

WaveStone ESG Report Quarter ending December 2023

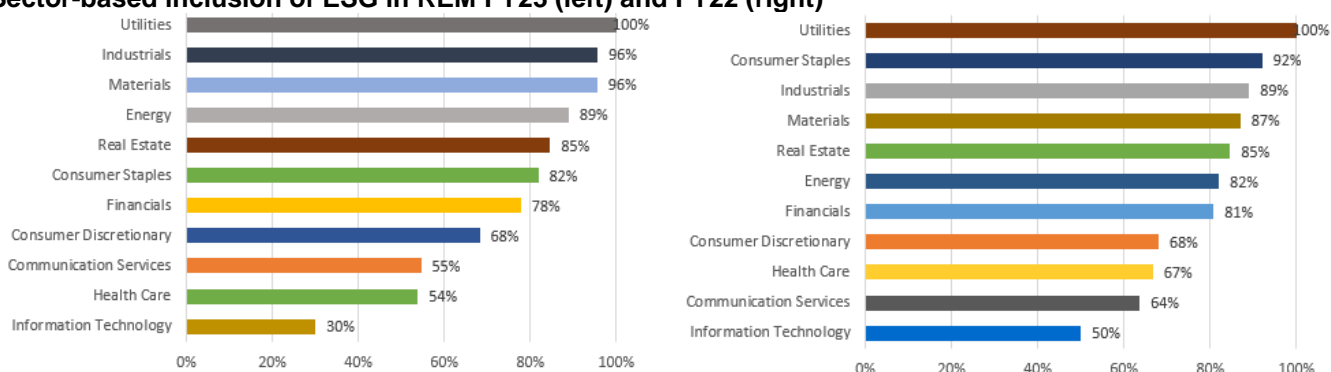
ESG Quarterly: AGM Season and ESG in Remuneration (REM) 2023

Following on from our December 2022 report on the use of ESG metrics in REM we are using this quarterly report as an opportunity to take another look at what ESG metrics were included in hurdles in FY23, and how this has changed over the past year. We also take a look at the significant uptick in REM strikes this year and consider whether these outcomes are a predictor of share price performance or indeed whether share price performance has been more of a leading indicator of the outcome. Finally, where they are based on earnings or return metrics, we compare FY24 award hurdles versus current consensus metrics for our portfolio names. Outcomes on this front can inform analyst views and may be a predictor of future movement in consensus estimates and share price returns.

80% of ASX 200 companies have some form of ESG linked to REM

Somewhat surprisingly given the increase from 73% in 2021 to 80% in 2022, 2023 (at 80%) showed no change in the number of ASX200 companies with ESG in REM. There remains material differences in the rate of inclusion between sectors with those industries with a larger carbon footprint or greater OH&S risk, still more likely to tie ESG metrics to compensation.

Sector-based inclusion of ESG in REM FY23 (left) and FY22 (right)



Source: Company Reports, WaveStone Analysis, Jefferies, Macquarie

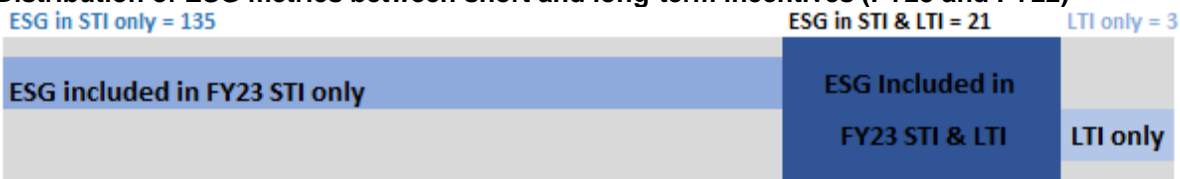
A June 2023 report by KPMG on ESG in Executive Remuneration found that generally, ASX companies are less progressed than their US and UK counterparts when it came to incorporating ESG metrics in REM. The report found that compared to the domestic market, there was both an increased use of carbon measures outside of traditionally carbon intensive industries and a broader application of diversity metrics outside of gender – which is typically the focus of diversity metrics in Australia.

(<https://assets.kpmg.com/content/dam/kpmg/au/pdf/2023/esg-in-executive-remuneration-report.pdf>)

15% of companies with ESG in REM tied an element to the LTI, up from 13% in FY22

Although ESG objectives are typically long term, the majority of ESG performance metrics remain tied to the STI. Of the 159 companies with an ESG metric in REM, only 24 (15%) included an ESG hurdle in the long-term incentive plan. This is up very slightly on 2022 which saw 21 (13%) of companies with an LTI ESG hurdle.

