



Ausbil Investment Management

Demystifying Sustainable investing

June 2018

Måns Carlsson-Sweeny
Nicholas Varcoe

Head of ESG Research
ESG Research Analyst



Why Ausbil for Australian equities

Strong, well managed organisation backed by New York Life

- Boutique Core Australian equities manager
- A top down/bottom up investment process that has delivered strong long term alpha
- Investment focus is earnings and earnings revisions
- Dedicated in-house ESG team creating proprietary research which is integrated into our investment process
- Highly experienced Australian equities team

Ausbil investment team

Integrated functions within portfolio management

PORTFOLIO CONSTRUCTION COMMITTEE

JOHN GRACE (16/32)
Co-Head of Equities

PAUL XIRADIS (22/39)
CIO / Head of Equities

GIAN PANDIT (3/27)
Deputy Head of Equities

RESEARCH

NICK CONDOLEON (11/24)
Head of Research / Equities Analyst

SHANELLE HOONG (12/12)
Equities Analyst

ANDREW PEROS (1/10)
Equities Analyst

LUKE SMITH (4/20)
Equities Analyst

JAMES STEWART (1/16)
Equities Analyst

JAN VAN DER SCHALK (1/32)
Equities Analyst

JORDAN WOODS (4/4)
Equities Analyst

ZELJKA BLACK (7/17)¹
Equities Analyst

ECONOMICS

JIM CHRONIS (4/26)
Chief Economist

ESG

MÅNS CARLSSON-SWEENY (3/15)
Head of ESG Research

NICHOLAS VARCOE (2/2)
ESG Analyst

QUANTITATIVE

KHAY-TUCK CHOW (18/31)
Head of Quantitative

STEPHEN YEUNG (1/1)
Quantitative Analyst

PORTFOLIO ANALYSIS

SALMAN SIDDIQI (2/9)
Portfolio Analyst

MICROCAP

MASON WILLOUGHBY-THOMAS (1/16)
Portfolio Manager

ARDEN JENNINGS (1/6)
Co-Portfolio Manager

GLOBAL SMALLCAPS

SIMON WOOD (1/16)
Portfolio Manager

TOBIAS BUCKS (1/12)
Portfolio Manager

DEALING

MATT OKKERSE (12/19)
Senior Equities Dealer

LEE DE MARIA (12/17)
Equities Dealer

NB. Numbers denote (Years at Ausbil/Years in industry) and have been rounded up. Members of the Investment Committee are represented in green.

1. Zeljka Black is currently on maternity leave.



Ausbil Investment Management

ESG capability



Agenda

- What is ESG (environmental, social and governance) integration and why do investors use it?
- How does Ausbil apply ESG integration in practice?
- Recent examples
- Active ownership or engagement on ESG issues
- Ausbil's Active Sustainable Equity Fund

“Evolution” of responsible investment

Responsible Investment



- **Ethical investment:** typically based on exclusions only (negative screening)
- **Socially responsible investment:** positive screening / thematic investments.
- **ESG integration:** better informed investment decisions with the view to improve returns.



ESG and returns – does it pay off?

- **Academic / empirical studies are generally supportive that ESG drives higher returns**
 - *Macquarie 2016; companies with engaged workforces consistently outperformed over nine years, 6.6% annually in the last 3 years.*
 - *‘ESG and financial performance’ 2015: empirical evidence from 2,000 studies found clear evidence for the business case for ESG investing.*
 - *‘Corporate Investment in ESG Practices’ 2015: corporate investment in ESG lowers cost of capital.*

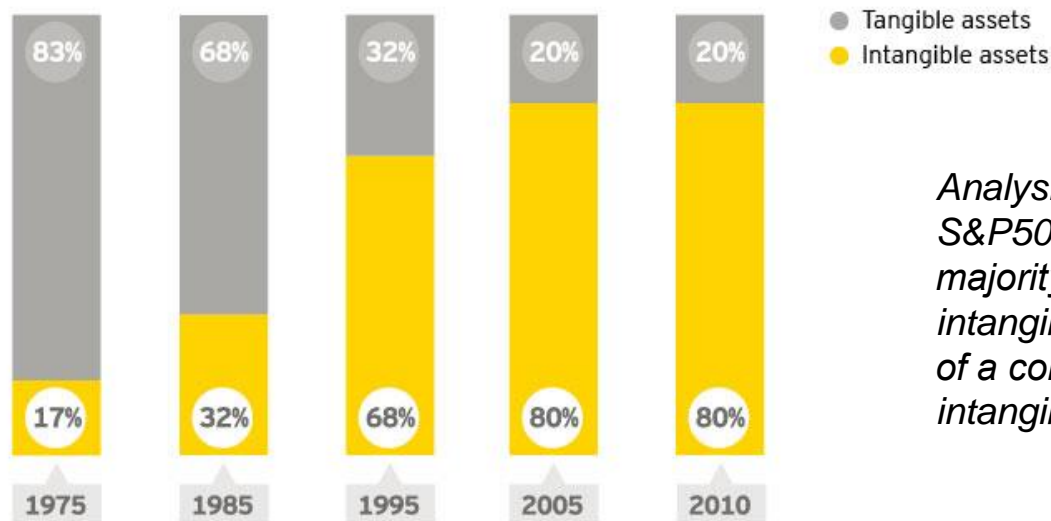
*‘Studies show ESG investment has solid payoff.’
Australian Institute of Company Directors. 8 July 2016*

