carlsson.



Ausbil continued to lead the investor community in the overwhelming rejection of modern slavery in supply chains. 2021 was the first year for mandatory Modern Slavery Statements from companies, listed or otherwise, that generate revenue in excess of A$100m per annum, as required by the Modern Slavery Act (Australia). As a sign of our commitment to this issue, Ausbil submitted a voluntary modern slavery statement, which is a product of an in-depth and proprietary human rights and modern slavery analysis across our own operating business and investment management activities.



The world's actions on decarbonisation are driving an unstoppable groundswell of change. At the heart of the major changes we are starting to see in decarbonisation was the COP 26 summit in 2021. The ripple effects of renewed commitments to net zero by 2050 are becoming tidal waves of change, with fossil fuels, energy production, manufacturing, and all aspects of the economy coming under scrutiny for carbon stewardship by savvy consumers, companies and investors. While companies have increasingly committed to net zero targets, we expect investors will need to scrutinise these to assess their credibility and impact. In 2021, Ausbil updated our climate change policy, prepared a new iteration of our proprietary climate change scenario model, and continued to engage with companies on climate change positive policy and action.

2021 shone a light on the importance of indigenous rights. In 2021, sadly the relationship between mining companies and indigenous communities and their sacred sites continued as a serious engagement issue. Significant publicity and condemnation across the community has seen some progress, however institutional investors must ensure that these problems do not repeat. A new tool developed by RIAA with participation by Ausbil has been designed to guide the investment industry in how to engage with and identify such issues in portfolios, and at site with mining companies and others engaged with the indigenous community in their activities.

Executive Summary

The pandemic further prioritised ESG outcomes across companies. COVID has changed several things in terms of ESG, including more focus on the 'S' in ESG, such as human capital development, human rights in supply chains and mental health. COVID has also elevated the vulnerability of workers in global supply chains and in some cases, due to labour shortages, it has increased the use of contractors, which has impacted occupational health and safety performance. Over the past few years, Ausbil has led engagements on these issues across companies, and we have made some progress in gaining focus on this at the highest levels of leadership and governance.

Occupational health and safety performance can be a lead indicator of operational performance. Ausbil's proprietary ESG research carefully tracks performance on lead and lag indicators in relation to occupational health and safety and engages frequently with management on these issues because poor performance can lead to operational issues in the future.

Human capital attraction and retention as well as customer advocacy are more important than ever. We also see human capital attraction and retention as well as customer reviews as lead indicators of operational performance. Labour shortages, new pace of change in the global economy as well as the risk of reputational damage through social media stories from staff and customers are key reasons why companies need to focus on their employee and customer satisfaction and engagement. To that end, Ausbil engages with companies on diversity and inclusion, staff engagement and customer net promoter scores.

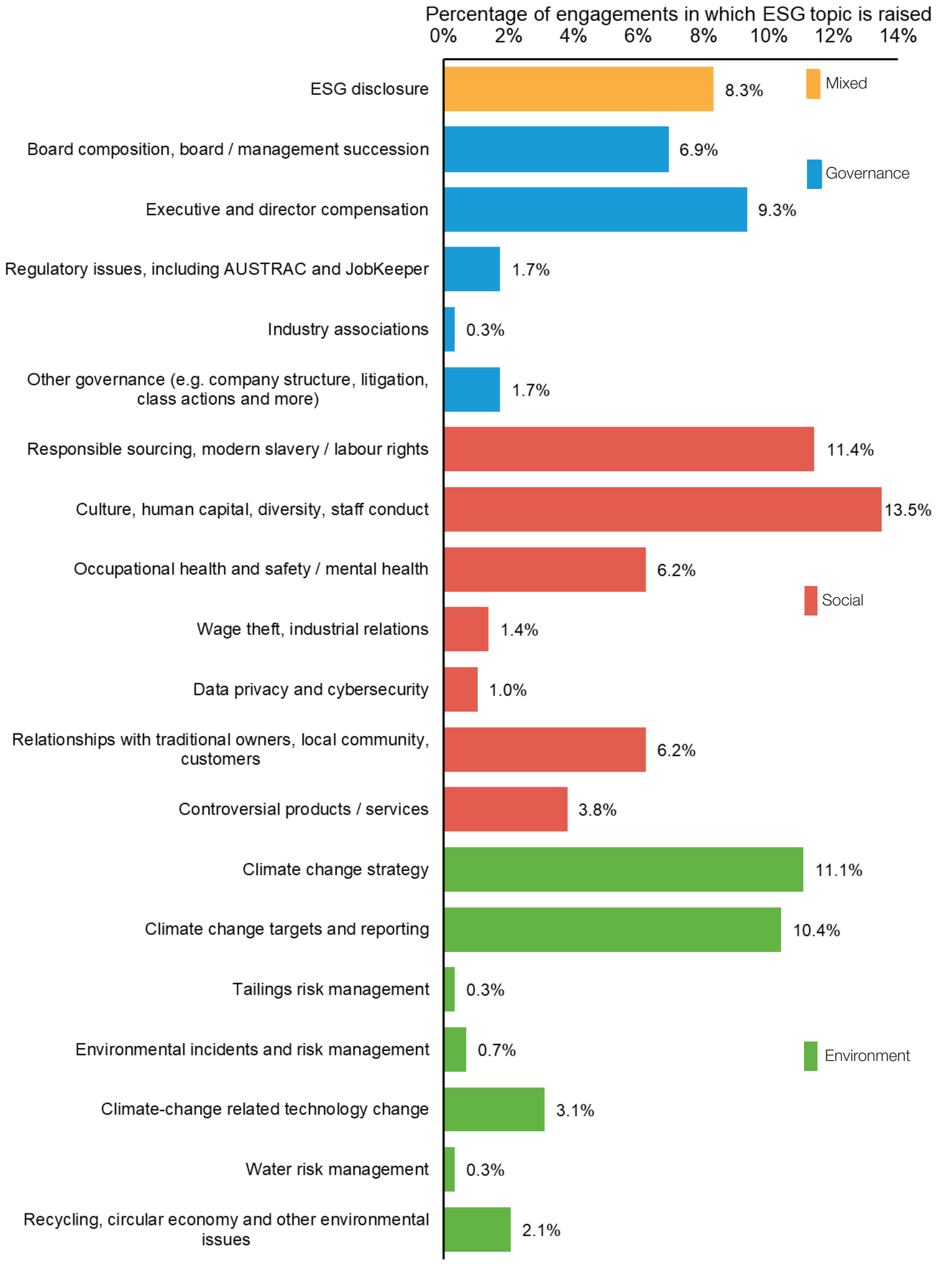
"The pandemic further prioritised ESG outcomes across companies. COVID has changed several things in terms of ESG, including more focus on the 'S' in ESG, such as human capital development, human rights in supply chains and mental health."