Distribution of ESG metrics between short and long-term incentives (FY23 and FY22)



159 Companies had ESG Metrics in their REM

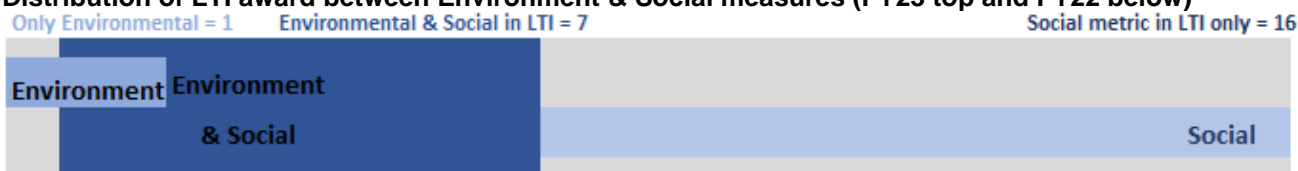


159 Companies had ESG Metrics in their REM

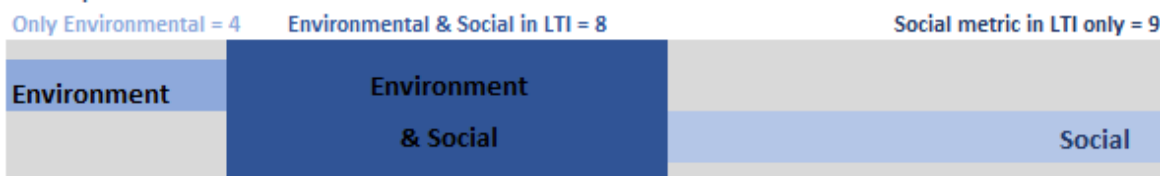
Source: Company Reports, WaveStone Analysis, plus data from Jefferies & Macquarie

While environmental metrics feature strongly in the LTI, social metrics still dominate.

Distribution of LTI award between Environment & Social measures (FY23 top and FY22 below)



24 Companies had ESG Metrics in their LTI



21 Companies had ESG Metrics in their LTI

Source: Company Reports, WaveStone Analysis

93% of the 41 WaveStone portfolio companies within the ASX200 have ESG metrics in REM

The WaveStone portfolio holdings compare favourably to this data. 41 of our portfolio holdings sit within the ASX200, of these 38 (or 93%) have an ESG linkage in REM and 15 (or 37%) have ESG included in the LTI. The outcome reflects our process which looks to identify companies with greater Sustainable Competitive Advantage (SCA). An assessment of the alignment of governance structures to desired corporate outcomes is a component of this process, as weaknesses in these frameworks has often been a contributing factor to poor financial outcomes.

The table below shows a summary of some of the data we collected on ESG metrics in REM for our ASX200 portfolio names in 2023. As with our 2022 report, there remains a clear preference toward the use of the STI for ESG objectives and it is still not always clear what percentage of the award has been directly attributed to an ESG outcome. The lack of standardisation continued to make our attempt at comparative analysis difficult. With ESG metrics often included within broader social and governance categories it is not always clear what the weight of an ESG metric is within a particular strategic or non-financial bucket. The use of multipliers also complicated the analysis. As we did for the 2022 report, in order to differentiate the knowns from the unknowns, we have created two separate categories of STI measures, those with a clear percentage attribution to the remuneration outcome, and those where we struggled to identify a specific outcome weighting – “Unclearly Weighted STI Measures”.