<http://aicd.companydirectors.com.au/advocacy/governance-leadership-centre/governance-driving-performance/studies-show-esg-investment-has-solid-payoff>

- **Ausbil’s own experience**
 - *130/30 fund and short positions based on / aligned with ESG can be a good driver of alpha.*

Why ESG integration?

- The importance of intangibles has increased over time.
- Analysing intangible drivers can help investor make better informed decisions



Analysis by E&Y on the components of S&P500 market value shows that the majority of a company's value comes from intangible drivers and that the proportion of a company's value that comes from intangible drivers has increased over time.

Source: EY, 'Integrated reporting – Tips for organisations on elevating value'



What are ESG drivers?

Examples

- **Environmental:** Environmental risk management processes and performance, EPA compliance, CO2 and other greenhouse gas emissions, climate change adaptation / risk mitigation and more.
- **Social:** Corporate culture, supplier relationships / supply chain risk management, customer relationships, human capital development, occupational health & safety, conduct risk management and more.
- **Governance:** Board composition and independence, alignment between shareholders' best interest and executive remuneration, corporate governance frameworks, whistle-blower processes and more.

Ausbil's ESG capability

ESG Integration

- **What does ESG integration mean to Ausbil?**
 - Better informed investment decisions -> can lead to better outcomes
 - Active ownership and engagement on ESG issues
- **ESG research: natural fit with Ausbil's investment philosophy**
 - Earnings revisions
 - Earnings sustainability
 - Proxy for management quality
 - Focus on change / momentum in a company's ESG profile.
- **Unique insights driven by proprietary internal ESG research**
 - Company-specific ESG summaries and ESG scores on 200+ companies
 - Weekly ESG newsletters, daily input to investment team meetings
 - Contribution to monthly stock selection meetings
 - Working closely with financial analysts (research and engagement)

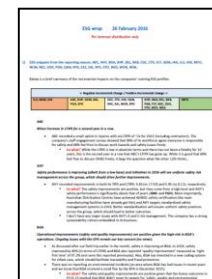
Proprietary ESG research:



