ausbil

Ausbil Investment Management Limited

CLIMATE POLICY

August 2024

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Purpose

This policy provides an overview of Ausbil Investment Management Limited's (Ausbil) approach to climate change. The policy has been developed to partly align with the Task Force on Climate-Related Financial Disclosures' (TCFD) recommendations. Ausbil aims to regularly update this policy as required.

Introduction: Ausbil's role in managing climate risk

The UN has called climate change the defining issue of our time[1]. Ausbil recognises climate change as a major global issue, with potentially destructive impacts on the global economy. The majority of scientific opinion supports the view that climate change is caused by increased levels of greenhouse gases, which result from human activity[2].

Ausbil acknowledges the science and the findings of the Intergovernmental Panel on Climate Change (IPCC). We also acknowledge the Paris Agreement's target of limiting global warming to well below 2 degrees Celsius above pre-industrial levels. In line with that, Ausbil acknowledges the target to achieve net zero greenhouse gas (GHG) emissions by 2050 and we encourage companies to work towards that goal.

As an institutional investor and responsible entity, Ausbil has a duty to act in the best interests of our beneficiaries. In this fiduciary role, we believe that Environmental, Social and Governance (ESG) issues, including climate change can also affect the underlying performance of investment portfolios. Ausbil undertakes research and engagement to better understand the potential impact of ESG issues, including climate change. Ausbil employs a dedicated ESG research team, which provides proprietary ESG research for Australian equities strategies. For Ausbil's global equities strategies, we use an external ESG research provider. In both cases, the ESG research includes climate change issues.

Ausbil believes climate change presents investment risks and opportunities, which can broadly be divided into 'physical' and 'transition':

- 'Physical' climate change impacts include, the risk and severity of extreme weather events, such as bushfires, hail, storms and flooding; changes to weather patterns; rising sea levels; and increased water risk . These issues can directly and indirectly impact company valuations and earnings volatility. Companies can by impacted by operational disruption; increased input costs for water; increased capital costs from physical damage to facilities, and resultant higher insurance costs on assets in high-risk areas; impacts on human health; and more.
- 'Transition' impacts include: regulatory changes, including pricing of carbon emissions; technology changes, such as lower emissions technology; the transition towards a circular economy; changing consumer behavior; changing demands for products with a lower carbon footprint; and more. These may impact company valuations and their value chains because of changes in the revenue mix and sources, changes to costs, re-pricing of assets, and increased capital investments in technology. There are also opportunities from the likes of better resource efficiency, including more efficient buildings, reduced resource consumption, increased recycling, and reduced operating costs from lowest-cost abatement.

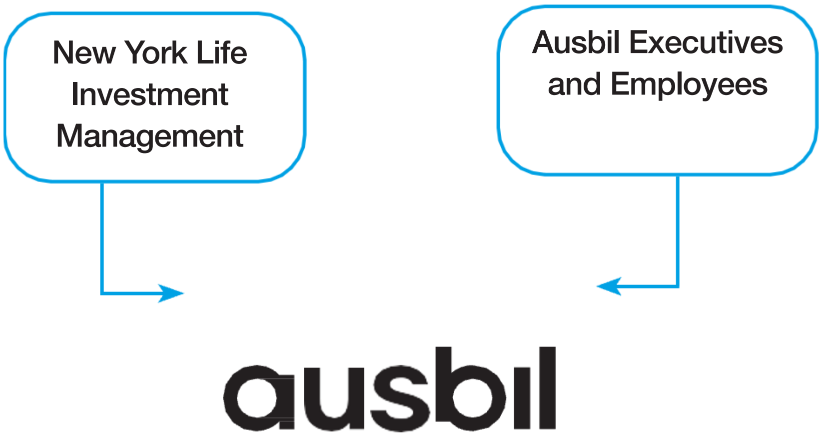
In short, Ausbil believes the impacts from climate change are multi-faceted and the timeframe of these impacts can vary greatly.

Further, Ausbil believes that advocacy and engagement (individual company engagement or collaborative engagement with other investors) can be an important step in managing climate-change-related risk. Ausbil is a signatory to the Principles for Responsible Investment (PRI) and is a member of both Investor Group on Climate Change (IGCC) and the Responsible Investment Association Australasia (RIAA).

Governance: Ausbil’s Governance structure and climate

Ausbil is a leading Australian-based investment manager. Established in April 1997, Ausbil’s core business is management of Australian equities for major superannuation funds, institutional investors, master trusts and retail clients. Ausbil is owned by its employees and New York Life Investment Management, a wholly owned subsidiary of New York Life Insurance Company. As at 31 July 2024, Ausbil manages over $19bn in funds.