ESG Metrics included in REM for WaveStone portfolio holdings

ASX Code	Sector	LTI Measure	LTI Factor	Clarity	Clearly Weighted STI Measures	Clear STI Weight	Unclear Weighted STI Measures	Unclear STI Weight
ALL	Consumer Discretionary	Customer, People, Responsible Gameplay	40%	Unclear			Individual (incl ESG)	30%
ANZ	Financials	Risk Based Measures	50%	Unclear	People & Culture	30%	Customer	35%
ARB	Consumer Discretionary							
ASX	Financials						Risk, Culture & People	1%
BHP	Materials				HSE & Community (Inc Climate), Sustainability People Social Value	50%		
CAR	Communication Services	Reputation (incl Carbon)	10%	Unclear	Engagement & Sentiment	10%		
CBA	Financials	Trust, Reputation & Employee engagement	25%		Customer, People & Leadership	30%	Strategy (incl Climate)	30%
CHC	Real Estate				People, Strategy & Customer (incl Decarbonisation)	40%		
CKF	Consumer Discretionary				Customer	15%	ESG Inc Emissions (downward modifier)	15%
COH	Health Care						Strategic (incl Diversity and Climate)	40%
CSL	Health Care				Sustainability	5%	Individual (incl risk, people, OH&S, ESG & quality)	35%
CWY	Industrials	Emissions	20%		Safety, Environment, Diversity & Turnover	40%		
DMP	Consumer Discretionary							
EDV	Consumer Staples	Responsibility	20%		Safety & Customer	40%		
FPH	Health Care						Non Financial Component (incl some ESG)	20%
GMG	Real Estate	Environment & Sustainability (Modifier)	15%	Unclear			Behaviour & ESG targets (downward modifier to EPS test)	100%
IAG	Financials				Employee Engagement, Risk & Carbon Emissions	20%		
IEL	Consumer Discretionary				People	5%		
IGO	Materials	Decarbonisation	5%		ESG (cannot see climate in the mix)	25%		
JHX	Materials	Scorecard (incl Safety, Culture & ESG)	50%	Unclear				
KED	Education Services							
LIC	Real Estate				Team Engagement Score	20%		
LYC	Materials	Sustainability	10%				Non-financial (incl Safety, GHG, Diversity & Circ Economy)	40%
MQG	Financials						People, Conduct, Risk & Leadership	100%
NAB	Financials	Risk Performance	50%		Customers, Colleagues & Safe growth	40%		
NEC	Communication Services							
NST	Materials	Decarbonisation	20%		Safety, Environment & Culture	30%		
PXA	Real Estate				Risk awareness, Employee & Brand trust	15%		
PLS					Safety & Gender Balance	30%	Culture, Leadership & Strategy	10%
QAL	Investment Manager	Leadership, Culture & ESG	15%	Unclear	Leadership, Culture & ESG	12.5%		
RIO	Materials				People, ESG & Social Licence	40%		
RMD	Health Care							
RWC	Industrials						Personal, ESG & Culture, Leadership	30%
STO	Energy	40% of 2021 Growth Grant - Emissions	40%		Sustainability	25%		
SVW	Industrials				People, Safety & Sustainability	20%		
TCL	Industrials				HSE, Sustainability, Reputation & Leadership	30%	Customer & Delivery	15%
TLX	Healthcare							
TWE	Consumer Staples				Leadership, Inclusion, Equity, Diversity & Sustainability	50%		
WDS	Energy				Sustainability (Inc Emissions)	14%	Priorities (incl New energy); Individual Perf (incl Culture)	44%
WES	Consumer Discretionary				Safety & Sustainability	20%		
WOW	Consumer Staples	Reputation (RepTrak)	20%		Customer & Safety	40%		
WTC	Information Technology							
XRO	Information Technology				Customer & Employee	20%	Individual objectives (incl leadership & values)	20%

Source: Company FY23 Remuneration Reports

ESG Metrics should be tailored, quantifiable, verifiable, transparent, and challenging

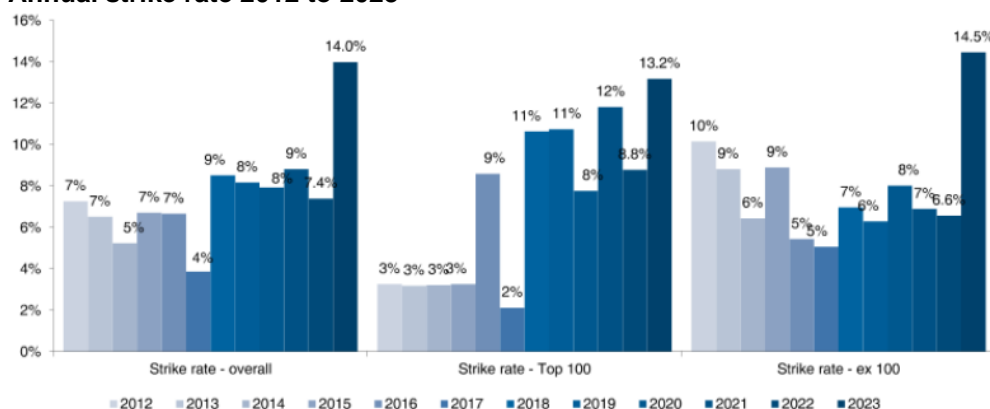
This is the second time we have collated this data centrally. While it provides a useful tool for benchmarking the portfolio and highlighting change over time, its primary purpose is to guide some of our engagement activities in the upcoming year with the hope of achieving better outcomes.

