



**AUSTRALIAN
GOVERNANCE & ETHICAL**
Index Fund

Responsible Investing

Going mainstream

October 2019

Disclaimer



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Agenda



- 1** History, evolution and measurement
- 2** **E**nvironment – the future of energy
- 3** **E**nvironment – understanding the changing climate
- 4** **S**ocial – impacts and consumer priorities
- 5** **G**overnance – building and maintaining customer trust



1 History, evolution and measurement

What is 'responsible' investing?

Giving consideration to non-financial risks or outcomes in investment decision making



A brief history

Incorporating “ethics” in investing is not a new concept



1960s—mid 1990s

Niche investment products with exclusionary investment screens driven by common personal beliefs (**negative screening**)

2010s—today

More widely adopted with strategies evolving beyond integration to consider positive impact (**impact investing**)



Early history

Traditionally rooted in the practices of religious believers (of Judaism, Christianity and Islam) who sought to align investments with their faiths

Late 1990s—2010s

Further developed to be incorporated into “traditional” investment analysis, primarily as a risk management tool (**ESG Integration**)

The future

Investors are beginning to target **both** positive **financial returns** and **positive impact**



United Nations Sustainable Development Goals ('SDGs')



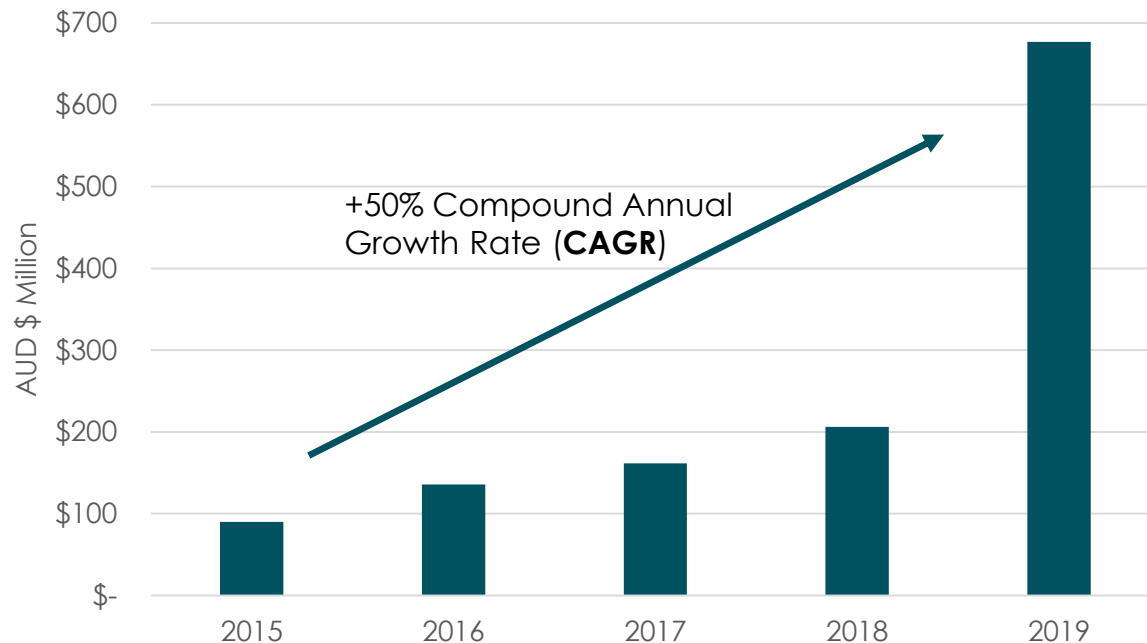
Some statistics

Today, investor interest in ESG is growing exponentially...



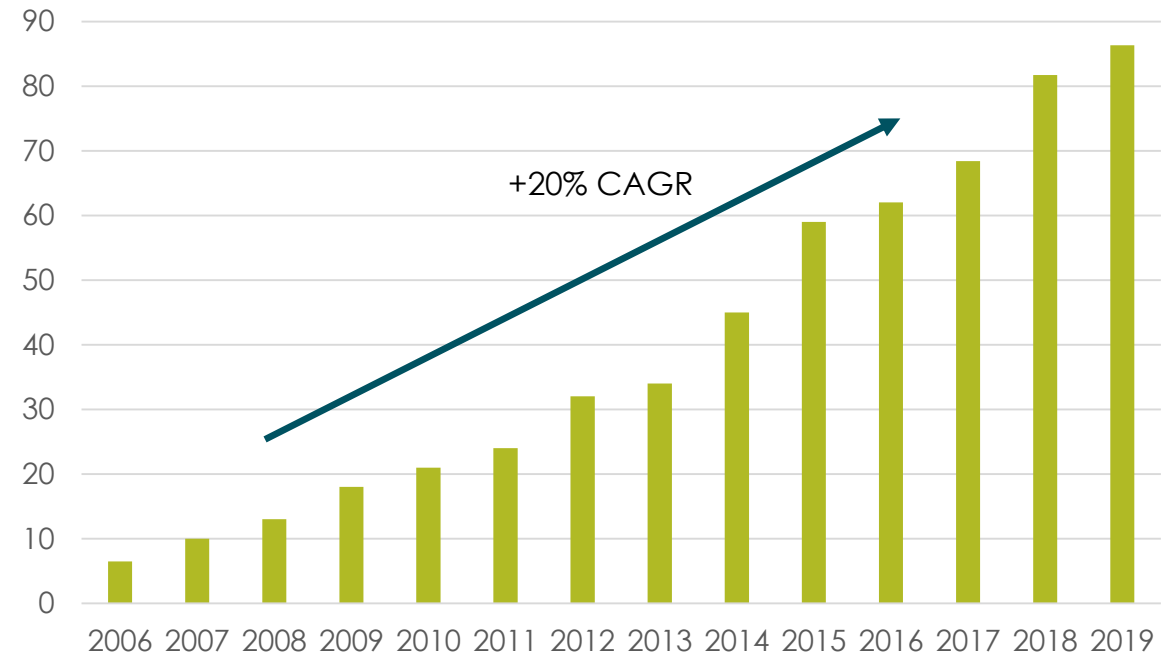
Retail investors

Funds under management (FUM) of Australian domiciled ESG related exchange traded funds (ETFs) (2015–2019)



Institutional investors

United Nations Principles of Responsible Investment Signatories Gross Assets Under Management (AUM)



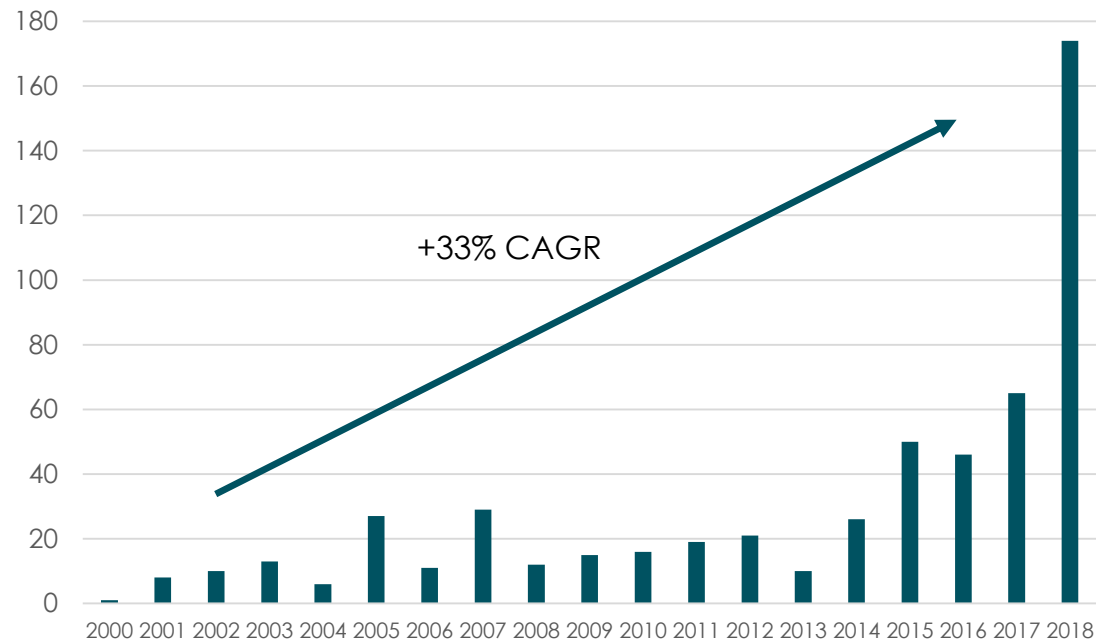
Some statistics

...and regulators and corporates are responding in kind



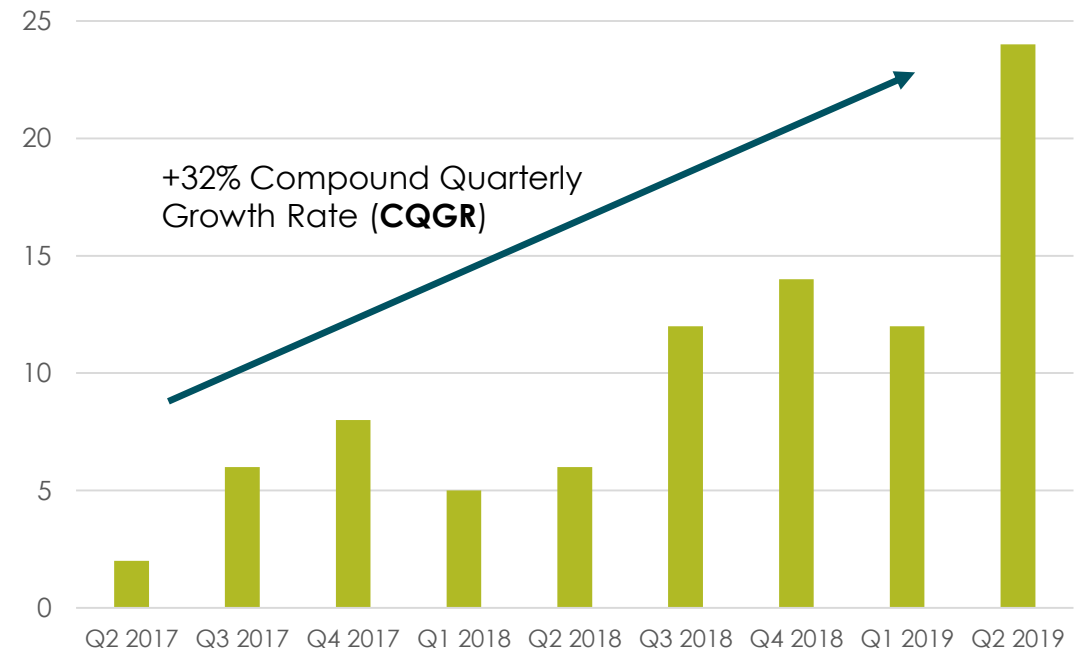
Regulators

Number of new global ESG-related regulations by year (2000–2018)



Corporates

Number of times 'ESG' referenced on S&P500 conference calls by quarter (2017–2019)



What is behind the growth?