Snapshot of 2021's active engagements

Snapshot of 2021's active engagements

In 2021, Ausbil engaged with 90 companies on ESG matters, spread over 175 different occasions. These engagements covered a vast range of topics as illustrated in Chart 1, covering a wide range of topics that can be divided across the ESG spectrum of environment, social and governance engagements.

Chart 1: The spectrum of ESG engagement topics in 2021

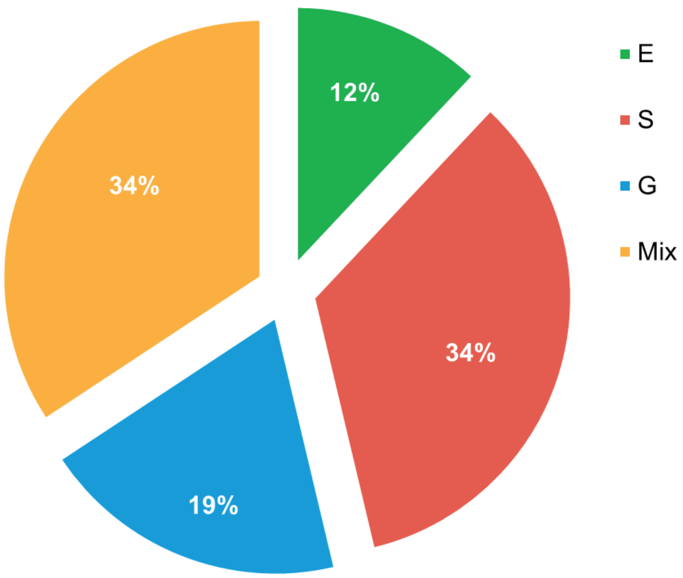


Source: Ausbil. Please note that the percentages represent the proportion of total meetings we undertook that included each issue. For this reason, they may not total 100%.

Snapshot of 2021's active engagements

In our engagement meetings in 2021, some 34% of meetings covered more than one ESG topic as we take a holistic view of ESG in our work. We achieved a solid coverage across the key ESG categories as illustrated in Chart 2.

Chart 2: The broad view of where we spent our time on ESG



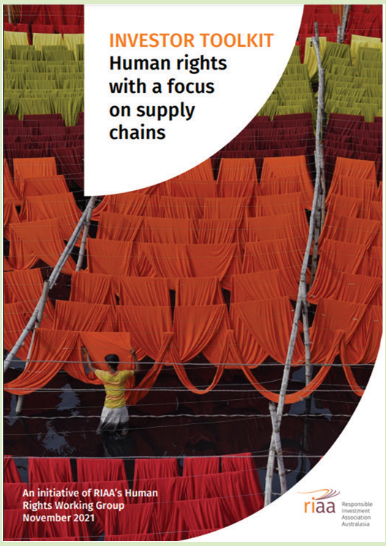
Source: Ausbil. Please note that the percentages represent the proportion of total meetings we undertook that included each issue. For this reason, they may not total 100%.

As can be seen from the Chart 1, staff culture, human capital, diversity and staff conduct, and responsible sourcing were the key 'S' topics we discussed in engagements with companies, being an engagement topic in 13.5% of all the ESG engagement meetings. Among the 'E' issues, unsurprisingly, climate change strategy (11.1%) including risks and opportunities related to climate change, as well as climate change targets and reporting (10.4%), were key engagement topics in 2021.

Snapshot of 2021's active engagements

In many cases, company engagements are a multi-year, in-perpetuity process and it is invariably difficult to ascertain the level of change which can be directly attributed to Ausbil's engagement activities at any given point in time. However, some of the key achievements and progress from engagements undertaken in 2021 are summarised as follows:

- We achieved significant progress against engagement goals and targets around modern slavery and human rights with a number of listed companies.
- We contributed to the writing and development of two key engagement toolkits launched by RIAA (Responsible Investment Association Australasia), where we chair the Human Rights Working Group. The first is an updated version of an Investor Toolkit: "Human rights with a focus on supply chains". The second is a new Investor Toolkit: "An Investor Focus on Indigenous Peoples' Rights and Cultural Heritage Protection".
- We successfully encouraged a number of companies to adopt voluntary and advisory say-on-climate change resolutions at their AGMs, and to improve their ESG disclosure.
- We engaged with mining companies about cultural heritage management and supported a shareholder resolution calling for improvement to the WA Cultural Heritage Protection Law.
- We exercised our voting rights and advising companies on executive remuneration in order to create better alignment with the interests of shareholders.
- We continued with our vigorous engagement and advocacy on human rights and the Modern Slavery Act. As part of this work, Ausbil's efforts and expertise in the area was acknowledged through our appointment to the Federal Government's Expert Advisory Group.



Investor Toolkit on Human Rights with a Focus on Supply Chains.

In 2020, Ausbil was a member of the Australian government advisory panel for the Modern Slavery Act (Act). Ausbil went on to co-author the toolkit on modern slavery as part of our work with RIAA. The purpose of the toolkit is to highlight the investor perspective on modern slavery, but more importantly, to provide examples of leading practice to stimulate positive engagement by encouraging companies to adopt a best practice policy and practice approach toward solving modern slavery. The information used in this guide has been sourced from company disclosure, but more importantly, through primary research by Ausbil through overseas trips to visit factories and suppliers across the supply chain in Asia. In 2021, Ausbil was a co-author of an updated version of that toolkit, which can be read here.

