Environmental, Social and Corporate Governance (ESG) Policy

Introduction

The purpose of this policy is to outline the Environmental, Social and Corporate Governance (ESG) and responsible investment philosophy of Lennox Capital Partners (Lennox). Lennox is committed to making responsible investment decisions on behalf of its clients and recognises that the ESG performance of companies in which it invests are relevant to the value, performance (risk and/or return) and reputation of the investments that are made as part of its portfolio. Lennox integrates ESG issues into its investment process as part of the qualitative assessment of the company. Lennox recognises that assessing ESG issues as part of its investment process is an ongoing, long-term commitment and it is expected that this Policy will evolve over time to reflect any change to approach and business practices.

UN Principles for Responsible Investment

Lennox is a signatory to the United Nations Principles of Responsible Investing (UNPRI). Lennox is committed to the following principles:

Principle 1 – We will incorporate ESG issues into our investment analysis and decision-making processes.

Principle 2 – We will be active owners and incorporate ESG issues into our ownership policies and practices.

Principle 3 – We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Principle 4 – We will promote acceptance and implementation of the principles within the Investment industry.

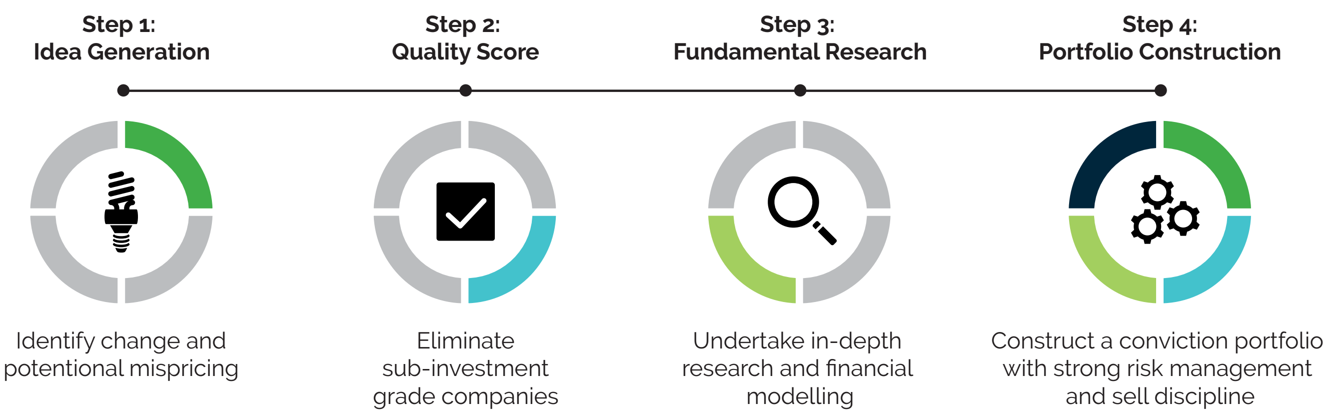
Principle 5 – We will work to enhance our effectiveness in implementing the Principles.

Principle 6 – We will report on our activities and progress towards implementing the Principles.

ESG considerations incorporated into the investment decision-making process

Lennox recognises ESG encompasses a broad range of issues that may have material impact on the risk and return of our investments. As such Lennox believes ESG is integral to the investment decision process in order to manage investments for the long term and is explicitly considered and assessed in Lenox's investment process. Figure 1 below summarises Lennox's investment process. ESG issues are incorporated in Step 2: Quality Score.