Investor demand, and an understanding that companies who exhibit superior ESG performance should have a **competitive advantage** against industry peers



More sustainable business models	Less exposed to exogenous risk	Command a valuation premium
<ul style="list-style-type: none">• More competitive due to better use of human capital and resources	<ul style="list-style-type: none">• Better risk management and corporate governance• Lower regulatory incidents and remediation costs	<ul style="list-style-type: none">• Lower variation in operating performance and less exposure to systemic risk• Superior market 'perception'

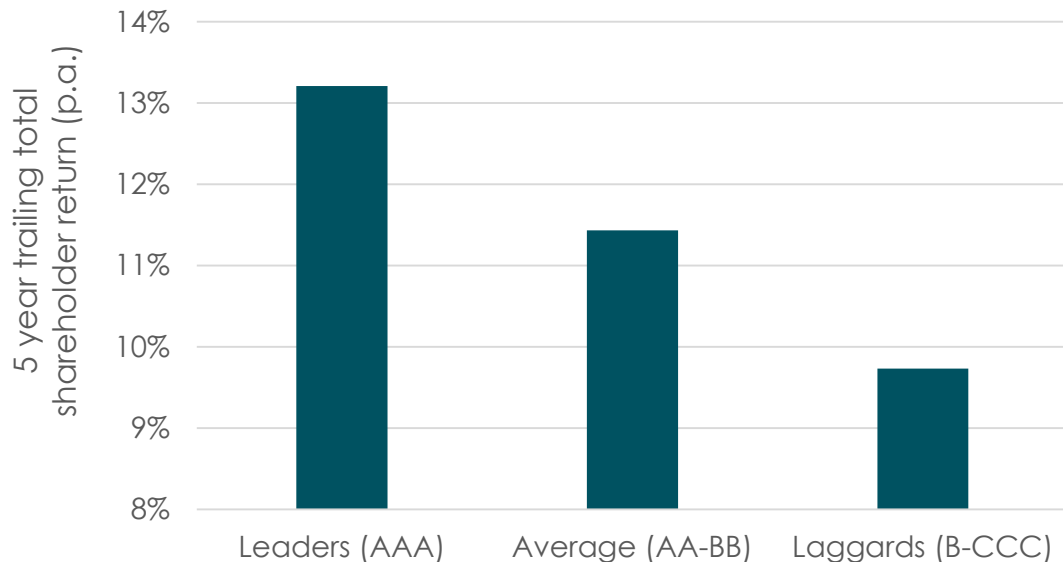
= **Better cash flow and profitability** + **Lower tail and stock specific risk** + **Higher valuation**

Backed up by the data

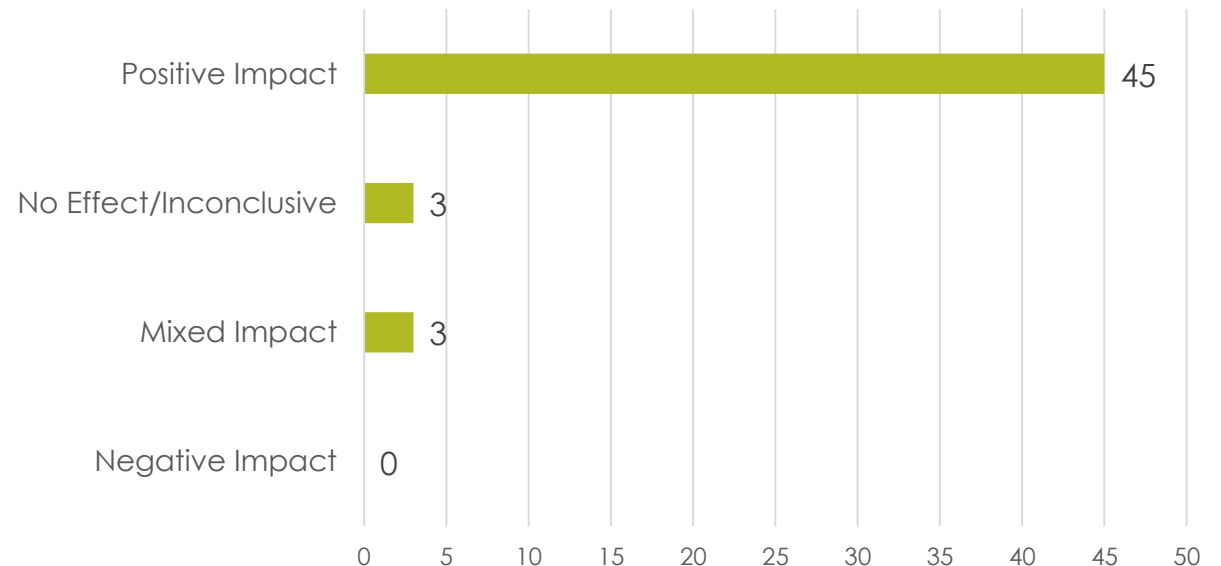
There is increasing evidence that **companies with stronger ESG standards outperform** at both a share price and operational performance level



Median annualised total shareholder return by MSCI ESG Rating (1 January 2013—31 December 2018) – European MSCI ACWI constituents



Review of results of empirical studies on the relationship between ESG and corporate performance (1982—2015)



So how do you measure it?



Analysis can be highly subjective, but this creates opportunity

ENVIRONMENTAL ('E')	SOCIAL ('S')	GOVERNANCE ('G')
Biodiversity/land use	Community relations	Accountability
Carbon emissions	Controversial business	Anti-takeover measures
Climate change risks	Customer relations/product	Board structure/size
Energy usage	Diversity	Bribery and corruption
Raw material sourcing	Corporate Culture	CEO duality
Regulatory/legal risks	Health and safety	Executive compensation
Supply chain management	Human capital management	Ownership structure
Waste and recycling	Human rights	Shareholder rights
Water management	Responsible marketing	R&D Transparency
Weather events	Privacy and data security	Voting procedures

