



WaveStone's approach to ESG integration

ESG integration forms a natural part of WaveStone's investment process. The consideration of environmental, social and governance (ESG) issues is embedded in our corporate DNA principles.

- **ESG Research** - ESG factors are considered through qualitative fundamental analysis in the very first step of the investment process. We assess material ESG factors affecting a company and identify any improvement in ESG practices over the years.
ESG information is obtained from a number of sources including in-house research (company accounts, media reports and engagement), as well as from sell-side broker research and Bloomberg.
- **Active Ownership** - Company engagement is an integral part of WaveStone's investment process. At WaveStone, we believe that successful engagement can, not only reduce risks to asset owners but also create value.

WaveStone engages all companies in which it invests, and those in which it intends to invest, on material ESG issues and exercises its voting rights giving consideration to the outcomes of such engagement activity. Through its active ownership practices WaveStone seeks to improve ESG performance by investee companies and encourage them to better manage their own ESG risks and opportunities.

Engagement is undertaken by the portfolio manager and analysts specialising in the relevant sector who are familiar with the company as well as the ESG issues most material to the business.

How we evaluate key Environmental, Social and Governance factors in our investment analysis is outlined in detail below.

Environmental Factors

We see environmental issues as not only a potential investment constraint but also an opportunity, with many companies set to benefit from the push towards sustainability.

Environmental issues are considered on a case by case basis. The materiality of potential environmental issues will dictate the degree of analysis conducted.

Key Environmental factors considered in our analysis:

Climate Change

Carbon dioxide in the atmosphere, predominantly as a result of human activity, has led to global warming. There has been a global move to reduce carbon emissions worldwide. The Paris Agreement, which outlines country-specific targets for reducing carbon emissions, was adopted in 2015 and has since been signed by 195 countries (as of July 2018). Countries must set out their plans for meeting their reduction targets by 2020, including Australia.

We expect well managed companies to be aware of the extent of their carbon exposure and encourage them to have plans in place to mitigate their carbon emissions in the long term. We also assess a company's exposure to weather-related impacts of climate change.

Our review of climate risk exposure includes checking whether a company has sustainability policies in place including carbon mitigation strategies and whether they have a representative on the board who is responsible for the company's carbon reduction plans.

Additionally, we monitor the carbon intensity of our portfolios against their benchmark.

WaveStone is also a member of the Climate Action 100+ initiative, an investor-led collaborative engagement group focused on engaging with systemically important greenhouse gas emitters and other companies across the global economy to improve governance on climate change, curb emissions and strengthen climate-related financial disclosures.

Water supply and management

Global trends such as the growing global population, economic growth and increasing affluence are leading to increased demand for clean water both in industry and agriculture. We see both risks and opportunities in this area. Currently only 0.5% of the planet's water is available for use by mankind and global ecosystems and massive investment will be needed to upgrade and expand current water infrastructure to meet future demand and protect water quality. Equally industries heavily reliant on water could face significant risks due to conflict over water supply and consequently costs of water usage will rise. We assess and engage with companies on how they manage their water usage, interact with the local community and manage supply risks.

Waste disposal, pollution and contamination

The production of goods and services results in waste throughout the product life-cycle. With the global population set to increase to 9 billion by 2050 waste management is an important topic. We see both risks and opportunities in this area with companies affected by increased regulation of the use of landfill sites and the risks of both reputational damage, compensation or clean-up costs for companies who manage this badly, especially as it relates to hazardous waste. We see opportunities for companies creating innovative solutions to waste disposal to emerge as winners.

Renewable energy generation

As the world looks to move to a low carbon economy we expect to see a gradual shift away from fossil fuels and into renewable energy. With increased investment and technological advances in renewable energy generation and storage we expect the cost of renewable energy to continue falling and to become cheaper than traditional fossil fuel energy within a few years. We see opportunities in this space in companies which are either directly involved in renewable energy generation and storage or those which are increasing their usage of renewables in their energy sources.

Social Factors

Key Social factors considered in our analysis:

Occupational health and safety

Inadequate health and safety practices can lead to lost productivity due to workplace absences as a result of injury, as well as prosecution and fines.

We engage companies on their health and safety practices including training of staff and seek disclosure on health and safety incidents. We also place emphasis upon a company's safety record and management's commitment to safety in the workplace, including analysis of lost time injury frequency rates (LTIFR rates) and stated safety policies. In general, we aim to ensure companies are implementing best practice safety systems and look for evidence of improving safety metrics or continued excellence in this regard. Additionally, in our engagement activity we strongly encourage companies to implement gates that ensure zero harm in their REM policies.

Human rights and child labour

Companies with global operations or supply chains in countries with no human rights laws can face increased public scrutiny and brand erosion.

We assess companies to ensure that they are not exposed to any human rights abuses in their company operations or supply chains. We would engage any companies exposed to such issues to change their practices and put policies in place to protect their workers.

Supply chain management

Unethical or unsafe practices within a company's supply chain can leave a company exposed to reputational and operational risks. We expect well managed companies to have good oversight of and transparency within their supply chain. We encourage companies to have policies in place for effective assessment and monitoring of their supply chains.

Workplace relations and working conditions

Well-managed employee relations and good working conditions improve productivity within companies. We aim to ensure the companies we invest in, treat their employees in a fair and ethical manner. Companies that promote diversity, have low staff turnover and invest in ongoing staff training are looked at positively.

Corporate Governance Factors

Corporate governance is central to any stock investment; it is typically a strong indicator of superior corporate DNA and hence forms a key part of WaveStone's investment process.

Key Corporate Governance factors considered in our analysis:

- Logical capital allocation (as described in our philosophy and process)
- Track record / shareholder focus (as described in Step1 of our investment process)
- Sound REM policies that align the interests of management & shareholders
- Board tenure
- Diversity at board and senior management level
- Articulated policies around sustainability
- Proper skilled assessment of board

WaveStone has a formal ESG Policy which outlines its objectives in ESG integration, engagement and voting in further detail.

This policy can be found on our website: <https://www.wavestonecapital.com/how-we-invest/esg/>

WaveStone is a signatory to the UN-backed Principles of Responsible Investment (PRI) and publishes a report on an annual basis as part of its requirements. Our PRI Transparency Report and PRI Assessment Report can be viewed here

<https://www.wavestonecapital.com.au/wp-content/uploads/2018/11/2018-Public-Transparency-Report-for-WaveStone-Capital.pdf>

<https://www.wavestonecapital.com.au/wp-content/uploads/2018/11/2018-Assessment-Report-for-WaveStone-Capital.pdf>