Figure 2: Ausbil ownership structure



The Board operates pursuant to a Board Charter and is responsible for the overall management of Ausbil. The Board has delegated to the Chair of the Executive Committee (EXCO Chair), who is authorised to exercise all the powers of the directors (subject to matters that are reserved for the Board), responsibility for the implementation of the Board’s strategy and overall performance.

Ausbil has a Sustainability Committee (comprising members from different teams across the organisation, including Ausbil’s CEO) to assist Ausbil’s ExCo in implementing the Company’s strategic Sustainability Goals. The Sustainability Committee also assists in the oversight, monitoring and review of the Company’s practices, which includes minimising and managing environmental risks and impacts, including climate change.

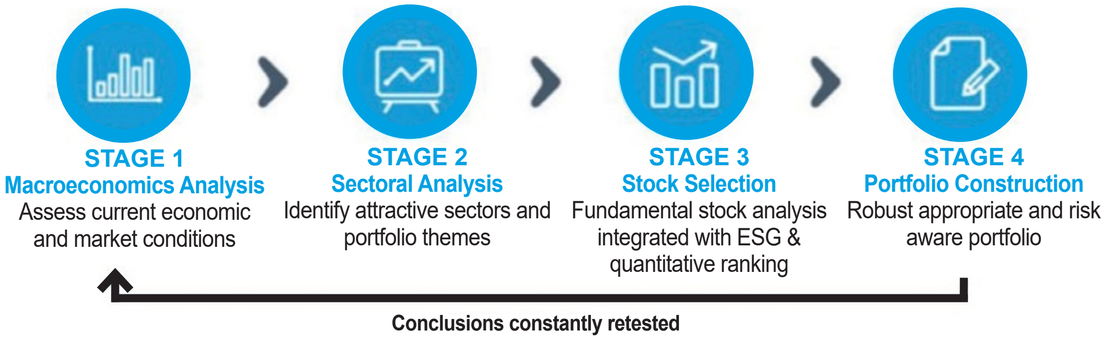
Strategy: Climate change impacts form an integral part of Ausbil’s investment strategy

As mentioned, the key impact of climate change on Ausbil’s business is on its investment portfolio. Ausbil’s investment philosophy is to actively manage our portfolios to generate consistent and risk-controlled outperformance. Our investment approach doesn’t focus just on growth or value investing, rather we exploit inefficiencies across the entire market, at all stages of the cycle, and across all market conditions. We are a top-down, bottom-up investment manager.

To anticipate stock price movements, we identify earnings and earnings revisions at an early stage. We position our portfolios towards sectors and stocks that will experience positive earnings revisions. And we move away from those likely to suffer negative revisions. At any time, our portfolio is tilted toward stocks with the most compelling opportunity to appreciate over the coming twelve months.

We believe that equity markets are relatively efficient, but not perfect. Because we combine top-down macroeconomic research with in-depth bottom-up stock analysis, we gain better insights into the earnings profile of our universe of companies throughout the various stages of the economic/investment cycle. Our philosophy is that stock prices ultimately follow earnings and earnings revisions. We believe the market excessively emphasises the current situation and does not sufficiently consider the likelihood of future changes to the earnings profile of individual companies and sectors. As an active manager, Ausbil can shift how our portfolio composition in a timely manner.

As part of our four-stage investment process outlined below, we identify climate-change-related risks and opportunities using in-house proprietary ESG research and external ESG research, engagements with companies, voting, and through generating ideas:



- **Stage 1 - Macroeconomic Analysis**

We assess market conditions impacting global markets to determine a macroeconomic framework that informs our portfolio strategy. Ausbil takes ESG considerations into account at the macro and country level, including national and global regulatory developments.

- **Stage 2 - Sector/Region Analysis**

We focus on the early identification of sectors subject to earnings revisions − upward and downward − over the coming 12 months. We consider ESG features for various sectors, which helps inform security selection at the next stage, Security Selection.

- **Stage 3 - Security Selection**

We identify securities we believe will achieve the greatest outperformance within the investment universe. The primary objective is to investigate and assess all facets impacting on each company's earnings profile. We undertake deep fundamental research, stock-specific ESG research, sustainable earnings analysis, analysis of management quality, company visitations, and we also undertake a detailed company valuation. For Ausbil's Active Sustainable Equity, Global SmallCap and Global Essential Infrastructure strategies, our ESG approach includes refining the investible universe by applying a negative screen. (Please see 'Negative company screening (controversial activity exclusion)', below for further information.)

- **Stage 4 - Portfolio Construction**

We construct a portfolio using input from the previous stages and the ongoing portfolio review. Here, Ausbil assesses ESG factors in its investment decisions that are relevant to the positive financial performance of the investment.