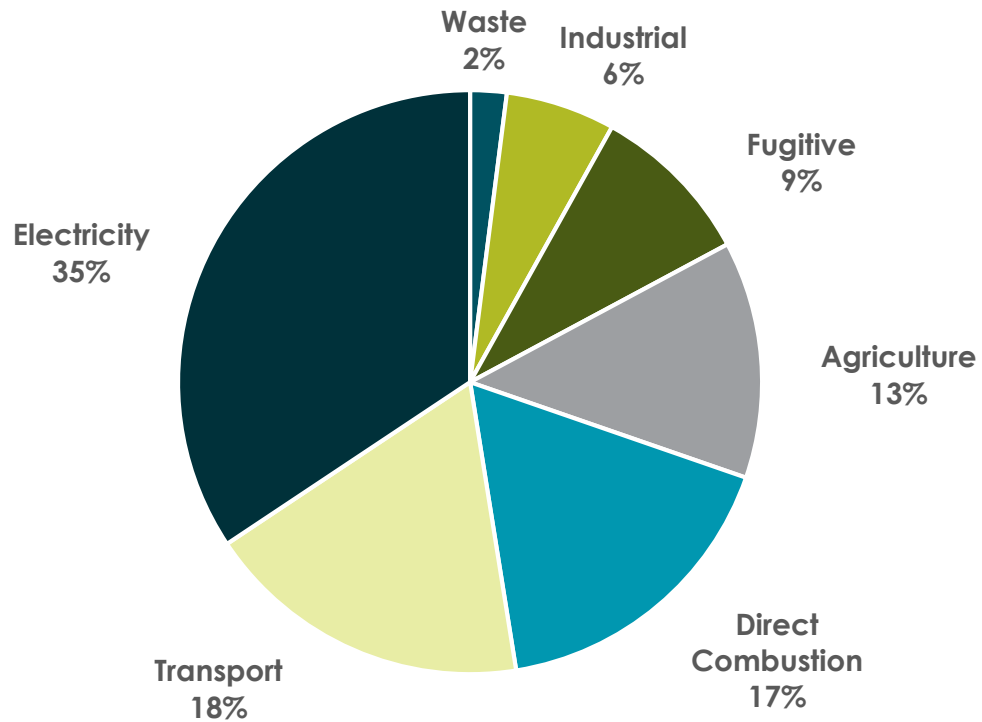


2 Environment: The future of energy

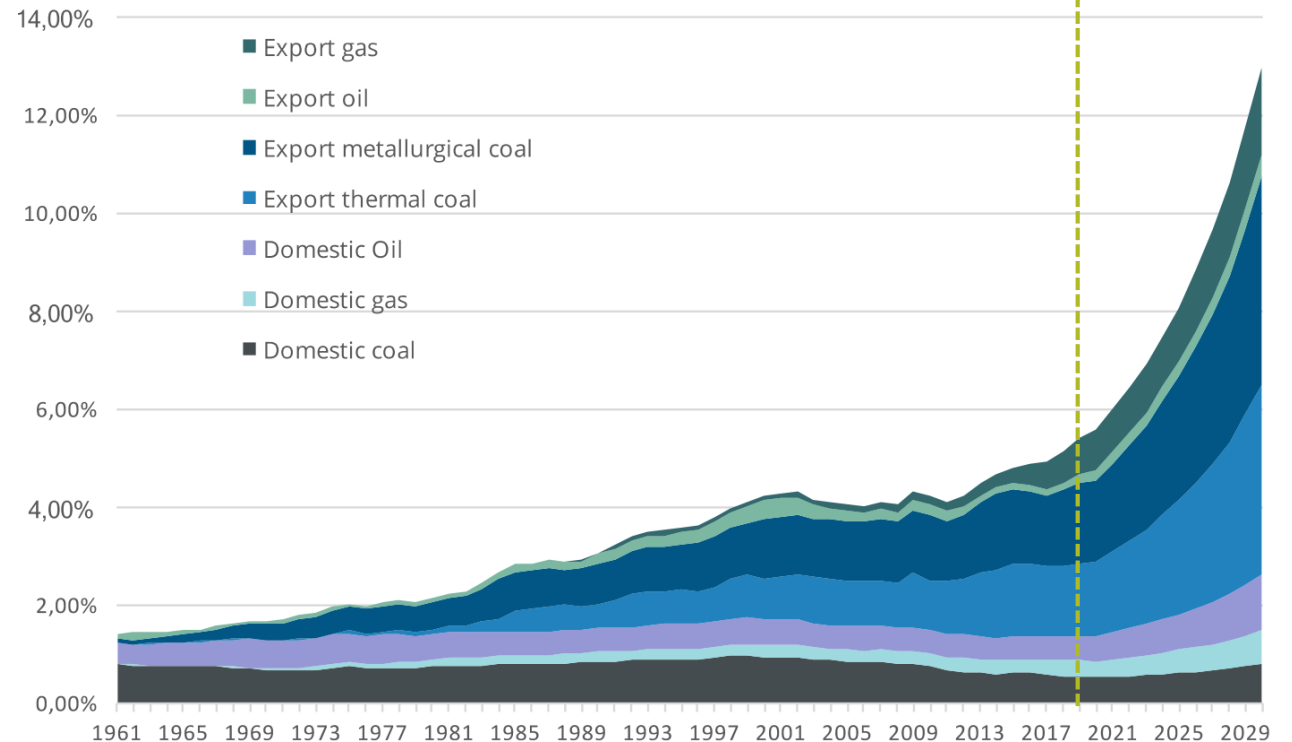
Stranded assets

If we are to comply with global emissions targets, what is most at risk?

Share of CO2 emissions by industry in Australia (2017)



Australian share of global fossil fuel CO2 emissions (1961–2030 [projected])



What is it worth?

What is the value of long dated assets that can't be financed or insured...



Selected Australian coal-fired power stations

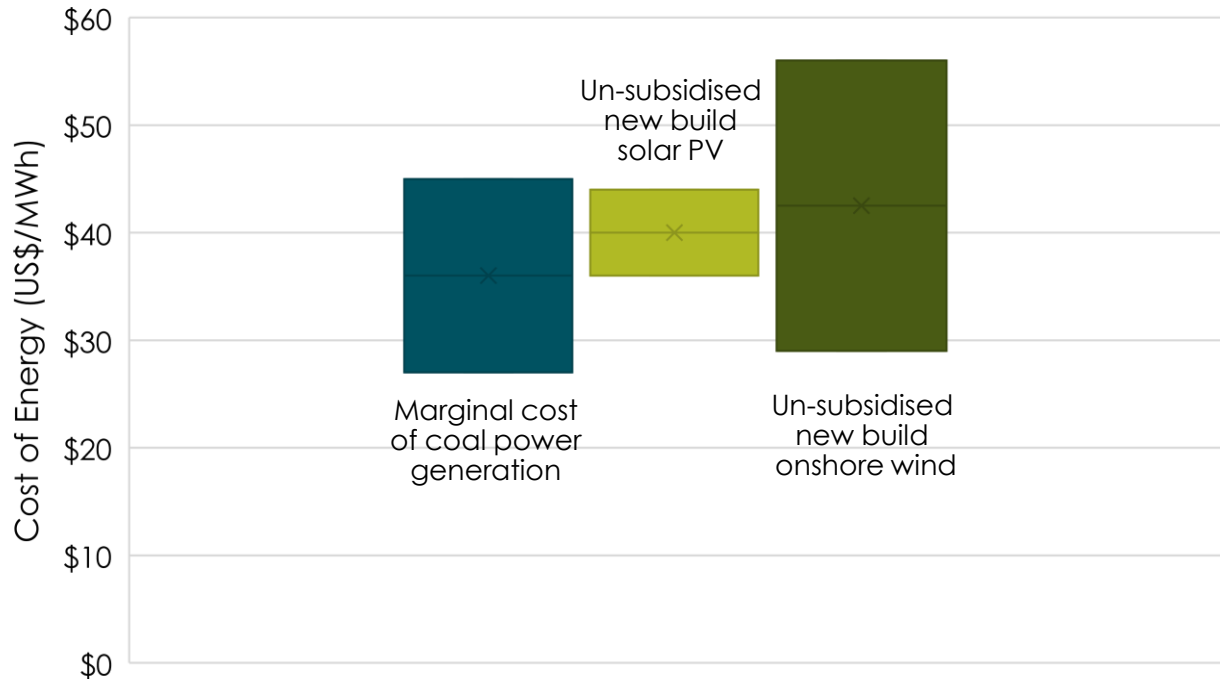
Station	Output (TWh)	Scope 1 Emissions (t CO2-e)	% of total sector emissions	Estimated useful life (years)	Owner
Liddell	8.5	7.8m	5%	3	AGL
Yallourn	10.2	13.7m	8%	5-9	Energy Australia
Gladstone	9.0	8.5m	5%	10	Consortium
Vales Point	8.1	7.0m	4%	10	Sunset Power
Eraring	17.2	14.8m	9%	13	Origin
Tarong	12.1	10.4m	6%	16	QLD Gov't
Stanwell	8.8	7.6m	5%	24	QLD Gov't
Bayswater	15.5	13.7m	8%	16-26	AGL
Loy Yang B	8.9	10.1m	6%	28	Chow Tai/Mitsui
Loy Yang A	17.0	19.8m	12%	29	AGL

Economics of power generation

Is coal the 'low hanging' fruit?



2018 Levelized cost of Energy Analysis version 12.0 (unsubsidised)



Mean unsubsidised levelized cost of energy (new build) and CO2 equivalent emissions

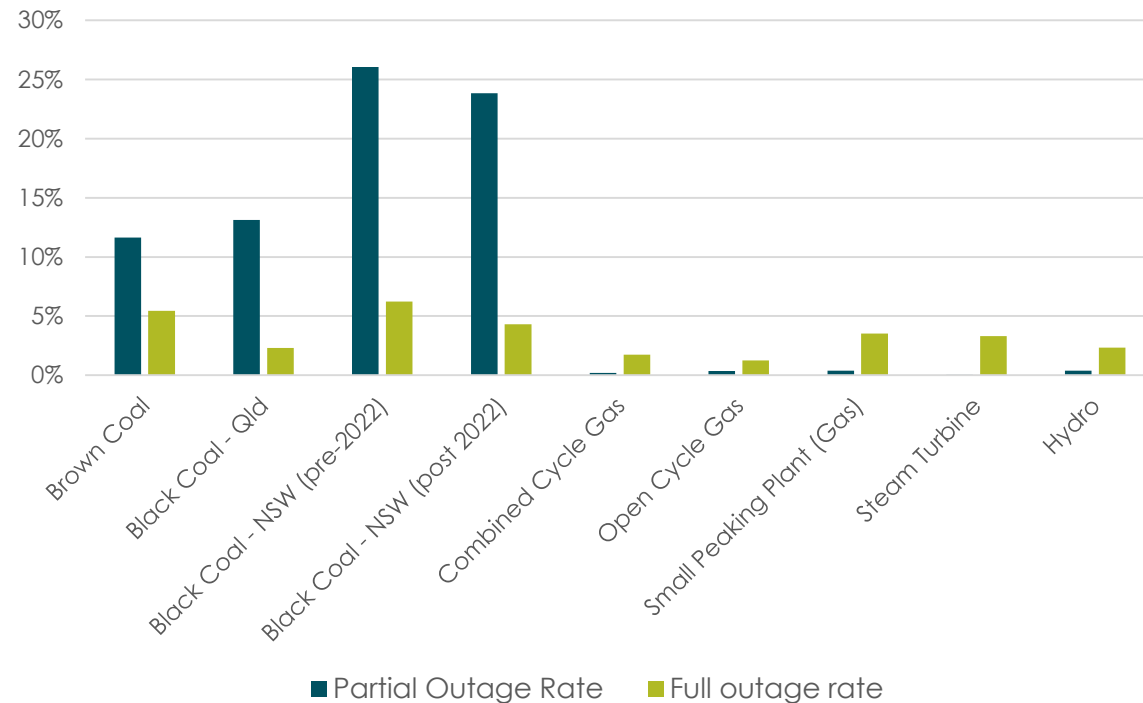
	Estimated Cost (US\$/MWh)			CO2 Emissions	
	2009	2018	% Change	Tons/MWh	% Reduction (vs. Coal)
Coal	\$111	\$102	-8%	0.92	-
Gas (combined cycle)	\$83	\$58	-30%	0.51	-45%
Nuclear	\$123	\$151	+23%	-	-100%
Onshore Wind	\$135	\$42	-69%	-	-100%
Solar PV	\$359	\$43	-88%	-	-100%