Figure 1: Lennox Capital Partners' Investment Process

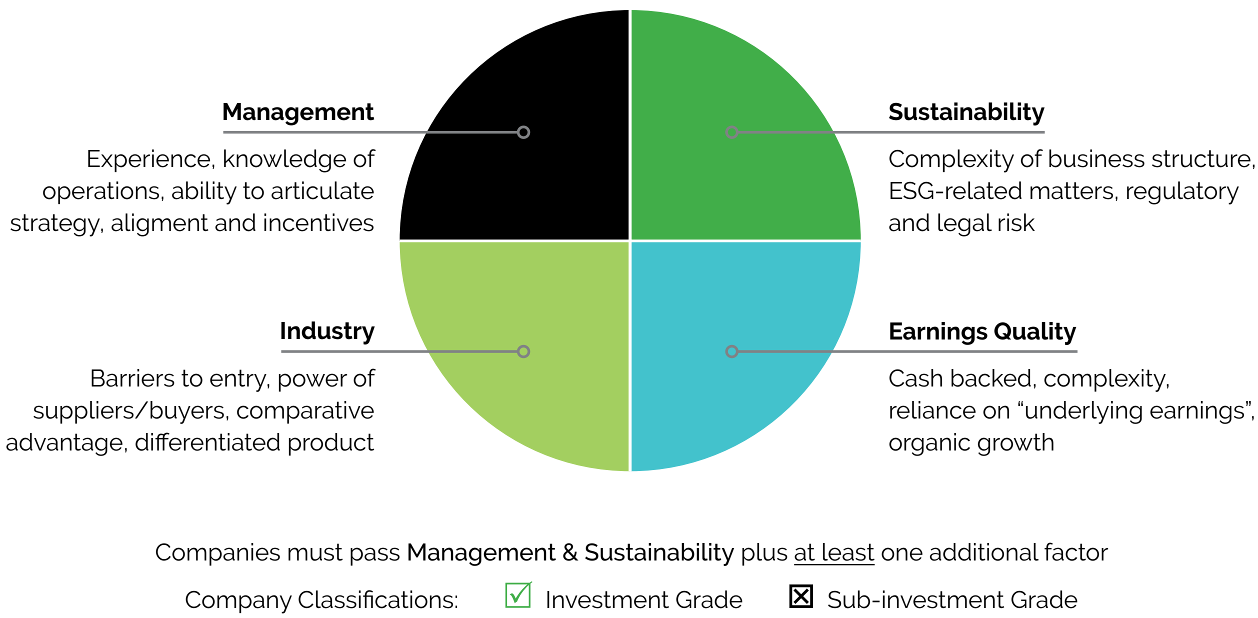


Source: Lennox Capital Partners presentation

All companies that are considered for in-depth fundamental research must pass a qualitative screening process that specifically measures and assesses a company's governance structure and the environmental and social consequences of its business.

Figure 2 illustrates the screening process. When assessing the quality score of a company to determine whether it is investment grade or sub-investment grade, Lennox examines four factors: Management, Sustainability, Earnings Quality and Industry. For a company to be assessed as "investment grade", it must pass Management and Sustainability and at least one additional factor. Lennox uses external research providers such as Ownership Matters and broker research to supplement its own research on ESG factors.

Figure 2: Four factors of an investment grade company



Source: Lennox Capital Partners presentation

Lennox recognises that ESG issues are not necessarily static and are likely to change over time. It is the responsibility of all employees to maintain and update the quality score of all companies in the portfolios and all prospective investments. Table 1 lists the assessment questions in each quality score segment. The questions outlined in red show how material ESG issues are integrated in Lennox's qualitative assessment of a company.

Table 1: Assessment questions asked as part of the qualitative screening process

Lennox's Four Factors

	Assessment	Pass/Fail
Management	Are management suitably experienced and skilled?	
	Do management understand their business and industry and can they are articulate their strategy clearly?	
	Does the remuneration structure align senior management with minority shareholders?	
	Do management have the appropriate level of experience, skill and incentivisation?	
Sustainability (ESG)	Is the business structure overly complex or opaque?	
	Environment	
	Does the business have materially negative environmental consequences that may result in regulatory change?	
	Does the business have a negative impact on local environment and risk management?	
	Does the business' operations have high carbon intensity and consequent exposure to carbon pricing?	
	Is the business impacted by climate change?	
	Is the business impacted by water supply and management?	
	Does the business' operations involve waste disposal?	
	Does the business' operations involve pollution and contamination?	
	Does the business' operations involve natural resource use and degradation?	
	Does the business' operations involve energy use and renewal energy generation?	
	Social	
	Does the business have materially negative social consequences that may result in regulatory change?	
	Is the business' corporate culture and conduct appropriate?	
	Does the business have a good OH&S record?	
	If the company operates within the gambling industry, do they exceed minimum standards for risks related to Responsible Gambling, Corruption & Instability, Privacy & Data Security, and Labour Management?	
	Does the business' operations involve the exploitation of human rights and child labour?	
	Is the business impacted by workplace relations and working conditions?	
	Is the level of community impact and engagement appropriate?	
	Is there workplace diversity in the business?	
	Are there supply chain management issues in the business?	
	Governance	
	Is the governance structure that is currently in place protect minority shareholders and safeguard against wrongdoing?	
	Is the Board independent?	
	What is female representation on the board?	
	Board composition – are the board suitably experienced and skilled?	
	Board composition – what's the average tenure of the board? Have less than 20% of the board been members for more than 10 years?	
	Is employee remuneration appropriate?	
	Are there any issues with bribery and corruption?	
	Are there any conflicts of interest within the business and are there policies in place for accountability and compliance?	
	Is the business well governed, structured to protect minority shareholders and devoid of significant regulatory risks?	
Earnings	To what degree are earnings cash backed? (Use 5 year average OCF/EBITDA cash conversion or similar metric)	
	Are earnings easily forecastable / overly complex?	
	Is there a reliance on "underlying earnings" or can earnings be manipulated by management assumptions?	
	Is future revenue / earnings growth organic or through acquisition?	
	Are earnings forecastable and a true reflection of cash generation?	
Industry	Does the product / service have a significant competitive advantage over peers?	
	What are the barriers to new market entrants and are they significant?	
	Is cyclical / structural change a tail or headwind for the industry?	
	Does the industry benefit from cyclical/structural changes and does its structure protect/aid future company earnings?	
Quality Score	**Summarise the quality of the business**	