As outlined in Ausbil's Environment, Social and Governance Investment Policy, we incorporate some additional ESG considerations for several strategies and individual mandates (including positive and negative screening).

But Ausbil's main approach is built on ESG integration. The ESG research input for that integration differs slightly between Australian equities strategies and global equities strategies, as described below. (Australian equities strategies make up the vast majority of funds under management. As of 31 December 2023, this was 95%.)

Australian equities strategies:

Ausbil's ESG research team performs proprietary ESG research on the constituents of the ASX200, plus any company outside the ASX200 held in any of Ausbil's Australian equities strategies. Each company has an ESG-related SWOT (strength, weakness, opportunities and threats) analysis as well as company-specific and industry-specific ESG scores (which, combined, constitute proprietary Sustainability Scores).

Climate change is a key component in this analysis, both from a short-term and long-term perspective. ESG industry scores, for instance, include: potential regulatory changes and physical risks that relate to climate change; company ESG scores that include companies' decarbonisation strategies; and governance and disclosure quality. The ESG SWOT analyses summarise key ESG-related strengths, weaknesses, opportunities and risks as they apply to Ausbil's investment philosophy of earnings revisions driving share prices, and our preference for quality management and sustainable earnings.

Ausbil's equities analysts incorporate the key outputs in this analysis and they form part of the final investment recommendation. ESG research is discussed directly with relevant analysts during regular investment team meetings and more formally during monthly stock selection meetings.

Ausbil's proprietary ESG research is based on a variety of sources, including company reporting; corporate access; and independent research on climate change, NGOs and industry analysis. A key input for Ausbil's ESG research is the Net Climate Change Risk analysis (NCCR), an extensive climate change scenario analysis, which is described in more detail under 'risk management'.

Global equities strategies:

For stocks not covered by Ausbil's internal ESG Research Team, Ausbil's global equities strategies source ESG research from an external ESG data provider. This gives us access to ESG rankings, ESG data and qualitative ESG assessments, all of which includes significant focus on climate change. For smaller companies not covered by either Ausbil's internal ESG Research Team or the external ESG data provider, the global equities investment teams perform their own analysis, using the same rating framework in place.

The global equities strategies also use elements of the proprietary ESG research Ausbil uses for Australian equities. They also have access to thematic ESG research (including climate change) provided by the internal ESG Research Team.

Ausbil's ESG research and ESG integration – for both Australian equities and global equities strategies – also benefits from membership of various industry associations and initiatives, including the Investor Group on Climate Change (IGCC), the Principles for Responsible Investment (PRI); the Responsible Investment Association Australasia (RIAA) and its engagement working groups; as well as the engagement initiative, Climate Action 100+.

Risk management: A holistic approach to climate risk incorporating our proprietary NCCR model

Australian equities:

Ausbil has access to third-party-sourced carbon emissions data and the ability to conduct so-called 'carbon footprint' analyses, which assesses the carbon intensity of a portfolio and compares it to the benchmark. While such analysis can be useful in identifying major emitters, the impacts of climate change are multi-faceted. Ausbil believes a more holistic approach is needed to assess risks and opportunities.

A central piece in Ausbil's ESG research for Australian equities is Ausbil's proprietary model called 'Net Climate Change Risk' (NCCR). NCCR is well suited to our investment process. Ausbil generally does not apply discounted cash flow (DCF) for analysis of individual stocks. Instead, Ausbil mainly use earnings multiples, such as P/E ratios for valuation. We have therefore chosen not to apply a DCF analysis on climate change. Rather, the NCCR 'scenario analysis' covers the following elements:

- Three different climate scenarios, including a 1.5 degrees warming scenario, based on the International Energy Agency's (IEA) assumptions and complemented by other assumptions.
- Three timeframes: rolling-12 months and rolling 5-years (both timeframes are in line with Ausbil's tactical and strategic investment time horizons, respectively); and 2050. While 2050 is not in line with our investment time horizon, it provides a long-term view on risks and opportunities, particularly with respect to the quality of a company's business model and the fundamental issue of survivorship . A long-term scenario is useful when we assess how companies are fundamentally and materially preparing for the decarbonisation process.
- Holistic impacts on companies' business models (ranging from -3 to + 3) based on both physical and transition risks. These risks include: impacts on asset valuation, input prices and human health; disruption to supply chains or operations; opportunities from climate-friendly product/services; risks of revenue shortfall from regulatory changes in export destinations; impacts from a price on carbon (direct or passed through); increased insurance costs; impacts from regulation on recycling; and other such risks.