Snapshot of 2021's active Voting

Snapshot of 2021's active voting

Across 2021, Ausbil actively researched, evaluated and acted on 971 resolutions presented by ASX-listed companies at 158 annual and extraordinary/special meetings, as illustrated in Figure 1.

Figure 1: High-level voting activity

Total meetings where votes considered	**158**
Total resolutions considered	**971**
Votes where FOR is submitted on all resolutions	**110**
Active votes AGAINST a board recommendation	**29**
Active votes AGAINST a proxy recommendation	**35**
Proposed shareholder resolutions considered	**30**

Source: Ausbil, 2021.

Of the 971 resolutions presented at 158 meetings in Australia, Ausbil voted 'against' on at least one resolution at 22% of the meetings, underscoring the fact that all resolutions are considered on their individual merit and actioned accordingly. A formal 'abstain' or abstention from voting predominately occurs where Ausbil has participated in a capital raising that requires that Ausbil abstain from voting for legal and governance reasons.

ESG integration in Ausbil's investing

ESG integration in Ausbil's investing

At Ausbil Investment Management, we integrate ESG (environmental, social and governance) factors for better-informed investment decisions, by taking an active advocacy, engagement and ownership approach, and seeking to increase the investible universe of highly-rated ESG companies.

We believe that the integration of ESG research, with active engagement and advocacy, can help identify mispriced securities in an active investment approach. ESG can provide a more holistic assessment of a company's earnings sustainability, drive long-term value and reduce the risk of value destruction. For these reasons, Ausbil has integrated ESG in the investment process for all our investment funds and institutional mandates.

Ausbil has an in-house ESG research team that produces proprietary ESG research, including ESG-related SWOT analyses and ESG scores by company, which are factored in by stock analysts when they set their investment recommendations.

As an investment manager, Ausbil has an inherent duty to act in the best interests of our beneficiaries. In this fiduciary role, we believe that ESG issues are not only central to our fiduciary duty, but can profoundly affect the underlying performance of our investment portfolios.

In integrating ESG in our investment decision making we add significantly more information and intelligence to the management and reduction of investment risk.

As such, we operate under the following principles, that:

- capital flows have the power to drive change,
- proprietary ESG research can deliver unique insights not available in pure fundamental approaches,
- ESG integration leads to better-informed investment decisions,
- active ownership, advocacy, and engagement on ESG issues can reduce the risk of value destruction,
- working with companies is the most productive form of engagement, and
- collaborative engagement can reduce systematic ESG risk for investors.

Focus area: Modern slavery and forced labour in global supply chains

Focus area: Modern slavery and forced labour in global supply chains

Modern slavery and forced labour in supply chains has been a significant focus for Ausbil over many years. For instance, Ausbil published an investor statement on modern slavery and had an active engagement program on these issues years before the Modern Slavery Act was ratified. A number of recent cases have highlighted the link between share prices and labour rights issues[1]. For example, the share price of UK-listed Boohoo halved between 30 June and 8 July 2020 following reports by the NGO Labour Behind the Label and the Sunday Times of labour rights abuses in the company's supply chains. This saw several retailers suspend Boohoo from their sales inventory following long-standing criticism by NGOs over Boohoo's human rights due diligence processes.

In another worrying case, the share price of Malaysian medical glove manufacturer, Top Glove, suffered a major sell-off in March 2021 as US Customs and Border Protection (CPB) executed a seizure order. The authorities acted on information and evidence it had obtained that Top Glove used forced labour in production. The US had already banned products from two subsidiaries after accusations of debt bondage, excessive overtime work and abusive working and living conditions. In early 2022, a sixth Malaysian glove manufacturer was also banned from exporting to the US.

To help assess the risk of modern slavery and broader human rights issues, Ausbil has developed a proprietary human rights risk analysis tool that covers approximately 250 listed companies. Philosophically, our starting point is that all companies have exposure to some degree of human rights risk, particularly deep down in their supply chains. The hotspots for modern slavery are well known, both in terms of industries (such as electronics, mining, building materials, garments, transport, hospitality and services, and in the horticultural and cleaning sectors in Australia), and geographies (some 40 million people were estimated to be in modern slavery conditions before COVID, with the majority located across Asia).

We analyse companies on two key metrics in order to assess the potential for the existence of human rights and modern slavery risk in operations and supply chains, geographic risk exposure and the maturity of a company's risk management function.

"To help assess the risk of modern slavery and broader human rights issues, Ausbil has developed a proprietary human rights risk analysis tool that covers approximately 250 listed companies"

1. https://www.ausbil.com.au/Ausbil/media/Documents/Research%20and%20Insights/Investor-Toolkit-Human-Rights-with-a-Focus-on-Supply-Chains.pdf

Focus area: Modern slavery and forced labour in global supply chains

> In 2021, Ausbil engaged with more than 20 companies specifically on modern slavery and human rights issues in the supply chain

Firstly, risk exposure, is largely based on the geographical location of operations. It also extends into the geographical location of tier-1 suppliers, and suppliers beyond tier-1. Additionally, this analysis looks at the inherent risk of the products and services offered, and the input materials used to deliver these service and products, and their underlying industry dynamics.

Secondly, the level of maturity of a company's risk management offers significant insight into the overall potential for unidentified abuse in the supply chain. Based on a company's disclosure quality, the quality of a company's risk assessment and supply chain mapping, and the quality of the actions taken by a company, we can assess the likelihood of exposure to supply chain and human rights abuse.

Companies in our analysis are stratified on their risk of exposure to human rights abuse in the supply chain, and their framework for identifying and managing these risks. This analysis feeds into the general ESG research and company ESG ratings, and it also helps Ausbil to identify and prioritise companies for engagement.

Ausbil has gone on the record, many times, highlighting that a risk assessment, whilst necessary as a starting point, is not in itself a conduit for change. Rather, we believe engagement with companies is the key role to play for investors, and that this engagement should be done on the expectation that companies will implement continuous improvement programs focused on the identification, reporting and elimination of these risks in their supply chains.

Focus area: Modern slavery and forced labour in global supply chains

Recent and ongoing engagements on modern slavery

Ausbil's engagements on modern slavery includes both company-specific engagements, collaborative engagements, and industry engagement and advocacy activities. In 2021, on a company-specific basis, Ausbil engaged with more than 20 companies specifically on modern slavery and human rights issues in the supply chain.

