

EXTRACTIVE INDUSTRIES and FOSSIL FUELS

The Alphinity Sustainable Share Fund seeks to address the UN's Sustainable Development Goals (SDGs) to the greatest extent practical and invests in companies that can support the achievement of one or more of these goals. When considering the potential investments of the Fund, which are shares listed on the ASX with market capitalisation greater than \$100m at the time of purchase and with adequate liquidity, we further refine the universe to:

- Companies producing products/operating in industries not excluded in the Fund's [Charter](#)
- Companies with strong ESG practices; and, where possible
- Companies that address one or more of the SDGs

When filtering out unacceptable activities we considered excluding companies involved in extractive industries altogether, including those producing Fossil Fuels, but decided against it. We set out our reasoning and conclusions below.

Extractive Industries

The Sustainable Share Fund Compliance Committee debated whether to exclude mining companies from our investable universe altogether. While there would have been some simplistic appeal in doing that, when we considered that one of the aims of the Fund is to address to the greatest extent possible the various SDGs, it became clear that supporting some companies involved in extractive activity would be required.

Some extracted materials are essential to achieve the Sustainable Development Goals. We cannot build badly-needed infrastructure that will enhance peoples' lives without materials like steel and concrete. We cannot produce technology without rare earths, plastics and glass. We cannot move to electric vehicles without access to materials like Copper, Graphite and Lithium to make motors and batteries.

But we also concluded that we need to make sure that the companies producing these commodities are behaving in an environmentally and socially responsible way, so having strong ESG practices is especially important. Where a viable and more sustainable alternative becomes available, we will adjust our commodity restrictions accordingly.

Having said that, some extractive activity is unnecessary or unhelpful. What social value is added by mining Gold? Its usage primarily consists of jewellery making and speculation/investment, and the environmental damage caused by gold mining can be severe due to the toxic chemicals often used and the challenges of disposing of the tailings generated. There are some industrial uses of gold, however this sort of demand can easily be satisfied by gold produced as a by-product of more socially-necessary metals such as Copper. Therefore we have excluded companies with a material* involvement in gold mining from investment in the Fund.

Fossil Fuels

Securing reliable energy supplies is critical in order to sustain and improve living standards throughout the world, and therefore important to achieving many of the SDGs. It is undeniable that Fossil Fuels are by nature finite, and that ongoing consumption of those

fuels even at current levels, let alone the greatly-increased levels needed to lift living standards among populous low-income countries, is by definition not sustainable. In addition the greenhouse gasses emitted by consuming Fossil Fuels contribute significantly to global warming. The world needs to move towards generating more energy from sources that are not finite and do not generate greenhouse gas emissions. These might include traditional renewables, like hydro, solar and wind, as well as emerging sources like geothermal, tidal, biofuels and many others. It will require a mix of technologies to provide adequate redundancy and reliability.

A practical dilemma for developing economies – at least until very recently – has been that the cost of deploying renewable energy generation has been materially higher than that of traditional Fossil Fuel-powered energy. This however is in the process of changing and renewables are quickly becoming a lower-cost source of energy.

One of the challenges of increasing system reliance on renewables is the intermittent nature of many of them. For instance, solar is only effective during daylight hours and production will vary with the season and the weather. Wind generation is only effective when the wind is blowing. Geothermal should be a reliable source of power but is only viable in some geographies and has not yet been proven at scale. Biofuels should also be reliable but are not yet at sufficient scale to contribute meaningfully to baseload energy supply, and in some cases their use also raises moral questions around the diversion of food away from human or animal consumption to energy production.

As such, some type of storage is required in order for the electricity networks to remain reliable as renewables increase. Storage currently can take the form of batteries, pumped hydro, and more emerging technologies such as chemical storage. Storage technology is not yet widely enough established in Australia and most other places in the world to allow renewables to replace Fossil Fuels for baseload energy supply at scale. Until storage is sufficient to adequately support energy needs, some form of Fossil Fuel usage will still be required.