Storage the missing link

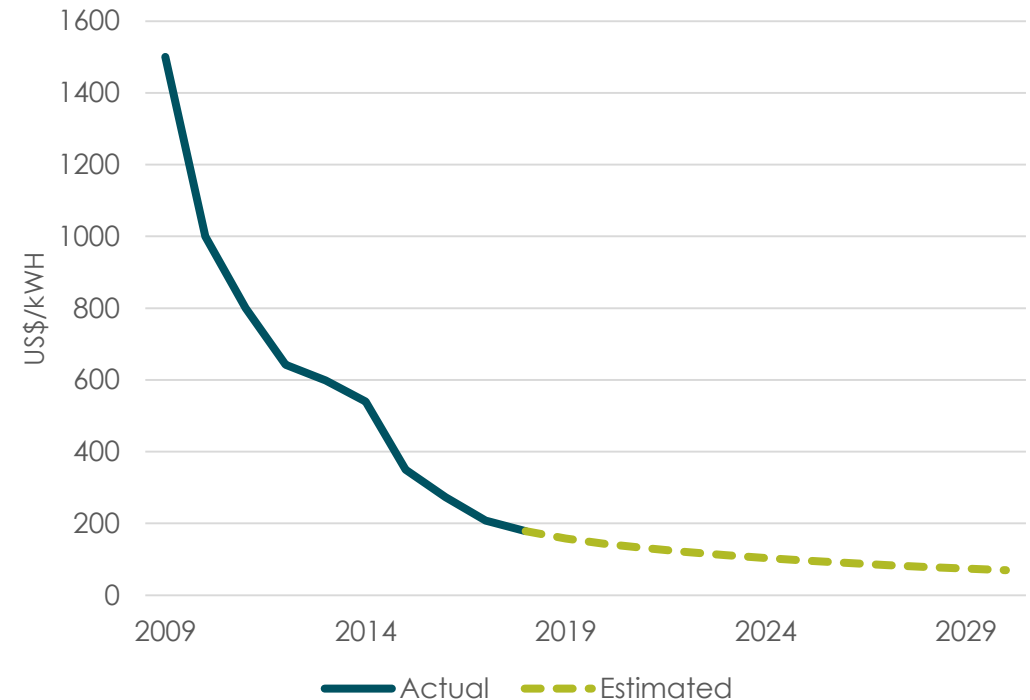
Reliability concerns can be addressed by incorporating storage into intermittent generation



Australian Energy Market Operator (AEMO) forced outage assumptions (10 year forecast) - %



Average price of lithium ion batteries (US\$/kWH)

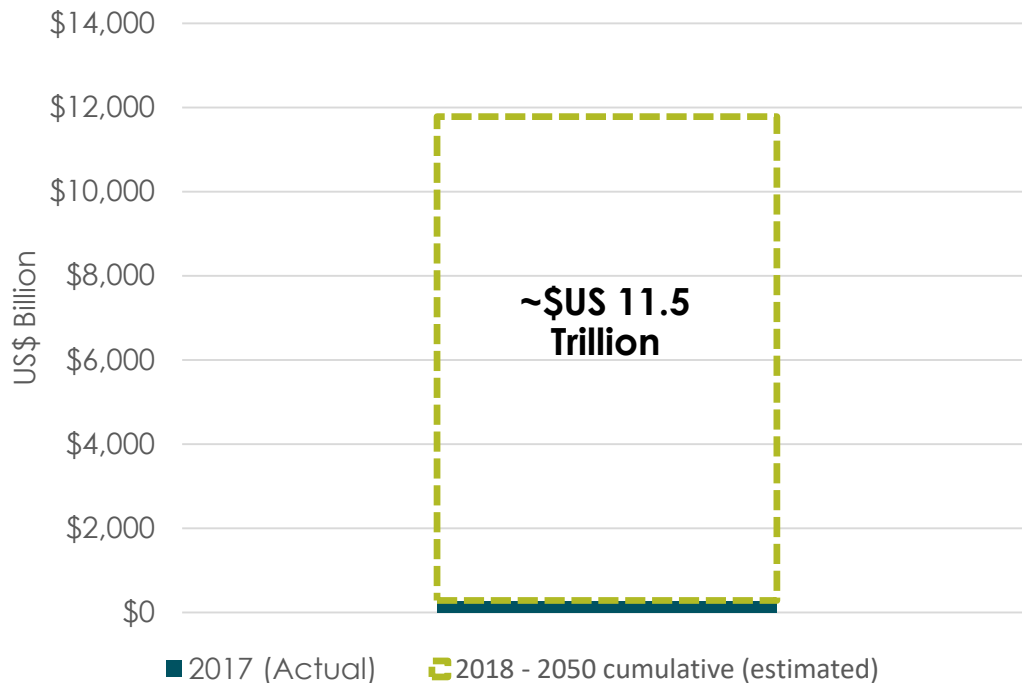


Renewables origination and financing

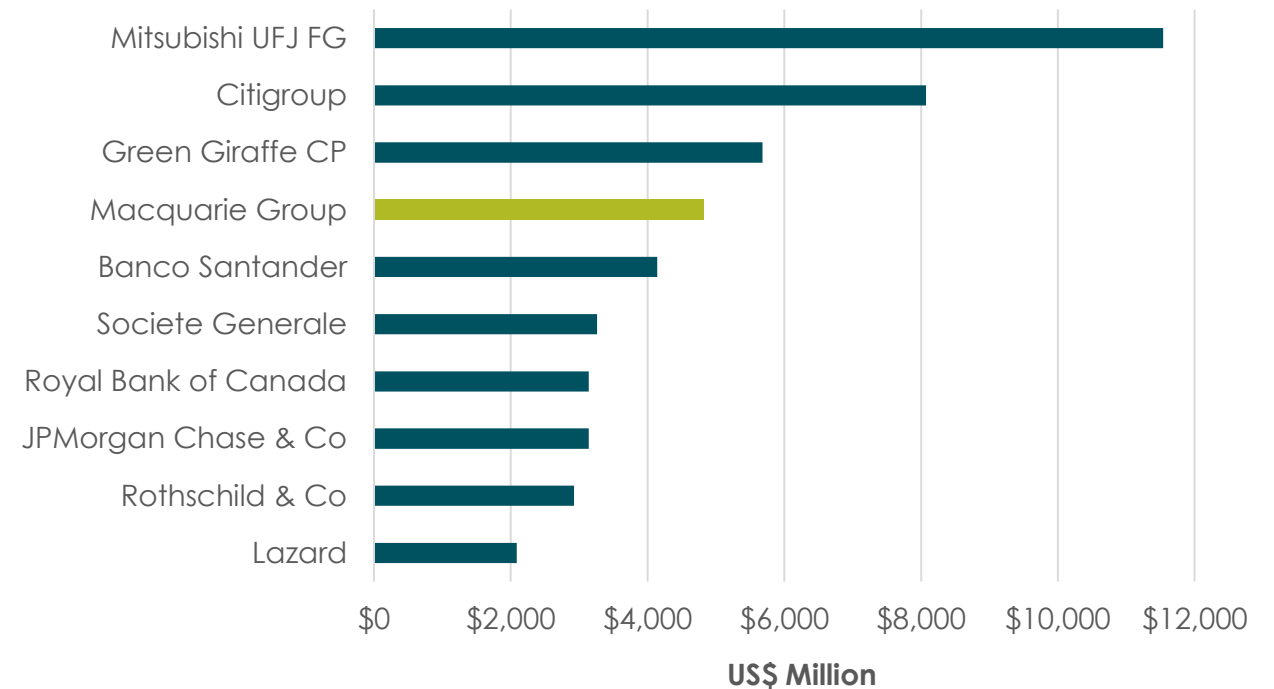


‘During the gold rush, it’s a good time to be in the pick and shovels business’ *Mark Twain*

Estimated new global renewable energy capacity investment (2018–2050)



Global renewable energy investment – Asset Finance financial advisory by total deal flows (2017–2019)





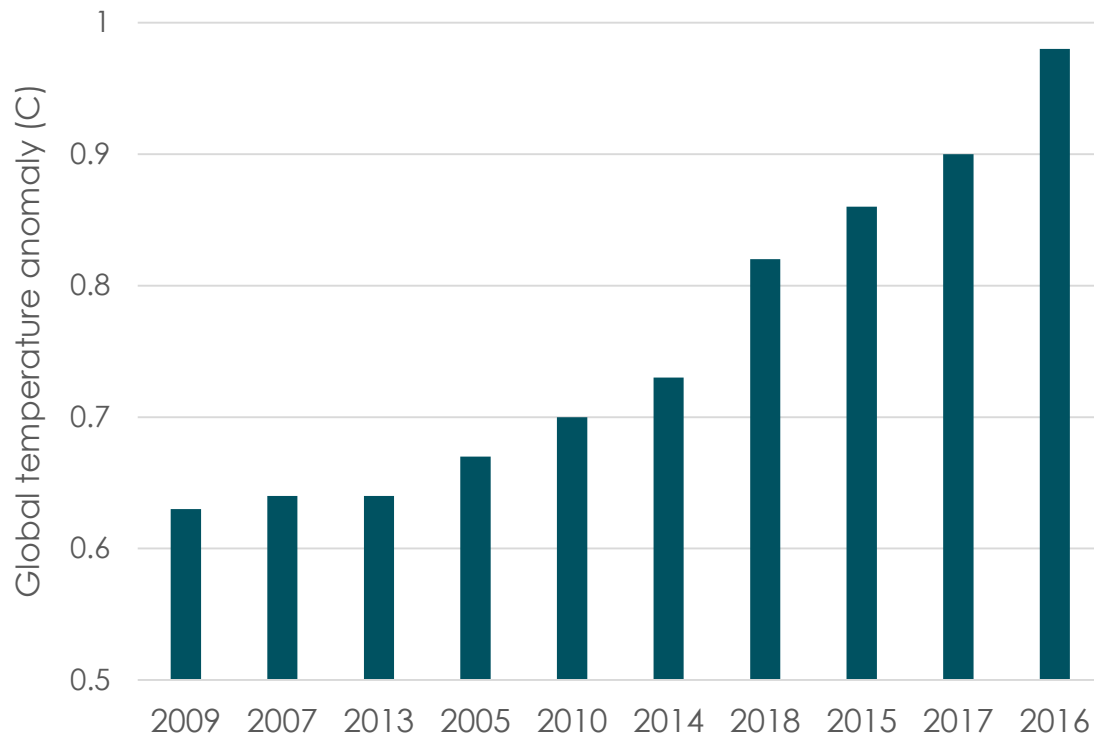
3 **Environment:** Understanding the changing climate