In collaborative engagement with other investors, Ausbil is an active steering committee member of IAST-APAC (Investors Against Slavery and Trafficking – Asia Pacific), where we are also a lead investor on one company engagement, and a support investor on three other company engagements. Ausbil also co-chairs the work stream 1 of IAST-APAC, which involves an investor statement on modern slavery and information sharing and advocacy opportunities.

Ausbil is also the chair of RIAA's Human Rights Working Group. In 2018, in preparation for the Modern Slavery Act, Ausbil chaired a group of investors producing an investor toolkit on human rights in the supply chain, which is the most downloaded publication RIAA has ever produced. In 2021, Ausbil was a co-author of an updated version of that toolkit, which can be read on our website **www.ausbil.com.au**. The purpose of the toolkit is to highlight the investor perspective on modern slavery, but more importantly, to provide examples of leading practice to stimulate positive engagement by encouraging companies to adopt a best practice policy and practice approach toward solving modern slavery. The information used in this guide has been sourced from company disclosure, but more importantly, through primary research by Ausbil through overseas trips to visit factories and suppliers across the supply chain in Asia.

Ausbil is also engaged in advocacy as a means for helping eliminate the risk of modern slavery in supply chains and to spread knowledge on practical and simple actions that work. For instance, Ausbil is the investor representative on the expert advisory group on modern slavery that is assisting the Australian Federal Government on the implementation of the Modern Slavery Act. Prior to that, Ausbil was the investor representative providing assistance to the government on developing the guidance notes for the Modern Slavery Act, with Ausbil co-authoring an investor guide on Modern Slavery Act reporting.

We are also active in industry engagements. Ausbil is a regular speaker at events related to modern slavery, addressing a wide audience, including investors, industry representative bodies, non-government organisations, government and regulatory bodies, and companies.

Focus area: Modern slavery and forced labour in global supply chains

Progress on modern slavery statements

Ausbil submitted our inaugural Modern Slavery Act Statement on a voluntary basis in 2021, outlining Ausbil's risk assessments and actions taken to help mitigate any risk identified in compliance with the requirements and intent of the Act. Ausbil's statement can be read on our website at **www.ausbil.com.au** or downloaded from the website maintained by Australian Border Force at **https://modernslaveryregister.gov.au/**.

Ausbil read over 250 Modern Slavery Act submissions made by companies in 2021. From this process, it is patently clear that very few companies have identified actual instances of modern slavery issues or suspected issues. This relates to companies mainly auditing just their tier-1 factories and suppliers in this first round of statements. In our experience, the main issues are typically found in the tiers below primary manufacturing and supply relationships. This is why Ausbil actively encourages companies to extend their risk assessments beyond tier-1 relationships, into deeper levels and relationships in the supply chain in a 'six-degrees-of-separation' approach to finding and weeding out human rights and modern slavery risks. Ausbil also encourages companies to consolidate their supply chains and incentivise suppliers to improve their risks and practices.

Ausbil actively engages with companies to eliminate conflicts of interest between procurement and responsible sourcing teams, and encourages companies to adopt innovative solutions, often technology based, to augment their qualitative risk assessment approaches. We believe that the old model of periodic factory audits alone is not sufficient. If periodic factory audits were sufficient, modern slavery and other labour rights issues would not be as prevalent as they are today.

> "Ausbil read over 250 Modern Slavery Act submissions made by companies in 2021"

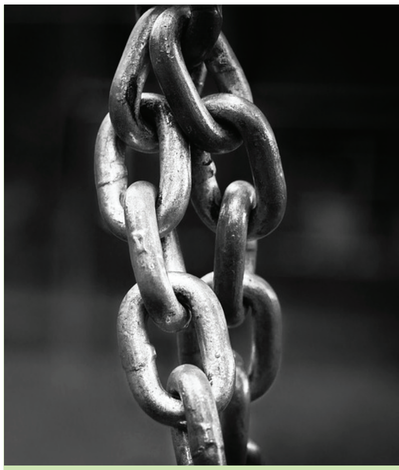
Focus area: Modern slavery and forced labour in global supply chains

Managing risk of modern slavery in our own business

Ausbil has established a Sustainability Committee that comprises the ESG team, which also holds the position of Chair, and staff representatives from various departments, focusing their efforts on addressing modern slavery risk.

In 2021, Ausbil evolved its approach to recognising and managing the risk of modern slavery in our business. Since 2020, the Sustainability Committee and the Finance team have assessed our suppliers on their risk profiles, and risk management processes. Our Supplier Code of Conduct Policy, developed in 2020, was distributed to all suppliers that were classified in our assessment as having a high-risk potential for modern slavery in their supply chains (based on an annual spend threshold of at least $5000). Following this notification process, we will be following-up our suppliers in 2022 to obtain assessments from them on their risks, and how they are managing these risks.

In order to up-skill the whole company in the issues of modern slavery, Ausbil's entire workforce was engaged through focused training on modern slavery our policies, modern slavery statements and how we are looking at our investee companies, and our own business through this lens. Ausbil's ESG team ran two sessions, with the first session on broad modern slavery awareness training and the second session with an external consultant for procurement staff on practical approaches to identifying and managing the risk of modern slavery in our own purchasing program.



"In 2021, Ausbil evolved its approach to recognising and managing the risk of modern slavery in our business"

Focus area: Climate change and decarbonisation

> In early 2021, Ausbil co-signed the 2021 Global Investor Statement to Governments on the Climate Crisis

Focus area: Climate change and decarbonisation

Decarbonisation and the outcome of COP 26

The trajectory towards global decarbonisation since the Paris Agreement in 2015 has rapidly accelerated. The 2020 COVID pandemic saw an acceleration in 'green-stimulus' globally, with COP 26 recently confirming the world's commitment towards net zero, and even brought forward decarbonisations programs.

The drive towards decarbonisation was for many years the domain of lobby groups, future thinkers and the stuff of fringe politics. Today, the decarbonisation revolution is here, and is real and accelerating, increasingly supported by government policy, economics and compelling rates of return. With world governments declaring net zero targets, a ramp-up in large-scale manufacturing of electric vehicles (EVs), and a fundamental shift to renewable energy plants and batteries, we are now seeing the demand that has long been hoped for.