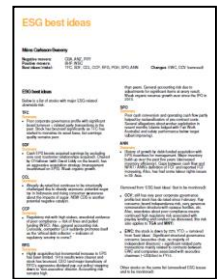
Thematic research



Company-specific ESG summaries



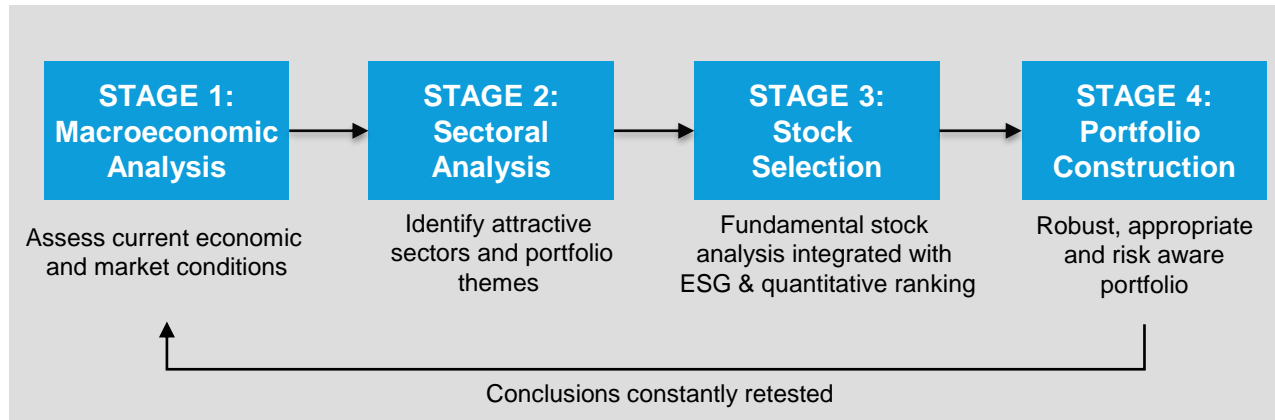
Weekly ESG newsletters



Monthly ESG best ideas

Ausbil's ESG capability

ESG elements in the Australian equities process



Proprietary ESG research inputs

Quantitative outputs – ESG scores

- **Industry ESG score** (range 1-5)
ESG risks and opportunities *inherent in the industry*
- **Company ESG score** (range 1–5)
How a company manages its key ESG factors
- **Sustainability Score** (range 2-10)
Sum of company and industry ESG score

Qualitative outputs:

- Key ESG related risks and opportunities
- ESG SWOT analysis

ESG Direction

- ESG profile trajectory (range positive +1, neutral 0, negative -1)

Ausbil's ESG capability

Recent examples

- **Earnings revisions:**

- Food safety issues
- OH&S events
- Transparency issues



- **Earnings sustainability:**

- Payday lending
- Underpaid workers



- **Management quality:**

- ESG as proxy for management quality
 - Corporate governance issues
 - Momentum / direction on ESG





Ausbil's ESG capability

Advantages of Proprietary ESG Research

- ESG research tailored to fit Ausbil's investment philosophy
- Unique investment insights generated from a variety of sources
- ESG integrated investment team generates significant discussion and dialogue about key ESG issues on a regular basis
- Corporate access and active ownership can generate significant ESG insights
- Timely insights can proactively identify ESG-related earnings opportunities and risks



Ausbil's ESG capability

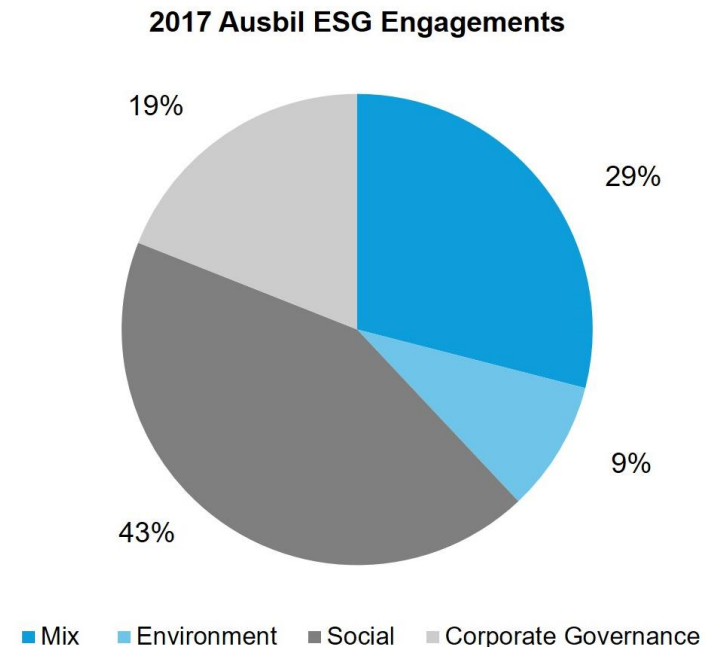
Industry participation

- Signatory to Principles for Responsible Investment (PRI)
- Asset manager representative on the PRI Australian Network Advisory Committee
- RIAA member since 2003
- Active member of RIAA Engagement Working Group & RIAA Human Rights Working Group
- Member of Investor Group on Climate Change (IGCC)
- Member of Climate Action 100+
- Only investor representative on the Advisory Committee for the Australian Business Pledge against Forced Labour
- Active member of Investor Statement on Bangladesh (ICCR)

Ausbil's ESG capability

Active ownership and engagement 2017

- Extensive corporate access enables regular engagement on ESG issues
- Ausbil engaged on approximately 140 occasions with 65 companies in 2017
- Ausbil carry out engagement as a team (PMs, stock analysts & ESG team)
- Engagement occurs at all company levels (board, executive management, line managers, site visits, etc)





Ausbil's ESG capability

Active ownership and engagement 2017 - examples

- **Human rights in supply chains**
 - Company engagement – focused on industry best practice
 - Government engagement - Modern Slavery Act
 - Collaborative engagement – Bangladesh Accord
- **Climate change:**
 - Task Force on Climate-related Financial Disclosures (TCFD)
 - IGCC / Climate Action 100+
- **Improved ESG disclosure**
- **Corporate governance**
- **Various company-specific engagements:**
 - Underpaid workers, culture, whistle-blower procedures, OH&S....