A changing climate

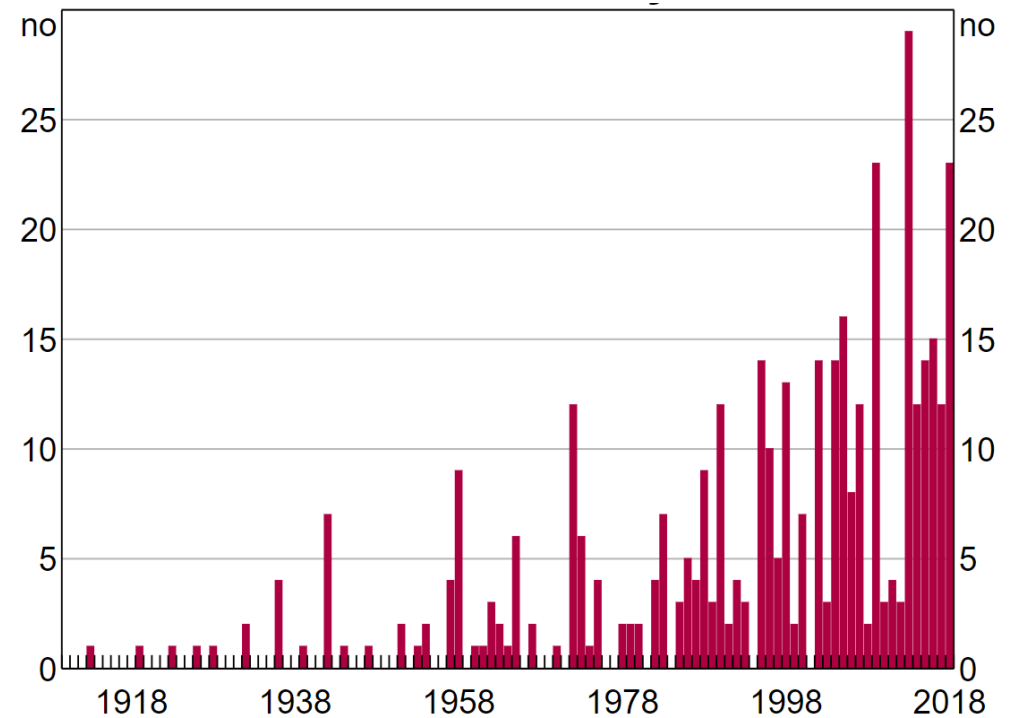
Temperatures are getting hotter and **extreme weather** events more frequent



Hottest years on record globally (1880–2018)



Number of extreme heat days in Australia p.a. (1918–2018)

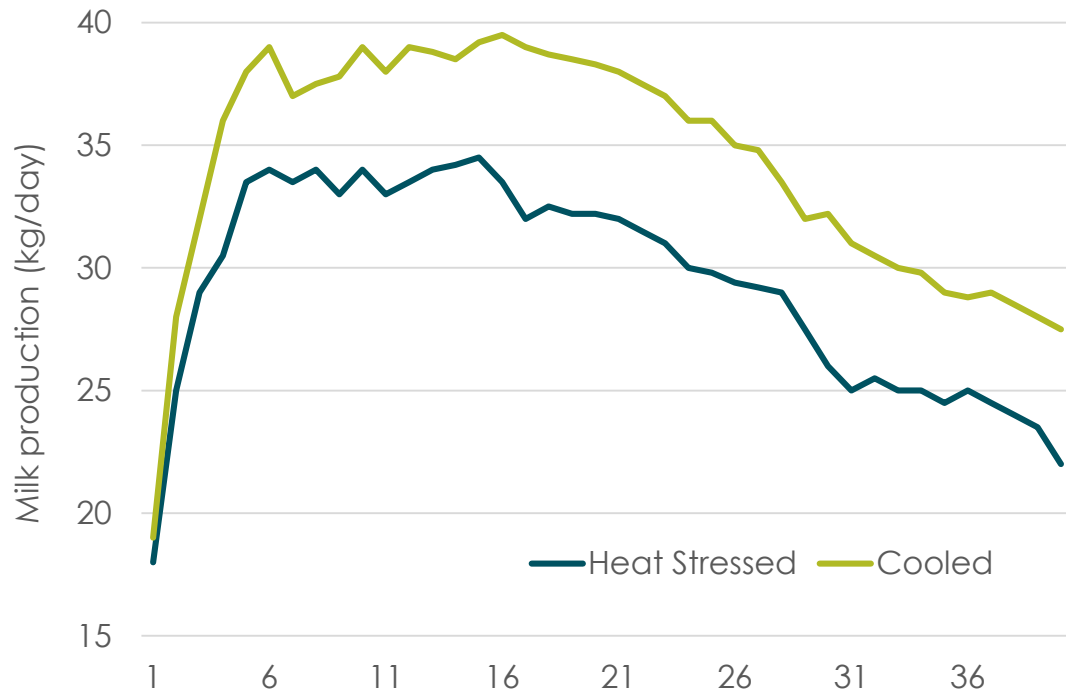


Industry impacts

Unpredictability of agricultural asset income streams likely to increase



Lactation curves for heat-stressed vs cooled dairy cows (weeks in milk)



Australian major banks agricultural exposure and loan loss rates

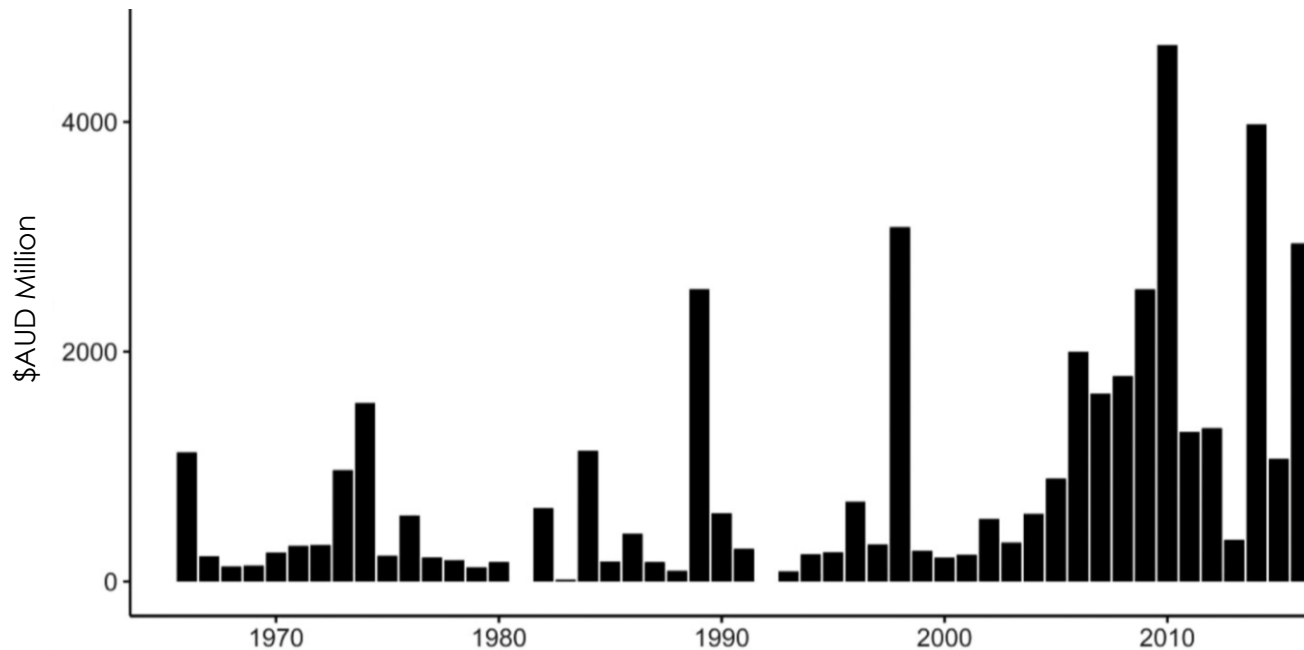
Bank	Agriculture Loan Exposure (AUD\$ loans outstanding)	% Agricultural loans troublesome or stressed (not impaired)	% Agricultural loans impaired
CBA	\$22.4 Billion	2.5%	1.9%
WBC	\$19.4 billion	6.6%	0.4%
NAB	\$45.2 billion	na	0.4%
ANZ	\$31.2 billion	na	1.1%

Industry impacts

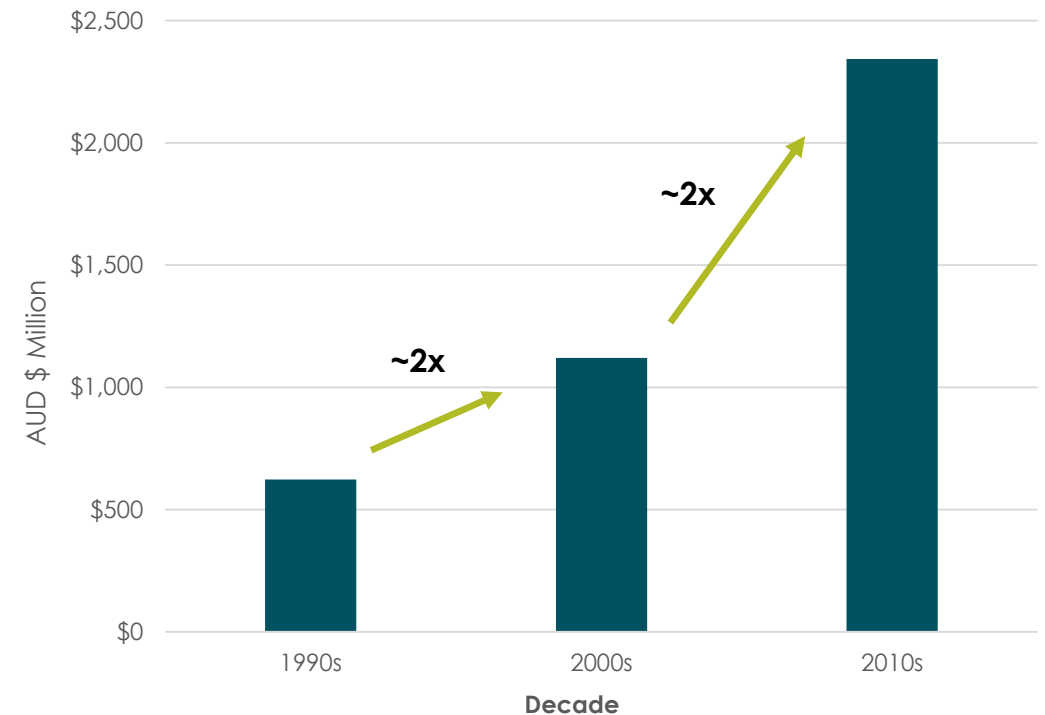
Insurers may find it difficult to accurately price new and uncertain climate risks