With war erupting in the Ukraine from the invasion by Russia, and the consequent energy shock the world is experiencing, the policy urgency coming out of COP 26 has only accelerated. Global leaders are now planning for some reversal in globalisation, and a return to internally focused procurement for critical commodities and energy. This is already seeing a global shift in policy from oil and fossil fuels to a more rapid renewable energy response that is expected to accelerate trillions in renewable energy investment as economies attempt to build energy capacity outside of oil.

In early 2021, Ausbil co-signed the 2021 Global Investor Statement to Governments on the Climate Crisis. This statement called on governments to act on climate change by strengthening their Nationally Determined Contributions ahead of the COP26. It attempts to get governments to commit to domestic net zero targets and outline a pathway and domestic policies to meet these targets. This required that they ensured that COVID-19 economic recovery plans support the transition to net zero emissions. It also required them to commit to mandatory climate change risk disclosures aligned with the Task Force on Climate-related Financial Disclosures (TCFD).

The COP 26 summit could be best described as keeping the target of limiting global warming to 1.5 degrees 'alive'. The summit saw a number of new climate change commitments, including agreement to reduce the use of coal, end inefficient fossil fuel subsidies and reduce methane emissions. The US and China signed a joint declaration committing them to tackle climate change through accelerated action in the 2020s, and all countries agreed to revisit and strengthen their nationally determined contributions (NDCs) at the next summit in Egypt in 2022.

While Australia has pledged to be net zero by 2050, the path to this target is still uncertain and contingent on technology change. With or without regulatory change, decarbonisation is happening. In part due to changing private capital flows, many companies are moving ahead of regulation with shadow carbon prices and decarbonisation pathways to take advantage of the superior branding positing and competitive advantage that it gives them in the marketplace.

Focus area: Climate change and decarbonisation

> COP 26 saw a number of new climate change commitments, including agreement to reduce the use of coal, end inefficient fossil fuel subsidies and reduce methane emissions

Focus area: Climate change and decarbonisation

> "We are still at an early stage in the development of renewables, and in the transition towards renewable energy dominated economies, and thus the opportunity to participate is rich with options"

Renewable energy and infrastructure

The world has long relied upon fossil fuels, fuels that are typically mined (coal) or drilled (oil and gas), then burned for energy conversion either through combustion engines for propulsion, or in furnaces for the powering of electricity generators. The carbon intensive nature of fossil fuels has contributed to climate change, and other detrimental environmental and health consequences.

Now, organisations like the United Nations have set targets for the transition to new types of cleaner and renewable energies, including wind, solar, geothermal, hydro-electric, hydrogen gas, and carbon capture utilisation and storage (CCUS), amongst the many examples. The Paris Agreement seeks net zero carbon emissions by 2050. The capital-intensive nature of energy development and conversion along the entire value chain means that the transition to full renewable energy may take several decades. More and more governments are signing up to a 'net zero by 2050' target. For investors, this means we are still at an early stage in the development of renewables, and in the transition towards renewable energy dominated economies, and thus the opportunity to participate is rich with options.

We have also seen governments increasingly focused on accelerating the pace of the energy transition, and infrastructure investment more generally. In most instances, this forms part of a nation's recovery plan from the COVID-19 pandemic. For example, the EU has agreed to a €670bn COVID recovery fund, with around €265bn to be made available for the green transition in the form of grants and loans. Additionally, in July 2021 the EU proposed 'Fit for 55', an ambitious undertaking of measures for cutting greenhouse gas emissions by 55% by 2030 (compared with 1990 levels). 'Fit for 55' proposes some significant policy measures, including a carbon border adjustment mechanism (CBAM), a major overhaul of the emission trading system to apply to shipping, aviation, and transport, and acceleration in the development of renewable energy while banning the sale of new fossil-fuel based cars from 2035.

In the USA, the election of the Biden administration in 2020 also gave renewed impetus to the energy transition. President Biden announced a goal to create a carbon pollution free power sector in the USA by 2035, and a net zero emissions economy by no later than 2050. During a leadership summit convened by the US in April 2021, President Biden announced a new target for the US to achieve a 50-52% reduction from 2005 levels in economy-wide net greenhouse gas pollution by 2030. In doing so, he has challenged the world to increase ambitions with respect to combatting climate change.

The Biden administration has proposed a 10-year extension to the production tax credit (PTC) and investment tax credit (ITC) for renewable energy. Not only are they proposing to extend the tax credit and change it to a cash refund, but they also seek to widen the eligibility criteria for the federal investment tax credit (ITC) to include energy storage and green hydrogen projects, and transmission grid investments. While there is an expectation that the eventual policy settings will be watered down somewhat in order to successfully pass Congress, there is no denying the growing momentum to decarbonise the US economy.

Focus area: Climate change and decarbonisation

Most recently, the Intergovernmental Panel on Climate Change (IPCC) released its sixth assessment report on the physical science basis of climate change. The report made for sober reading, underscoring the need for greater action to combat climate change. The IPCC found that it was an unequivocal fact that human influence has warmed the atmosphere, ocean and land. The IPCC also found that global warming of 1.5C and 2.0C will be exceeded in the 21st century unless deep reductions in CO_2 and other greenhouse gas emissions occur in the coming decades.

Policy measures to tackle climate change are highly likely to strengthen over time, and their objectives made more ambitious. This current and emerging policy backdrop will continue to create more and more investment opportunities for the utility and renewable energy companies, the benefits of which the Ausbil essential infrastructure portfolio is positioned to capture.