Source: Lennox Capital Partners

Lennox's investment focus is not confined to the short-term financial performance of a company. We believe over the long term a company's operations are unsustainable if they cause irreparable damage to the environment, workplace or end consumers, and will not knowingly invest in such companies.

Materiality of ESG factors

Lennox acknowledges that not all ESG factors will be relevant to all investments. As such, Lennox incorporates material ESG factors into the fundamental analysis of each company it includes, or is considering for inclusion in, its portfolio. Lennox determines materiality by considering which ESG risks and opportunities the industry is most exposed to as well as any ESG risks and opportunities specific to the company itself. A material ESG risk is one which can have a significant impact on the valuation of a company, if not well managed.

Specific ESG considerations

How we consider climate change risks and opportunities in our investments

Lennox subscribes to the scientific consensus that carbon dioxide in the atmosphere, predominantly as a result of human activity, has led to global warming with consequent changes in our climate. There has been a global move to reduce carbon emissions worldwide. The Paris Agreement, ratified by 195 countries, outlines country-specific targets for reducing carbon emissions. Lennox believes that uncertainty surrounding both the physical changes in our climate as well as the policy response around the transition to a low carbon economy can pose a risk to our investments. Equally, there will be companies that benefit from such a transition. As such, Lennox considers the physical and transition risks and opportunities of climate change as part of our fundamental analysis.

Physical risks can involve the increased frequency and severity of extreme weather events such as drought, flooding, hurricanes, heatwaves and rising sea levels. Transition risks include the risk of regulation around carbon emissions such as the introduction of a carbon tax, both within Australia and globally, which may affect demand for exports, the development of new technologies which are more aligned with a low carbon world as well as changing consumer preferences for low emission/energy efficient products.

Opportunities can arise from companies that develop technologies or solutions to deal with the physical aspects of climate change and those companies that are better prepared and less exposed to the negative effects of a transition to a low carbon economy. We consider all investee companies through this lens in our fundamental analysis.

We encourage the companies we invest in, or are considering for investment, to assess and disclose their exposure to climate-related financial risks, adopting where possible the framework set by the Taskforce for Climate-Related Financial Disclosures (TCFDs).

How we consider modern slavery risks in our investments

Lennox recognises that modern slavery, as well as being a serious ethical concern, can also pose a financial risk to businesses both from both a reputational perspective and from a disruption to their supply chains. Lennox recognises that, although less common, there are still instances of modern slavery within Australia, particularly in high risk industries such as textiles, financial services (through their supply chains), mining, construction, property, food and beverages, agriculture, and healthcare. When analysing companies in these higher risk industries Lennox will do additional due diligence to ensure the company has appropriate policies in place to manage these risks and treats its employees fairly. With companies that have supply chains in high risk regions overseas we take a similar approach, ensuring that the investee company has awareness of the risks of modern slavery within its supply chains and has policies in place to mitigate these risks.

How we consider gender diversity in our investments

Research has shown that companies with higher gender diversity on their boards have higher financial performance and are associated with lower variability of stock market returns. Lennox believes that greater gender diversity (as well as other forms of diversity) reduces the risk of groupthink. This can reduce risks and boost performance in investee companies. As such we consider the number of females on boards as part of our governance assessment. Through our engagement activity, we also encourage our investee companies to improve the gender balance of their boards.

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ESG engagement

Lennox will engage with the management teams and boards of companies to seek further clarification and provide feedback on ESG issues and help them understand how we think about ESG for our investment process. We record any ESG engagement with companies as part of our note taking process. At the investment committee meetings where investment ideas are proposed, the quality screening process for a prospective investment is discussed. For the investment to go ahead, the two portfolio managers need to unanimously agree the investment passes ESG factors.

In addition to company engagement, Lennox also votes at all the general meetings of the companies it holds in its portfolios. As an investment manager, we take our ownership responsibilities seriously as we believe the right to vote as proxy is an important asset.

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Next Scheduled Review Date: September 2023

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