Australian inflation-adjusted insurance loss for natural disasters (1966–2017)



Australian yearly average inflation-adjusted insurance loss for natural disasters by decade (1990s–2010s)





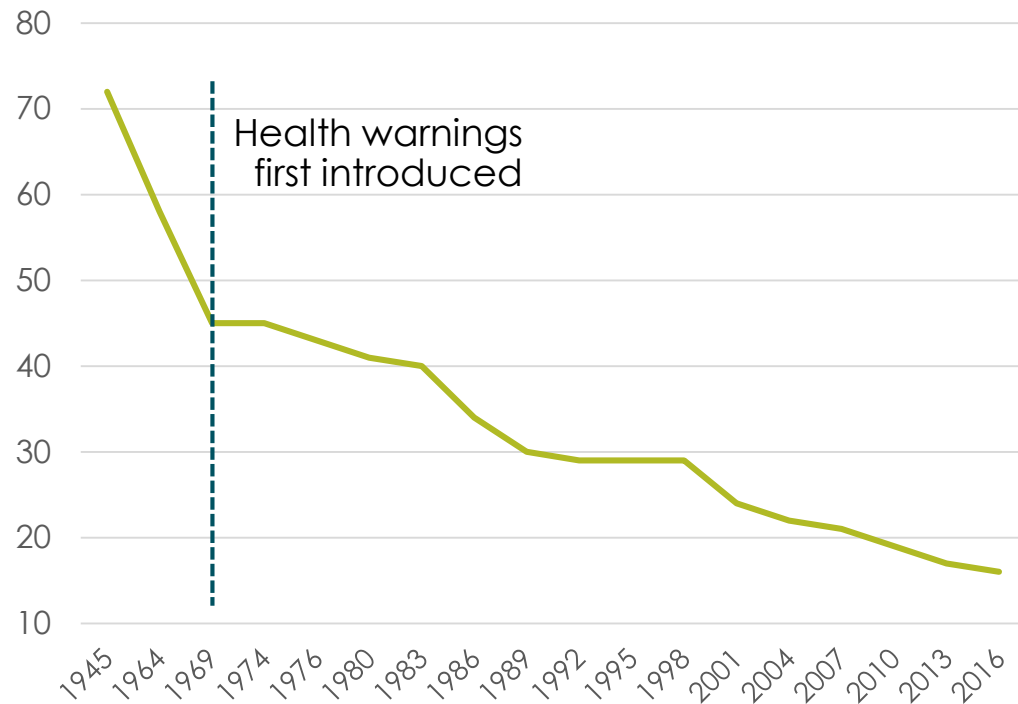
4 **Social:** Impacts and consumer priorities

Social impact changing behaviour

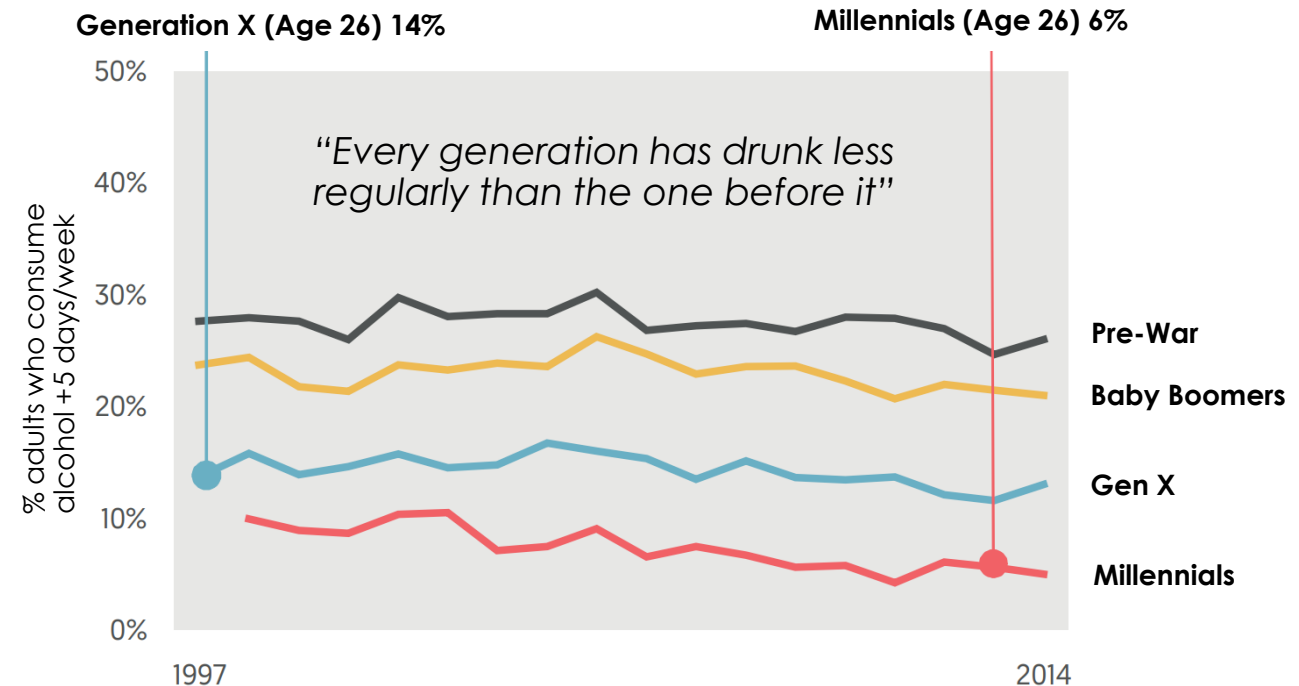


Generational change and **social considerations** are impacting consumer choices

Percentage of current Australian smokers (male) (1945 – 2016)



Frequency of alcohol consumption by generation (1997 – 2014)

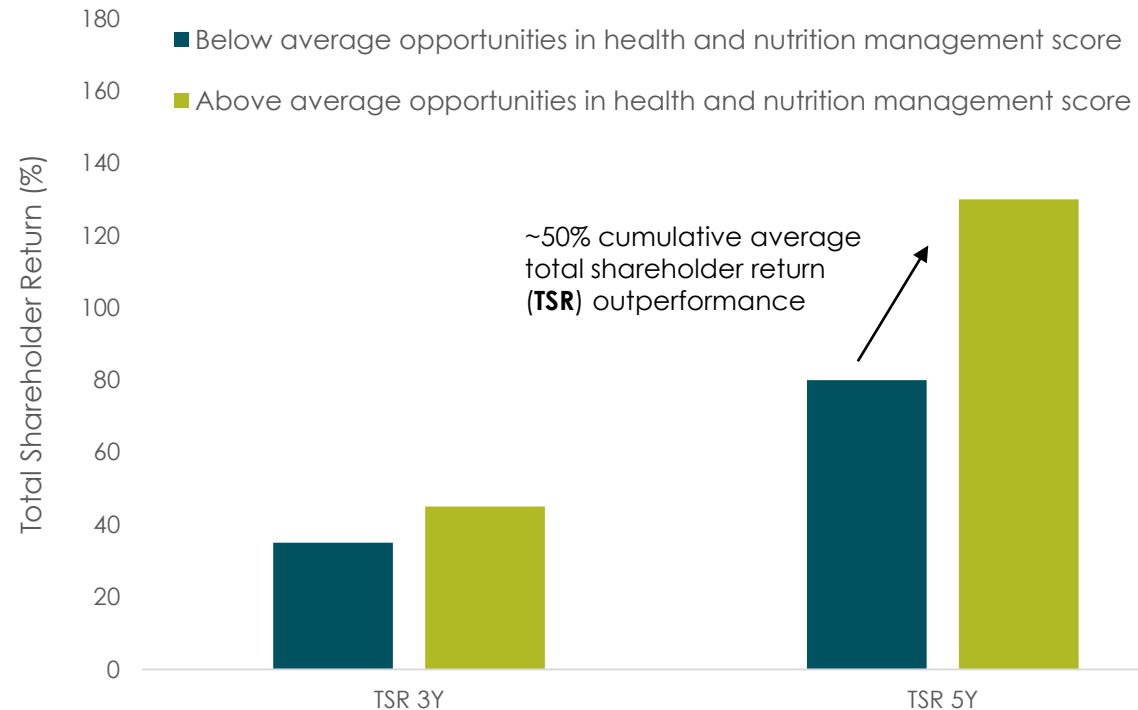
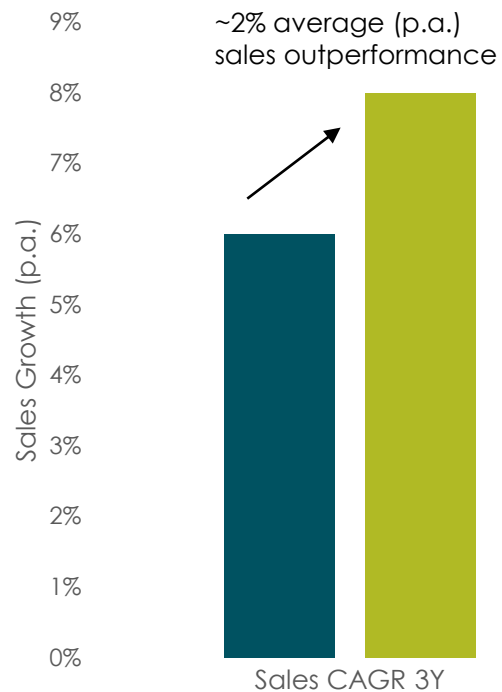