Ausbil updates this analysis annually, including a review of the assumptions under each scenario, including the global energy mix and carbon pricing assumptions (sourced from IEA scenarios), important regulatory changes locally and internationally, as well as individual company NCCR scores.

The NCCR output scores represent the net-effect of such impacts on a company's earnings and risk outlook, and on the sustainability of their business model. The analysis, a collaboration between financial analysts and the ESG research team, is shared with the wider investment team and fed into Ausbil's proprietary ESG research (and outputs) as described above, including ESG industry scores, ESG company scores, and ESG SWOT analyses. The NCCR also helps Ausbil prioritise engagement activities with Australian companies, and enables us to assess portfolios versus benchmark by comparing weighted NCCR scores by portfolio and scenarios versus that of the ASX200 index.

A key conclusion from the 2024 assessment is that the ASX200 index would be relatively more negatively impacted in a global warming above 2 degrees scenario (whereas a 1.5-degree scenario would lead to relatively more favourable outcomes). The 2024 assessment also confirmed that the majority of Ausbil's Australian equities strategies are well positioned compared to the index across all three scenarios, and across all three timeframes.

Global equities strategies:

The NCCR is an extensive proprietary climate change model, which cannot be easily applied to the large investible universes of the global strategies. Rather, we identify risk in stocks not covered by Ausbil's internal ESG Research Team by relying more on Ausbil's chosen external ESG research provider. We combine their research with the analysis of our global strategies' investment teams, who in turn are supported by the expertise of Ausbil's internal ESG Research Team. The external ESG data provider has the ability to run carbon footprint analysis, although a potential key challenge is coverage for smaller companies.

Engagement: Ausbil's advocacy and direct company engagement on climate change

Climate change is a systemic issue and Ausbil believes engagement and advocacy can help manage risk. Engagement can drive better-informed investment decisions and preserve invested capital.

Australian equities:

Every year, Ausbil creates an ESG engagement plan for Australian equities. The plan details ESG advocacy and engagement themes, and objectives and milestones.

As an active investment manager, Ausbil's engagement is mainly focused on portfolio holding companies and Climate change remains a key engagement theme. We seek to improve the resilience of companies around climate change. And we seek to improve climate-change-related disclosure to help investors identify risks and opportunities. This information creates a feedback loop that results in ever higher expectations and accountability, as well as genuine change in behaviour, planning, ambition and performance around climate change.

Because climate change is a systemic risk, it also makes sense for Ausbil to collaborate with other investors. Ausbil was an early signatory to Climate Action 100+ because the framework's goals align with our existing climate engagements. Ausbil signed up to become a 'support investor' to several of Climate Action 100+'s engagements across the diversified mining, oil & gas and steel industries.

Proxy voting is another important element of risk management. As an active investment manager, Ausbil can influence companies in which we invest. As a general rule, we prefer to engage directly with these companies through meetings with their governors and leadership rather than engaging through voting activities alone. However, in cases where we have been dissatisfied with the outcomes of engagement, Ausbil has supported shareholder resolutions against the company on climate change.

Finally, Ausbil has one Australian equities strategy (and a small number of mandates) that operate with ESG-related negative screens. The Ausbil Active Sustainable Share Fund excludes companies with 10% or more earnings exposure to fossil fuel, unless the company is deemed to play a net positive role in the transition to a low-carbon economy.

Global equities strategies:

Both the Australian and global equities strategies benefit from Ausbil's membership of Investor Group on Climate Change (IGCC) and Ausbil has historically signed and supported global climate change policy advocacy initiatives.

We also pursue climate-change-focused engagements with individual portfolio holdings as deemed appropriate by the global equities investment teams. The same applies to proxy voting activities where the global investment teams occasionally face climate-change-related shareholder resolutions for investee companies. In such cases, proxy voting decisions are made according to Ausbil's policy framework and often involves discussion with Ausbil's internal ESG Research Team.

Metrics and targets

Ausbil uses a number of climate-change related metrics for internal purposes. For Australian equities strategies, as discussed above, Ausbil:

- Acquires carbon data (ASX300 constituents only) to run carbon footprint analysis for the majority of its portfolios. This aids us in identifying climate risks and opportunities.
- Analyses portfolios versus the ASX200 index in terms of unweighted or weighted NCCR scores.

Additionally, Ausbil monitors the number of company engagements in relation to climate change, the percentage of the ASX200 index that has net zero commitments, as well as interim targets and Task Force on Climate-Related Financial Disclosures (TCFD) disclosures.

1. United Nations. (2020). Climate Change [website]. Retrieved from https://www.un.org/en/sections/issues-depth/climate-change/

2. https://climate.nasa.gov/scientific- consensus/

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