We are by no means prescriptive in what we look for in REM structures. In our view, the inclusion of ESG metrics in REM should be nuanced, tailored to suit the positioning and desired strategic outcomes of the company in question. We believe best practice should be the provision of targets that are quantifiable, externally verifiable, transparent and sufficiently challenging so as to encourage a greater push for ESG integration as opposed to allowing a simple uplift in executive pay. What is most suitable is likely to, and should, evolve over time to reflect the changing operating landscape. Much like the design of more traditional financial REM measures, the ESG metrics applied should be tailored to align to desired stakeholder outcomes. At WaveStone, we strongly believe in Active Ownership and in 2024 will continue to engage with our investee companies for better alignment of ESG goals to management remuneration outcomes.

The 2023 AGM season showed a marked uptick in strikes against REM

The 2023 AGM season delivered a strike rate significantly elevated relative to prior years. The incidence of strikes increased in 2023 from an average of 7% over the past decade to 14% this year.

Annual strike rate 2012 to 2023



Source: Macquarie Research

It is difficult to say what drove the higher strike rate in 2023. While the strike rate was fairly equivalent both within (13.2%) and outside (14.5%) of the top 100, recent trends suggest it is strikes against companies outside of the 100 that has increased the most relative to trend. This may reflect greater scrutiny being applied to small capitalisation companies, however, share price performance is likely also a factor.

Rather than being a predictor of future performance, strikes typically follow a period of underperformance suggesting the issues driving share price underperformance also result in greater scrutiny; with shareholders perhaps seeking better alignment of management REM to their own outcomes. Macquarie's ESG team investigated 10 years of data on strikes with their analysis showing companies with strikes have on average underperformed by 5.0% in the 120 days leading into the event and typically underperform a further 4.4% in the 120 days after. Jarden performed a similar analysis on the 17 names they identified with a strike in 2022 and 1H23, only focussing on post AGM returns, and found share price underperformance of -4%, -8% & -15% against the S&P/ASX200 over 1, 6 & 12 months respectively. Strikes likely point to broader issues confronting a company, which take time for resolution.

ASX100 Remuneration report strikes from AGM's in 2023

Company	Dominant reason	Percentage vote against	Strike number
ALQ	Board discretion exercised in allocation of one-off grants/discretionary awards	28.1%	First Strike
ALX	Acquisition of Chicago Skyway	51.3%	First Strike
AMP	Transparency of STI targets, Performance	49.1%	First Strike
APA	Thresholds for targets	25.6%	First Strike
BOQ	Governance	40.4%	First Strike
DXS	Performance	29.9%	First Strike

FMG	Additional payouts	52.0%	First Strike
LLC	Performance	39.8%	First Strike
QAN	Various governance issues	83.0%	First Strike
TWE	Performance	46.1%	First Strike
WHC	Structure encourages buying new mines	40.6%	First Strike
WOW	Safety	28.0%	First Strike

Source: Jarden, Company Annual Reports

Carbon Emission and Intensity Tracker:

WaveStone – Australian Share Fund (WASF)	Carbon Emissions		
	Portfolio	Benchmark	Difference
Carbon Emissions Scope 1+2 (tonnes CO2e/USD M invested)	81.8	148.2	-44.8%
Carbon Intensity Scope 1+2 (tonnes CO2e/USD sales)	122.0	210.3	-42.0%

Source: MSCI ESG (as at 31/12/2023)

Benchmark is the S&P ASX 300 Accumulation Index

Engagement

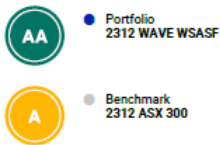
ESG-related Engagements during the Quarter

Company	ESG Category	Topics
RMD	Governance	Shareholder communications. Market guidance and expectations
CKF	Social Governance	GLP-1 potential impact. Removal of ESG disclosure in investor presentation
NAB	Governance	FY23 result. Group strategy, CPS 511. Remuneration and succession.
ALL	Social	Israel/Palestine conflict and staff support
IGO	Governance	Incoming CEO dismissal from prior employer – BOD's understanding of situation and risk mitigation plans
ANZ	Governance	FY23 result. Governance. Strategy, CPS 511. SUN acquisition
LYC	Governance	Key strategic priorities with incoming Chair, management, corporate communications
NEC	Governance	Board succession, management team and strategy
GMG	Environment Governance	Succession planning and key man risk. Lengthening LTI vesting tenure and construct. DC energy intensity
STO	Environment Social Governance	Permitting risk with offshore energy projects in Australia. Relationship with Traditional Owners. Management team
CAR	Governance	Board and CEO succession. Remuneration
ARB	Governance	Remuneration, management structure and strategy
DMP	Social Governance	Remuneration – lack of ESG linked incentives. GLP-1 potential impact. Board and management succession. Strategy
CWY	Environment Social Governance	LTI award structure. Capital intensity of business. Pricing of scarce assets to promote diversion. Recent ACCU trading and use of offshore credits. Below the line accounting. Safety outcomes
TCL	Environment Social	ESG strategy. REM structure and alignment of board priorities to shareholders. Corporate strategy. Corporate costs.