Ausbil's ESG capability

Examples of key themes for 2018

- Continued clean-up of the environment in China
- Royal Commission into banks / government inquiry into franchises -> increased regulation
- Cyber security
- Wage growth in health and aged care
- Continued engagement on key ESG themes
 - Human rights and labour rights in supply chains
 - Climate change
 - Improved ESG disclosure
 - Corporate governance



China ESG field trip in 2016: garment factory in Guangzhou and washing & dyeing facility outside Nanjing



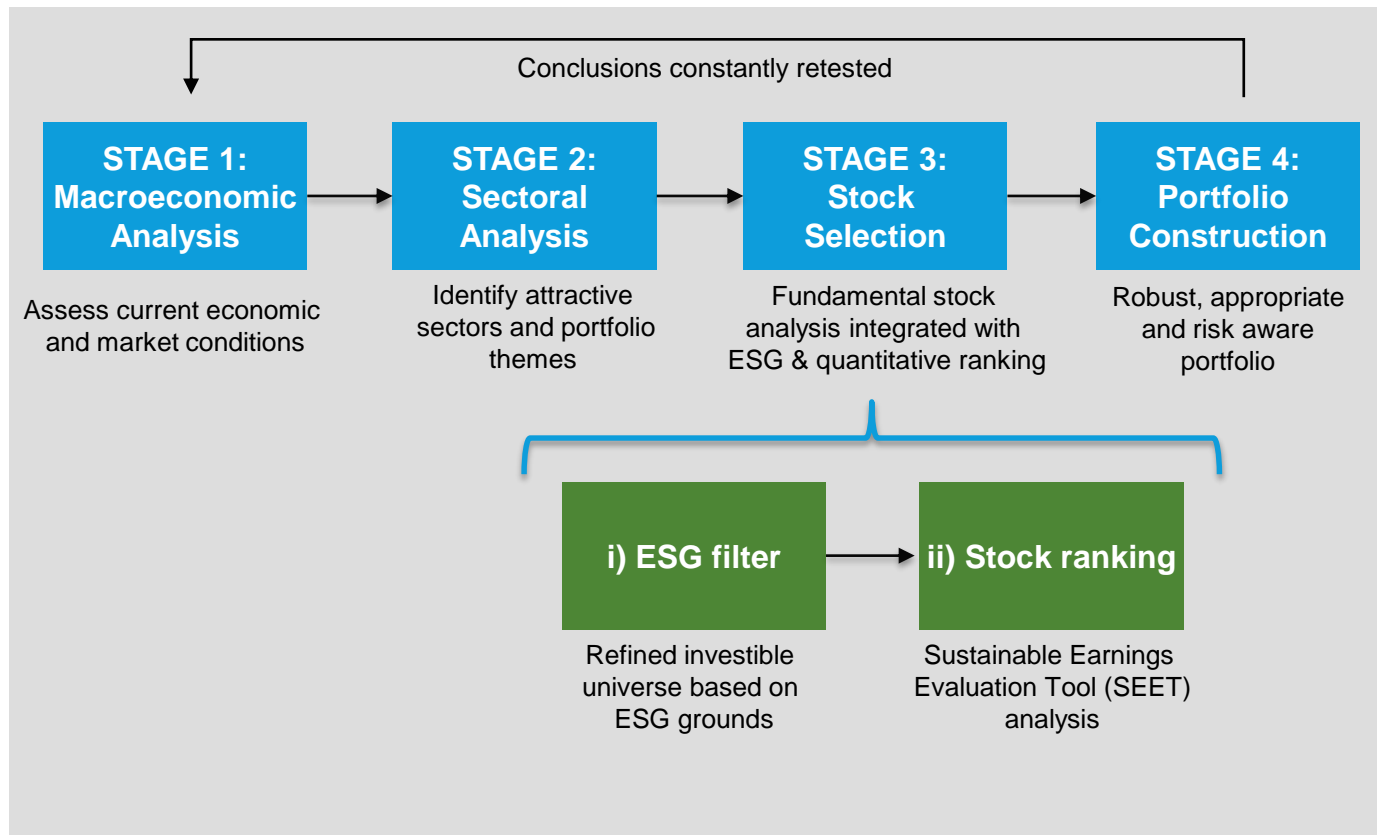


Ausbil Active Sustainable Equity

Philosophy & process

Ausbil Active Sustainable Equity

Process summary



Stage 3: ESG stock selection

Proprietary ESG research outputs

Qualitative outputs

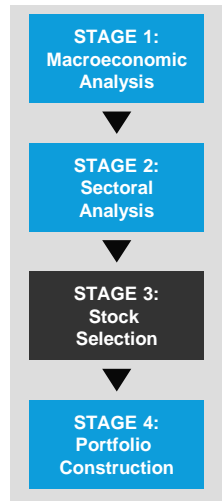
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ESG Direction