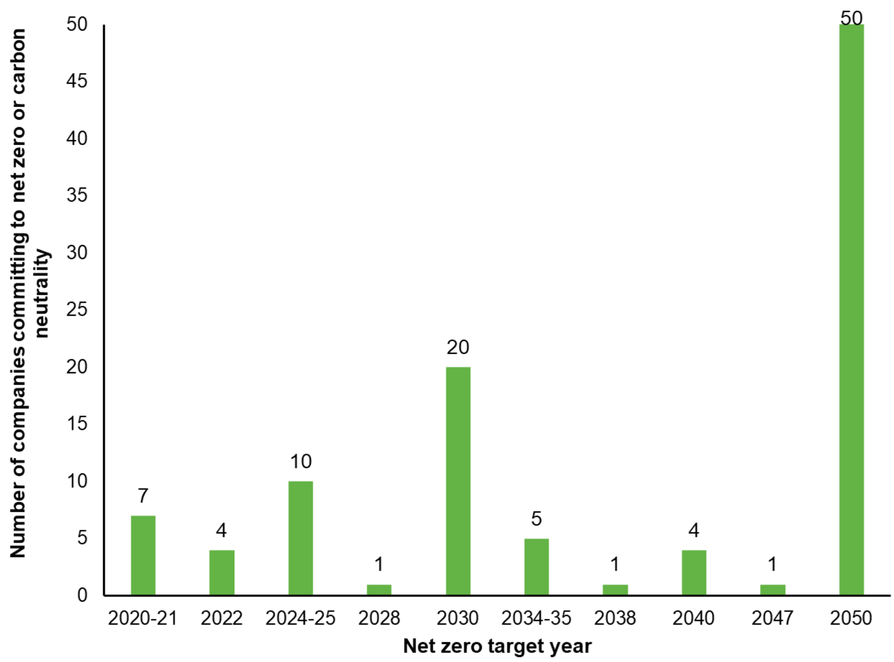
Focus area: Climate change and decarbonisation

Net zero targets

In June 2019, the UK became the first major economy to enshrine a net zero by 2050 commitment into law. Since then, more and more countries have quickly followed suit. Currently, around 53% of the global economy (as measured by GDP) has set or are intending to set a net zero by 2050 target. This is a fundamental shift in the driving forces behind the energy transition, moving from an economic motivation to a normative ESG-focused motivation with clearly defined legal requirements.

To date, many companies have already pledged net zero commitments. At the time of writing, 103 companies in the S&P/ASXASX 200 have made pledges to be net zero (88) or carbon neutral, from the present to 2050, as illustrated in Chart 3. These companies represent over 60% of the market capitalisation of the largest 200 companies listed on the Australian Stock Exchange (ASX). However, the paths to those commitments are not always clear and, in some cases, they rely partially or significantly on carbon offsets. We believe investors need to carefully scrutinise and evaluate these commitments and pledges to ascertain how credible they are. In some cases, they depend on long-dated technology changes and a few uncertainties.

Chart 3: Outlook for company net zero commitments



Source: Macquarie Equity Research

Focus area: Climate change and decarbonisation

In evaluating the credibility of pledges, we believe the Science Based Target initiative (SBTi) will play a role in achieving net zero targets. To date, less than 20 companies in Australia have been SBTi certified. Science-based targets show companies how much and how quickly they need to reduce their greenhouse gas (GHG) emissions to prevent the worst effects of climate change. Importantly, offsets cannot be used in this approach, making it a pure approach to carbon reduction. It should be noted, however, that this means that it is very hard to achieve SBTi certification in some hard-to-abate sectors.

Ausbil had significant focus on climate change in company-specific engagements throughout 2021. These related to general risks and opportunities from decarbonisation as well as climate change strategy and targets, including links to executive remuneration, disclosure and the role that technology can play. We believe that a number of commodities can play a major role in a decarbonising world, and we also believe banks can play a role as facilitators of the debt and capital required to fund this growth. We continue to engage with energy and steel companies on the credibility and practicalities of their decarbonisation strategies, including in-depth discussions about the application of hydrogen and carbon capture storage (CSS). While there are very few opportunities to invest in renewable energy through listed companies on the ASX, we regularly discuss opportunities with Macquarie Group, which is a major renewable energy investor.

Recent years have seen a flurry of shareholder resolutions on climate change and Ausbil believes it is important that companies get on the front foot on disclosure around climate change. Once Rio Tinto announced that it would have a voluntary and advisory say-on-climate change resolution at the 2022 AGM, Ausbil engaged with several mining and energy companies to adopt a similar approach, which they have done. We also continue to provide guidance and recommendations on climate change disclosure, including targets and metrics as well as scenario analysis to a number of companies.

"We continue to provide guidance and recommendations on climate change disclosure, including targets and metrics as well as scenario analysis to a number of companies"

Focus area: Climate change and decarbonisation

How Ausbil assesses and manages climate change risks and opportunities

Ausbil assesses climate change risks and opportunities in several ways, including:

- through extensive company level proprietary ESG research;
- with a proprietary Net Climate Change Risk (NCCR) model and analysis tool that was developed at company level to assess the inherent climate change risk in our portfolios;
- through detailed carbon foot-printing and climate change risk research;
- at a granular level through detailed company engagement on specific measures and plans for climate change policies and how companies are practically dealing with climate change risk in their businesses, and in their future; and
- through proxy voting

Regarding carbon foot-printing, this is a somewhat blunt tool in our view, but it can highlight the key outliers from a carbon emissions perspective. Many other investment firms adopt this approach, but without the extensive proprietary ESG research and multi-year tail of ESG engagement work on climate practices and change, they lag our more extensive approach, in our view. The drawbacks with carbon footprint analysis are, for example, the fact that it uses historical data only (not forward-looking trajectories), it ignores engagement and the potential to impact and improve on current practices, it ignores physical climate change risk, and it ignores climate-change-related opportunities.

On the latter, we believe a number of commodities, such as copper (electrification), lithium (for battery technology) and nickel could be major net beneficiary of accelerated decarbonisation, particularly if mining companies accelerate their operational emissions (scope 1 and 2). However, that is not apparent in a simple carbon footprint analysis.

To that end, Ausbil has developed a proprietary climate change analysis tool called Net Climate Change Risk (NCCR). This model generates a scenario analysis that uses three climate change scenarios (including a net zero scenario), across three timeframes (rolling 12-months, rolling 5-years, and by 2050). The NCCR assess the net risk / opportunity to a company's business model from physical climate change risk as well as transition risk. NCCR is supported by in-depth analysis done jointly by the ESG research team and Ausbil's team of equity analysts. The analysis undertaken in 2021 showed that the portfolio compared favourably to the S&P/ASX200 index in all scenarios, across all the three different timeframes. Importantly, this analysis includes an assessment of our view on the credibility of the climate change commitments, pathways to net zero and climate change targets communicated by companies (see discussion on net zero on page 22).