Consumer priorities

These changes highlight risks but also create *opportunity* for first movers



Performance of global food industry peers by nutrition and health score (sales / total shareholder return)

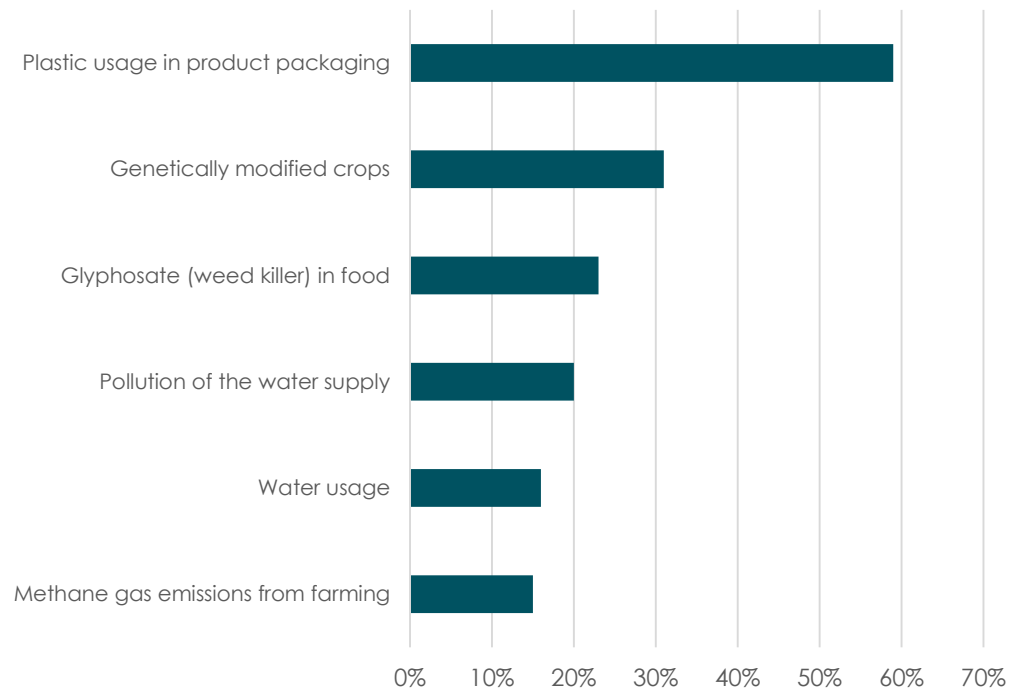


Plastics

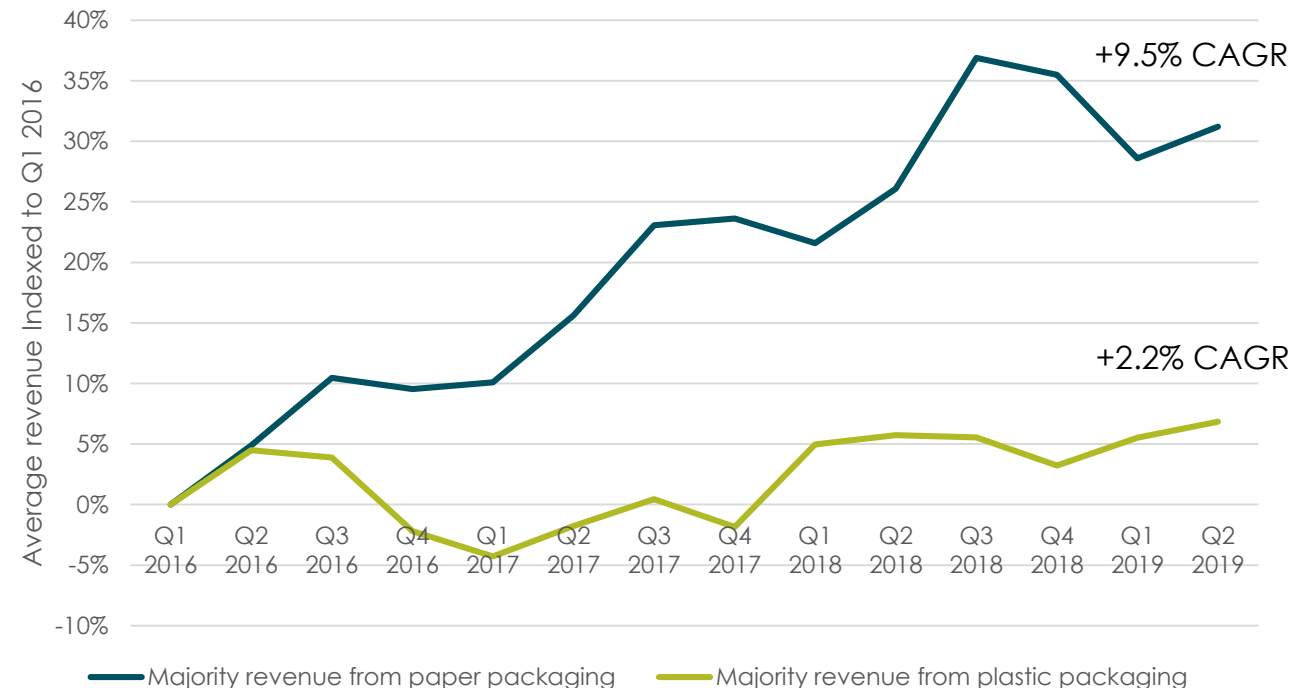
Sustainable packaging is of growing concern for consumers



ADHB/YouGov Survey 2019: What issue (if any) affected your food purchase decision?



Average revenue performance of companies with majority revenue from paper vs plastic based packaging (2016–2019)

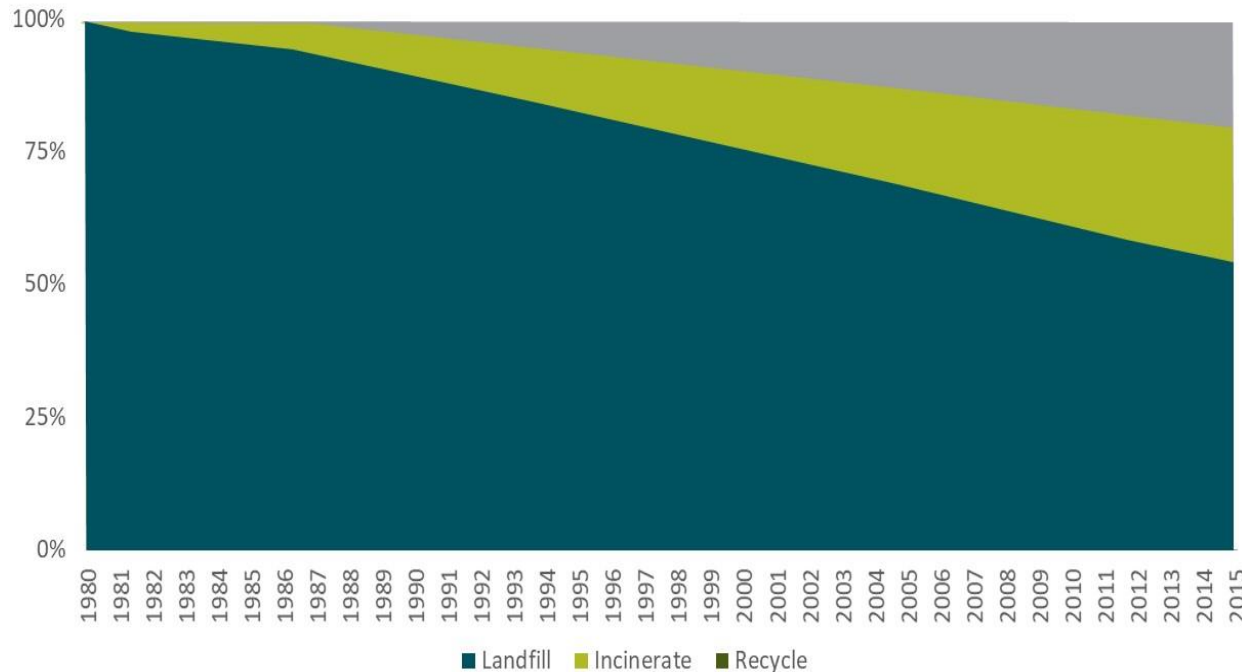


Recycling and waste management

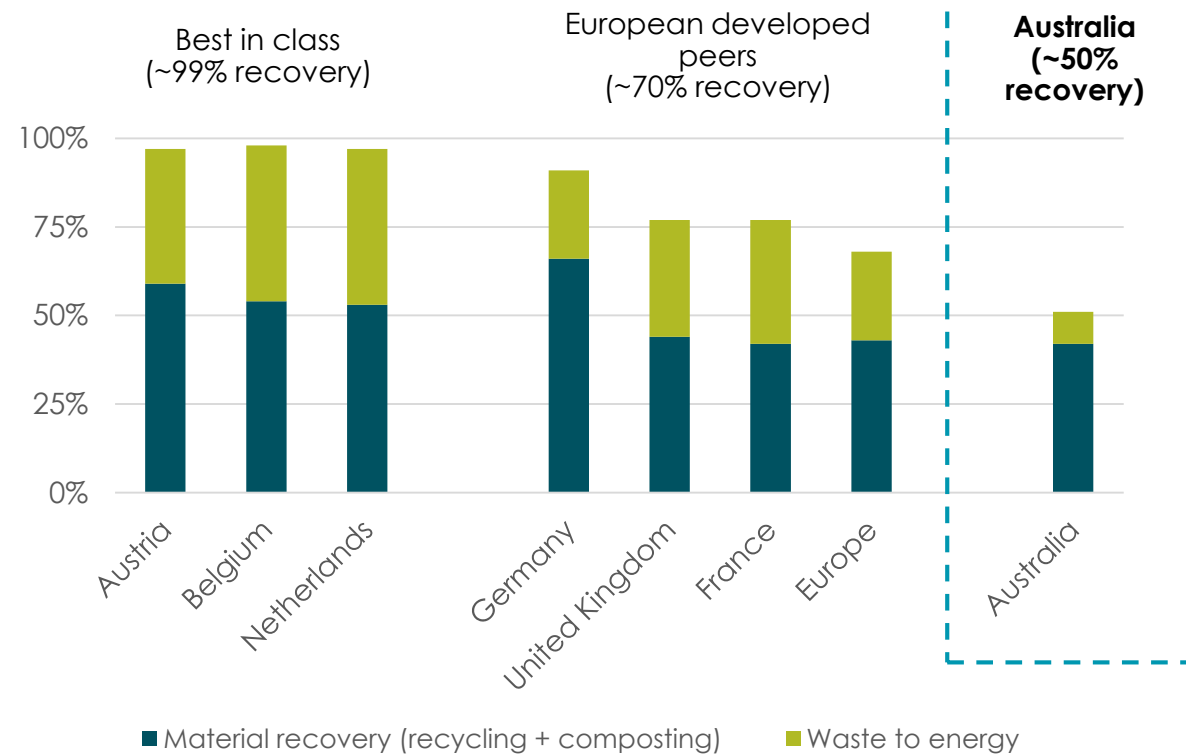
Opportunity for incumbent players - domestic recovery rates well behind global peers