However not all Fossil Fuels are created equal and, in our assessment, there are destructive Fossil Fuels and less destructive Fossil Fuels. To be clear, the ultimate aim needs to be doing away with the use of Fossil Fuels altogether but in order to achieve the transition to renewables without disrupting existing networks and still enabling economic development in populous countries, a degree of Fossil Fuel usage will be required for the foreseeable future. We will actively monitor developments in renewables and storage and our approach to fossil fuels will evolve in response to those developments. The question then becomes, for the more immediate future, which is the least damaging Fossil Fuel?

Oil: Oil is a useful and easily transportable energy source that has great usage around the world, primarily for the purpose of transportation. Reserves of Crude Oil are substantial, notwithstanding the immense annual usage that currently takes place. There are many sources of crude oil and many differing grades, each of which has its own environmental benefits and/or challenges. Usage of Crude Oil at its current rate is almost certainly going to decline as the penetration of electric vehicles builds, however the time required to replace the existing oil-powered fleet and infrastructure is likely to be decades, and there will also need to be substantial change in the electricity supply network to support it. While we are prepared to invest in Oil-exposed companies, we note that there are some methods of Oil extraction that are significantly more socially contentious, environmentally damaging and/or

environmentally risky, and we will not invest in companies materially* exposed to them. Examples are Oil Sands, Shale Oil and Oil sourced from the Arctic.

Coal: there are generally two types of Coal, Metallurgical Coal which is used in blast furnaces to make steel, and Thermal Coal which is used in electricity generation. There is as yet no reasonable replacement technology for Metallurgical Coal in the primary production of steel so, as steel is a vital ingredient in achieving several of the SDGs, we are willing to invest in companies that produce and/or use Metallurgical Coal. Thermal Coal however can readily be replaced by cleaner sources of Fossil Fuels and, as noted above, ultimately by renewable energy. There are several types of Thermal Coal but they largely fall into two categories: Brown and Black. Brown Coal is highly polluting and should not be used for energy generation. Black Coal is generally less polluting but far from optimal as an energy source. We will not invest in companies with a material* involvement in the mining of thermal Coal.

Gas: there are also many sources of Gas however we will categorise them into Conventional Gas and Unconventional Gas. Conventional Gas is tapped from conventional underground or undersea fields; Unconventional Gas requires extra intervention such as hydraulic/chemical fracturing to be released from its source. This is colloquially known as fracking. Gas is, in our view, the most acceptable type of Fossil Fuel, producing carbon emissions generally around 30% lower than that of the best type of Coal. As such, we are willing to invest in companies producing Gas which can provide users with access to reliable energy in a less-damaging manner than reasonable alternatives. We are conscious that over time, as renewables and storage become more widespread, the need for Gas to provide peaking or baseload energy will become redundant, at which point Gas will join thermal Coal as a sunset industry. As that time approaches we will reassess our exposure to Gas. In the meantime, we will look particularly critically at companies allocating capital to new long-life gas projects, such as LNG projects, given the potential for reduced demand for gas in the longer term.

Given the serious social concerns and potential for environmental damage as a result of fracking, we will not invest in companies with a material* exposure to Unconventional Gas which requires fracking.

Uranium

While Uranium is not a Fossil Fuel and can theoretically be a source of virtually zero-carbon emission energy, nuclear power plants are socially controversial and have become politically unviable in Australia, notwithstanding relatively safe operation at scale in some parts of the world. They take a very long time to build and are enormously expensive and, considering the pace at which the cost of renewables is declining, it is unlikely there will be many nuclear power plants built after those presently under construction are completed, as such this should also be considered a sunset industry. The bigger challenge with nuclear is the disposal of the residue, which remains highly radioactive for many lifetimes. As such we will not invest in companies which have a material* exposure to Uranium production or use.

*Material involvement is defined as 10% of the revenues of the company being assessed

Important information

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