Focus area: Climate change and decarbonisation

Engagement on climate change

Ausbil engages with investee companies on climate change on a frequent basis. This includes both company-specific engagements as well as collaborative engagement and advocacy activities. For example, in work we undertook in collaboration with the IGCC and Climate Action 100+ Ausbil was a support investor to six company engagements.

In 2021, Ausbil discussed both climate change-related risks and opportunities with companies, such as BHP and their asset portfolio mix. We also engaged successfully alongside other investors to encourage a number of companies to adopt voluntary say-on-climate change resolutions. We believe such resolutions will provide an opportunity for investors to vote holistically on a company's overall climate-change risk management approach, including its disclosure, its policies, actions, and the credibility of its decarbonisation pathway looking forward.

Focus area: Engagement with indigenous peoples

> When trust is broken with indigenous people, it can take decades to rebuild. There is a fine balance in relations with indigenous communities communities performance

Focus area: Engagement with indigenous peoples

Treatment of traditional owners

Following the Juukan Gorge incident in 2020 and its aftermath, including major executive management changes at Rio Tinto and a parliamentary inquiry, the investor community can no longer turn a blind eye to the issue of relations with indigenous communities. Importantly, investors need to understand how companies are actually managing their relationships with traditional owners. Unlike many other ESG issues where investors have direct access to other stakeholders, this issue can be more difficult to research. When indigenous heritage is lost, it is forever. When trust is broken with indigenous people, it can take decades to rebuild. There is a fine balance in relations with indigenous communities. The mining industry in particular brings many benefits to these communities. However, mistakes are easy to make and sometimes leave a permanent mark.

In 2021, a group of investors tackled the issue of indigenous relations in a similar way to how investors have tackled the systemic issues of hidden modern slavery and human rights issues in supply chains, namely by collaborating and producing an investor toolkit: Investor Toolkit - An Investor Focus on Indigenous Peoples' Rights and Cultural Heritage Protection. This was produced through the Responsible Investment Association Australasia (RIAA), and while Ausbil was not a main author, we were a contributor through our role as Chair of the Human Rights Working Group of RIAA. In a similar structure to the investor toolkit on human rights, which Ausbil co-authored, this toolkit includes suggested engagement areas and questions, and a guide on how to spot red flags for engaged investors. It also includes a foreword by the First Nations Heritage Protection Alliance. The toolkit can be read here.

Ausbil also had company-specific engagements on the topic with a number of mining companies, which improved our understanding of the issues and how individual companies are managing them. While the focus initially after Juukan Gorge was on Rio Tinto, this engagement has been carried out with a number of major and junior mining companies listed on the ASX. We also supported a shareholder resolution for Fortescue Metals Group which called for improvement to WA Cultural Heritage Protection Law.

Focus area: Occupational health & safety, and culture

Focus area: Occupational health & safety, and culture

It is more difficult to find a true laggard on occupational health and safety management today than it was 10-years ago as many companies have improved their performance, with more companies operating fatality-free and with lower injury statistics than in the past. This is partly driven by increased automation but also by outsourcing as genuinely better risk management and safety cultures show in the superior safety statistics. However, some companies keep having fatalities in high risk prone industries. To Ausbil, it is important to understand the drivers and circumstances behind each individual fatality and what the company has learnt from the incidents. COVID-19 has also led to some challenges in some cases, partly due to workplace density restrictions, but also absenteeism, which in turn has led to greater reliance on contractors. Ausbil has been engaging with companies on these issues.

At the heart of it, we see safety performance as more than just a 'social' issue. We believe there is a clear link between safety performance and operational performance. To that end, safety performance can act as a lead indicator of operational performance in the future. In a similar fashion, performance on cultural factors, such as staff engagement, but also on customer satisfaction can be lead indicators of operational performance.

"We see safety performance as more than just a 'social' issue. We believe there is a clear link between safety performance and operational performance"

Assessing culture is a challenge but is something that regularly features in Ausbil's proprietary ESG research. As we have seen, poor culture can result in significant value destruction. The banks and the Royal Commission is one good example. AMP, another one. Many companies themselves report on some cultural aspects, including gender and diversity, the results from staff engagement surveys, absenteeism and staff turnover rates, health and safety performance, among other measures.

Typically, these things are reported on an annual basis though and by the time the disclosure is out, perhaps it is already too late for investors to act. In our research, we also scan social media and we read independent customer reviews and independent staff reviews. Those are only samples, but they offer good insights into a company's culture and what is actually going on behind the corporate veil.

Diversity, including gender, continues to be a key focus area in our research and engagement activities. While gender diversity on boards is one metric that often gets mentioned in ESG research in general, Ausbil believes analysis needs to go further. The focus should be on fostering a meritocracy and equal opportunity, regardless of gender, race and other personal attributes, in order to ensure companies, foster their human capital and retain the best people they can. To that end, Ausbil's cultural reviews focus on how a company actually addresses diversity and inclusion, beyond what companies disclose in gender diversity policies and similar.

In early 2022, Rio Tinto released a report detailing a number of cultural issues, including bullying, racism, sexual harassment and even sexual assault in the workplace and remote fly-in fly-out mining settlements. Anecdotally, we believe there is a risk that these issues are widespread across the mining industry, and we expect this to be a major focal point of engagements across 2022, alongside other cultural and diversity issues.

Focus area:
The circular economy

> Energy-from-waste is still an emerging technology in Australia that is picking up speed and is evolving as one of the solutions towards eliminating waste that would have otherwise been sent to landfill

Focus area: The circular economy

Global decarbonisation and the circular economy go hand-in-hand and we continue to see the evolution of packaging and waste innovation across all sectors. A circular economy calls for everyone to reduce, reuse, recycle and recover materials. It is a multi-faceted issue as it can be tackled from different areas and government policy will tie it altogether to achieve a closed-loop system that is restorative or regenerative by intention and design. In the past year, we have seen a rise in net zero and carbon emission reduction commitments by corporates across the ASX, and waste reduction commitments have followed closely. A major push came from the big Australian supermarkets and food manufacturers which as a collective committed to making all plastic packaging reusable, recyclable or compostable by 2025 as part of an industry wide ANZPAC Plastics Pact supported by organisations across ANZ and Pacific.