End use of global plastics % (1980–2015)



Recovery rates of municipal waste (selected countries)





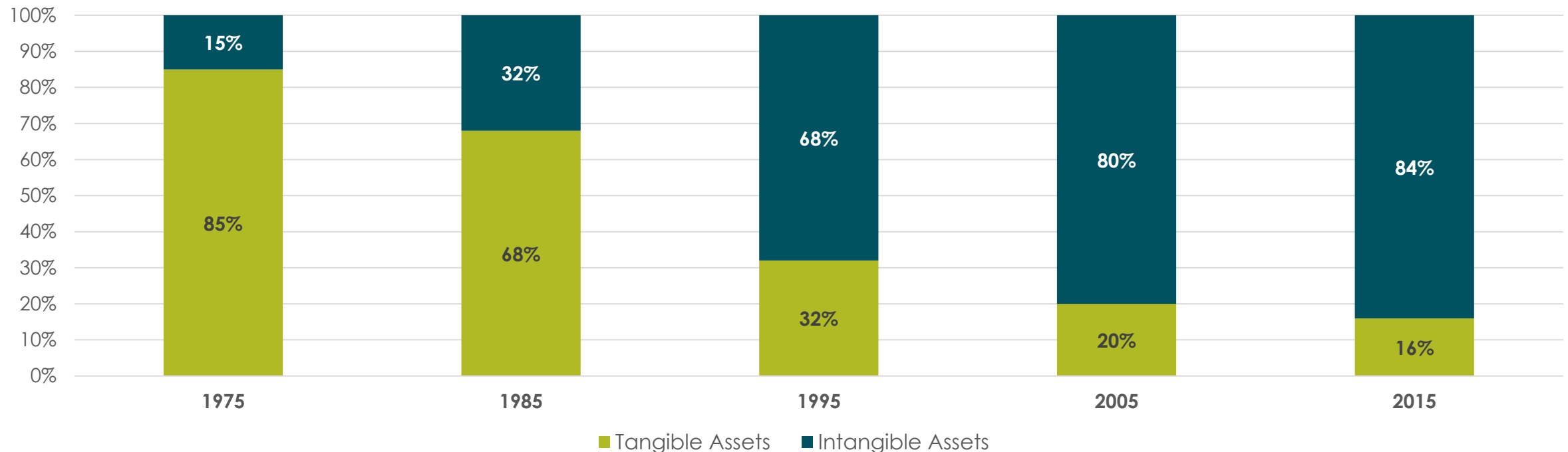
5 Governance: Building and maintaining customer trust

Why is it important?

Components of a corporation's 'value' have changed over time. 'Non-financial' factors such as corporate culture and brand value are becoming increasingly important.



Aggregate components of S&P 500 market value: 1975—2015

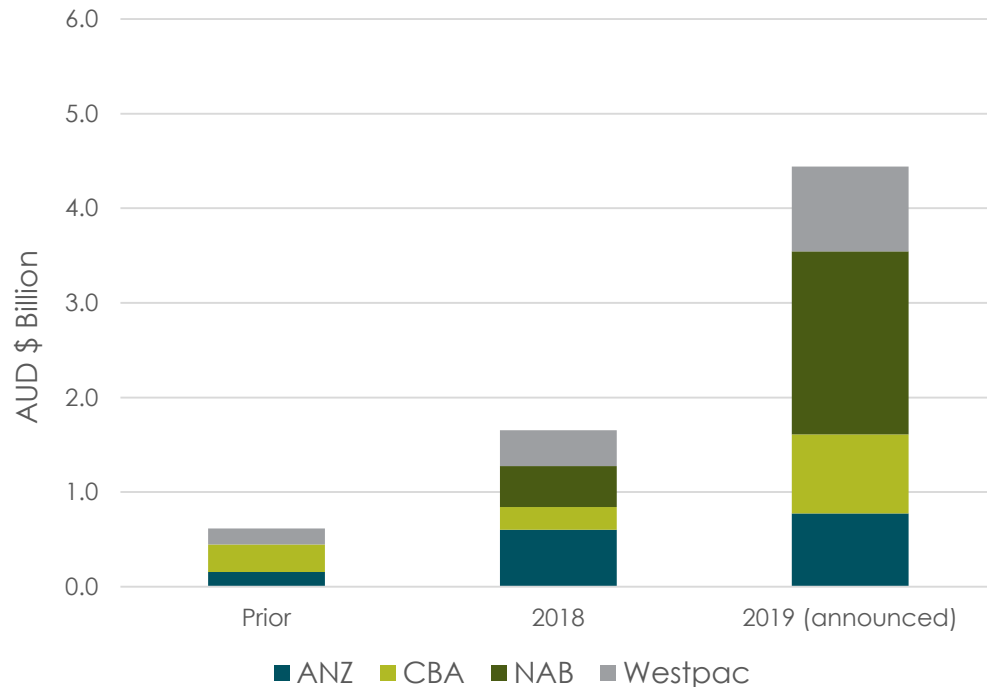


The cost of bad behaviour

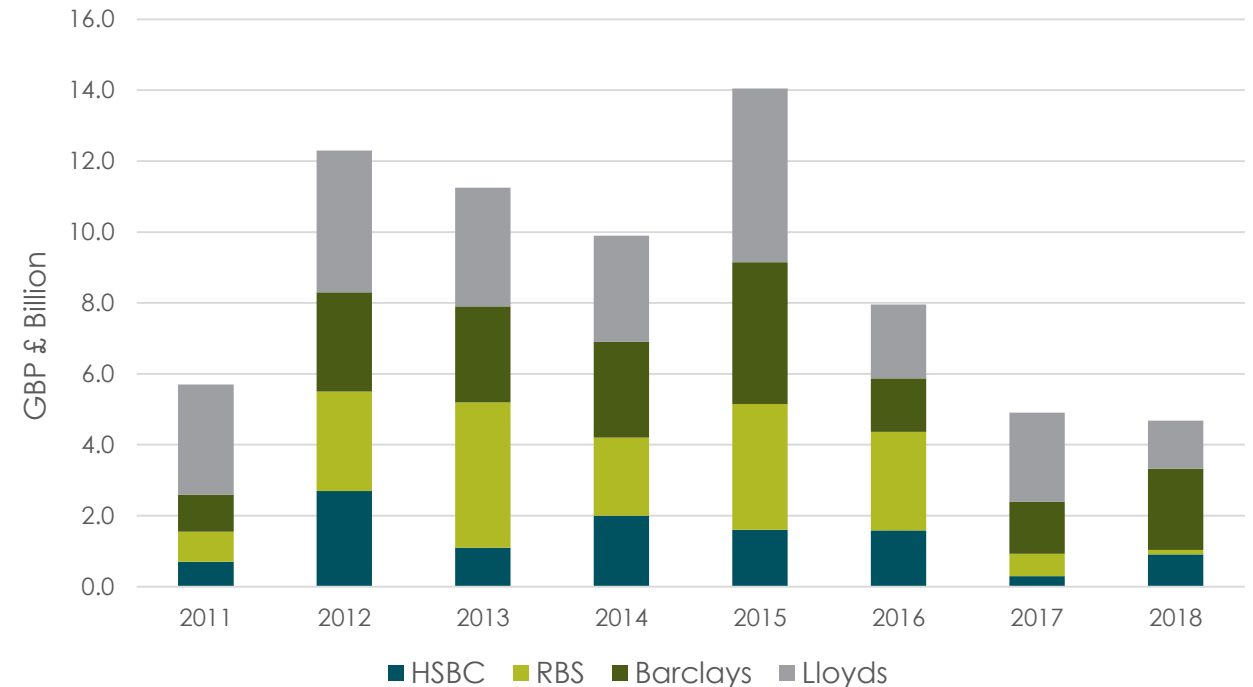
Overseas evidence shows regulatory fines, compensation and litigation charges can still be incurred long after investigations conclude



Australian Major Banks – regulatory fines, remediation and litigation costs (2017-2019)



UK Major Banks – regulatory fines, remediation/customer redress and litigation costs (2011-2018)



Investor perspective

As investors, how can we measure corporate governance and protect our capital?



Stewardship

Board and management
quality and expertise

Board independence
and diversity

Alignment

Equity ownership

Related parties and
transactions



Accountability

Pay structure

Pay materiality

Historic outcomes

Transparency

Reliability, timeliness and
accuracy of financial
reporting

Opacity of disclosures



6 Summary

Summary

- **Responsible investing is going mainstream** – primarily driven by institutional investors. This is impacting capital allocation decisions.
- **Longer-dated coal assets appear most at risk** as we transition to a low-carbon economy. The tipping point may come sooner than expected.
- The industry impacts of a **changing climate is already having consequences**. Agriculture, banking and insurance are likely to be impacted most.
- **Consumer priorities are evolving**, with a greater emphasis on nutrition, health and sustainable products/packaging solutions. Companies need to provide innovative solutions.
- **Corporate governance is the key to maintaining consumer trust**. With regulators taking action, this will be increasing and reflected in share prices.





Thank you... any questions?