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Stage 3: ESG stock selection

Refined universe – ESG filter

ESG Filter

Refine investible universe based on ESG criteria, removing companies subject to long-term earnings sustainability risk

1. Companies with material direct exposure or indirect exposure to 'controversial activities'

- Alcohol, tobacco, gambling, pornography, weapons & armaments and mining of thermal coal and uranium

2. Companies not meeting minimum ESG hurdle

- Stocks with an industry ESG score of 1.5 or below
- Stocks with a company ESG score of 1.5 or below
- Stocks with a sustainability score of 4.0 or below

STAGE 1:
Macroeconomic
Analysis



STAGE 2:
Sectoral
Analysis



STAGE 3:
Stock
Selection



STAGE 4:
Portfolio
Construction

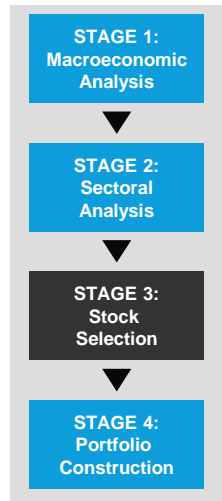
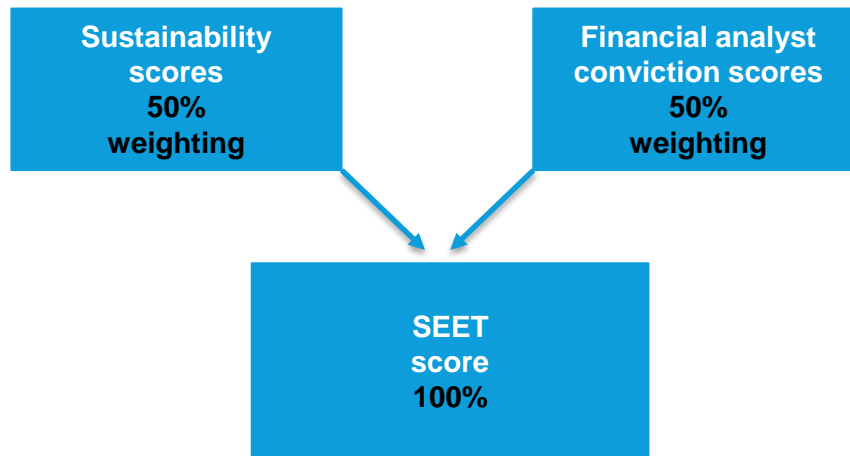
Stage 3: ESG stock selection

Stock ranking tool (SEET)

Stock ranking

Stocks in the universe are ranked by a proprietary tool - Sustainable Earnings Evaluation Tool (SEET)

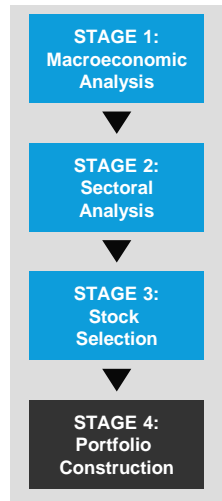
SEET takes into account both financial analyst conviction scores (50%) and sustainability scores (50%), normalised to a common scale.



Stage 4: Portfolio construction

Construct a robust, appropriate and risk aware model portfolio

- Minimum 50% of portfolio by weight must come from top 1/3rd of SEET ranking
- Specialist portfolio construction team – Paul Xiradis Portfolio Manager, Måns Carlsson-Sweeny Head of ESG Research, Nick Condoleon Head of Research
- PCC have discussions about stocks on a daily basis
- Portfolio construction guidelines provide bounds, manage risk and ensure consistency





Ausbil Active Sustainable Equity strategy

Key characteristics

- Specialist portfolio construction committee (Paul Xiradis Portfolio Manager, Måns Carlsson-Sweeny Head of ESG Research, Nick Condoleon Head of Research)
- In-house ESG research team creating proprietary research
- Benefits from Ausbil's existing process and research capability
- ESG direction identifies alpha opportunities
- Active ownership - heavy emphasis on engagement
- Refined universe, removing companies where we see major ESG issues or long-term earnings risks from ESG factors
- Proprietary ESG ranking tool (SEET) combining both ESG and financial considerations

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