Government regulation has supported the behavioural shift amongst the corporate sector where we have seen more bans on single-use plastics like shopping bags, cutlery, straws, and cups globally. Unifying countries in this endeavour is the United Nations who in early 2022 approved an agreement to create the world's first global plastic pollution treaty described as the most significant environmental deal since the 2015 Paris climate accord. The UN agreed on a plastic treaty roadmap with further information on implementation to be finalised by 2024. Commentary noted this as the biggest global agreement since the Paris Climate Accord in 2015 and will be a major catalyst into the New Year, and both material producers of oil and chemicals and consumer goods giants utilising single-use packaging will face the consequences of this shift if they themselves do not adapt or innovate.

Energy-from-waste is still an emerging technology in Australia that is picking up speed and is evolving as one of the solutions towards eliminating waste that would have otherwise been sent to landfill. The number of projects and developments in this sector are increasing where, for example, Cleanaway has recognised that it will be a core part of the business in the future. Cleanaway is investing into research to discover circular solutions for more materials. We have also seen acquisitions of relevant businesses to expand their scope and strategy. Other materials like glass and metal are on the rise as plastic bottles are less popular, and consumer behaviours are shifting towards consciously sustainable decision making.

Focus area: Cyber Security

Focus Area: Cyber security

Just like in 2020, cyber threats and security breaches did not decelerate throughout the year but we have noticed that the conversation amongst CEO's has shifted away from reacting to the problem and now towards pro-activeness and where further investment is being directed.

The setting is similar to 2020 with the prominence of flexible working within the workplace, which brings major challenges where organisations demand immediate, uninterrupted access for their users no matter where they are located. With the exponential increase in remote users and SaaS applications, more traffic between public cloud services, and offices and data centres, there is a need for a new approach to network security. Ever present is the volume of the attacks with the large Australian banks testifying that they are still blocking millions of malicious attacks per month. The types of threats we have seen most prominently in the past year include broader phishing attacks, service attacks, online fraud, ransomware attacks in the market such as disabling operations, and stealing confidential information. No one sector is safe from this risk, with miners realising that their technology dependency at mining sites is a major risk, for example, and an attack on core utilities and industrial companies could bring production to a standstill.

Corporates demonstrating a strong cyber security foundation are no longer at a comparative advantage given that cyber security is necessary in operating in this day and age. We need to see more C-level cyber security and IT expertise with threats reported directly to the CEO, expertise on the Board, a strengthened focus on cyber security in internal policies, and workplace training on threat identification and management as staff are at the frontline. Despite increased employee awareness training, human error is the biggest cause of data breaches and is exacerbated when staff are burnt out. Pairing this with a thin talent pool on cyber-security in Australia, and reduced immigration due to border restrictions, efforts towards cyber security are constantly challenged. This remains a growing area of focus for 2022.

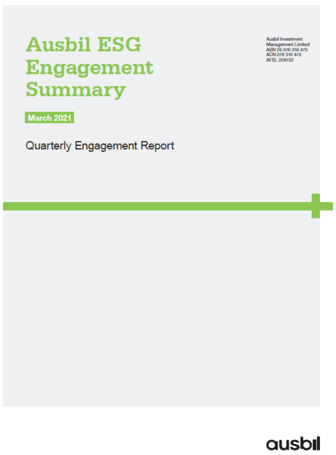
> "Corporates demonstrating a strong cyber security foundation are no longer at a comparative advantage given that cyber security is necessary in operating in this day and age"

Conclusion

Conclusion

In conclusion, Ausbil's commitment to ESG is evidenced by our integration of ESG across our investment decision-making complex. Underpinning our leadership in ESG is the active engagement and advocacy by our ESG team. Our engagements are deep, and we engage with listed companies over time on multiple fronts, and with a clear focus on achieving change, and improving their ESG behaviours and scores, regardless of whether we think they are investable or not. Or commitment to ESG is fundamental to our business, our investing, and how we operate as a company. We prefer to engage rather than shame, and to achieve change rather than exclude. Our philosophy is ultimately tied to the idea that to achieve the goals of ESG investing, such as net zero and carbon neutrality, we must try and bring every company along the journey, because at the end of the day, we are all in this together.

Appendix 1: Detailed outline of ESG actions, engagement and advocacy by company and theme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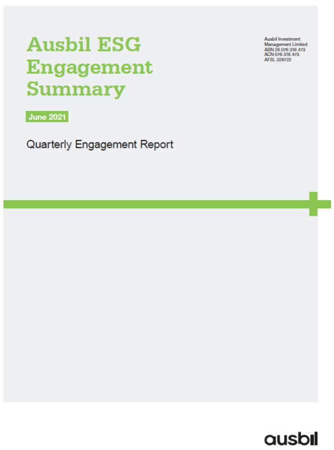
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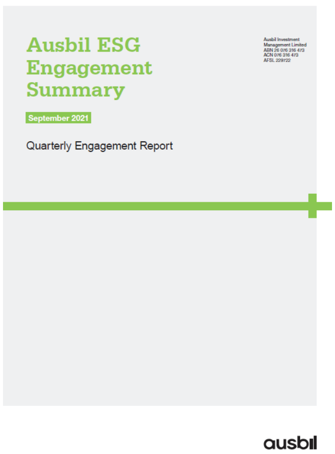
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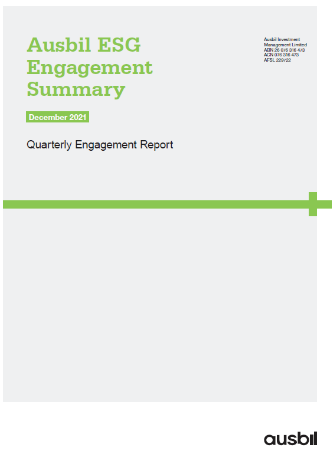
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United States
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CELEBRATING 25 YEARS IN FUNDS MANAGEMENT