	Governance	
COH	Environment Governance	Board structure and succession in audit chair. Clarity of ESG metrics in REM
CSL	Environment Social Governance	Management succession. Business strategy. REM and FY24 LTI grant. ESG metrics in REM. Patient and donor safety.
WDS	Environment	Decarbonisation plan and use of offsets. 2024 Climate Report. Impact on cost of capital given real or perceived non-compliance with global decarbonisation ambitions
ORA	Environment	SaverGlass acquisition and associative energy usage and decarbonisation plans
CHC	Governance	Management incentives

MSCI ESG Ratings*

MSCI ESG Ratings



Portfolio ESG Rating Summary

ESG Quality	Leader 15.00% above benchmark
ESG Ratings Distribution	Leaders 12.87% over benchmark Laggards 5.72% under benchmark
ESG Ratings Momentum	Upward momentum 4.32% under benchmark Downward momentum 5.98% under benchmark

Carbon Risk

(t CO2e/\$M SALES)

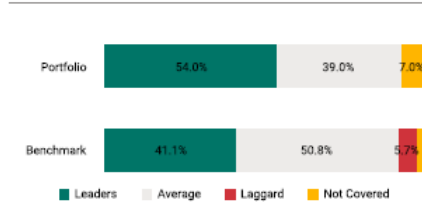
Moderate Carbon Risk
41.99% less than benchmark



How the MSCI ESG Rating is calculated

	Portfolio	Benchmark
Weighted Avg ESG Score	7.53	6.55
ESG Quality Score	7.53	6.55
ESG Rating	AA	A

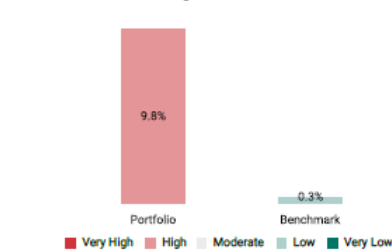
ESG Ratings Distribution



Reputational Risk

(Very Severe Controversy Exposure)

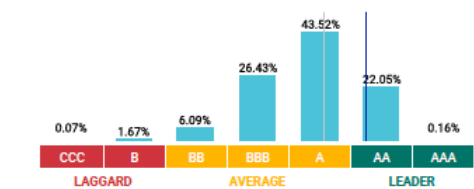
High Reputational Risk
9.46% greater than benchmark



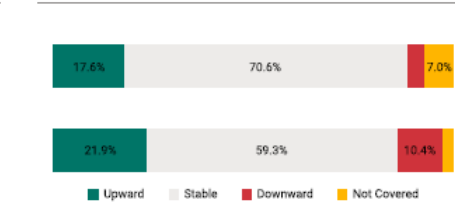
Portfolio : 2312 WAVE WSASF
Benchmark : 2312 ASX 300

Distribution of MSCI ESG Fund Ratings Universe

As of: 04/11/2023



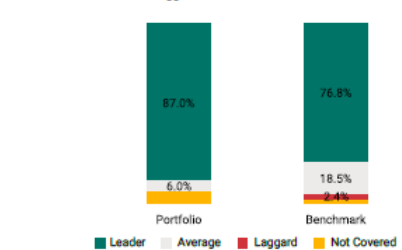
ESG Ratings Momentum



Governance Risk

(Global Percentile)

Leaders 10.20% greater than benchmark
Laggards 2.36% less than benchmark



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Memberships and initiatives

- Principles of Responsible Investment (PRI)
- Climate Action 100+
- 40:40 Vision

Links to WaveStone Policies

- ESG Policy: **WaveStone ESG Policy**
- ESG Activity Report: **WaveStone ESG Activity Reports**
- Proxy Voting Policy: **WaveStone Proxy Voting Policy**
- Proxy Voting Records: **WaveStone Proxy Voting Records**
- Engagement Policy: **WaveStone Engagement Policy**
- **WaveStone PRI Transparency Report 2020**
- **WaveStone PRI Assessment Report 2020**

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