Climate Change Statement

December 2022

Purpose

This statement has been developed to align with the recommendations of the Task Force on Climate-Related Financial Disclosures.

This statement will be reviewed on an annual basis, or more frequently where required.

Introduction

Background

Alphinity acknowledges the findings of the Intergovernmental Panel on Climate Change and supports the United Nations Paris Agreement to limit global warming to well below 2°C by 2050, compared to pre-industrial levels, and transition the economy to net zero.

As a key investment thematic, climate change presents a range of material social and economic threats and opportunities to investee companies. These threats and opportunities could be driven by the physical impacts of climate change (for example, increased average temperatures) or by the transition to a low carbon economy (for example, changes in local and global carbon policies as well as changes in demand and supply dynamics).

Achieving net zero emissions by 2050 will require coordinated action from all parties, including investors, private business, and government. It will also require ongoing investment in renewable energy, low carbon technologies and innovative solutions like carbon capture, offset programs that are reliable, measurable and good quality with a focus on nature-based solutions, and ultimately winding down of the fossil fuels sector.

As an investment manager, our fiduciary obligation is to maximise returns and minimise risks. Climate change risks are generally longer term and exhibit a lower degree of certainty in terms of impact and timing. As such, we undertake research and engagement to better understand the possible impact from climate risks and encourage company action which mitigates this. In regards to net zero, and the transition to a low carbon economy our view is:

Climate change is a systemic risk, recognised by the world's largest Governments, investors, and businesses as a material threat to our global economy. In response, there is a worldwide shift towards more sustainable and low emissions solutions, and away from unabated emissions-heavy industries and fossil fuels.

We recognise that some companies may benefit from the negative impacts of climate change in the shorter and mid-term, and the timing for the transition away from fossil fuels is still largely unresolved.

We review each company on a case-by-case basis and strongly encourage a logical and timely transition, in the interest of transitioning in line with the wider economy.

Global commitments

As of November 2022, around 140 countries had announced or are considering net zero targets.[1] More than $US130 trillion worth of investments have also committed to net zero through a range of initiatives including the Net Zero Banking Alliance and the Net Zero Asset Managers Alliance. This, along with commitments made by listed business globally, means that 90% of global carbon emissions are now covered by net zero goals.

The European Union have also released the EU Taxonomy and Sustainable Finance Disclosure regulation (SFDR). These new guidelines will support further disclosure and alignment of listed business activities and finance towards a more sustainable future.

We recognise that many of these commitments are for 2050 and beyond, and as such there is a long way to go before the goal of a net zero future is realised. Regardless, we believe that the broad objective of setting longer term commitments helps to focus strategic thinking and ultimately helps to drive action towards that outcome.

Our approach

We believe that climate change is a significant economic risk and, if not managed appropriately, has the potential to negatively impact many of the companies in our portfolios. We believe the timing of such impacts is uncertain and, as such, we encourage our investee companies to transition in a way that is most suitable to their business strategy, and which will drive suitable returns.

1 CAT net zero target evaluations | Climate Action Tracker

To enable greater transparency and clarity around risks to individual companies and to financial markets more generally, we support and encourage disclosures in line with the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD)

Governance

The Alphinity Board is responsible for approving the firm's ESG policy and any associated disclosures, including our commitments to climate change.

Alphinity reports on organisational risks to its Board of Directors. From 2023, a dedicated ESG report, including comments on climate change risk and reporting on carbon emissions metrics, will be presented to the Board at least annually.

The day-to-day management of climate-related threats and opportunities is the responsibility of all members of the Alphinity investment team. Where appropriate, this may include incorporating considerations into investment analysis and decisions.

Strategy

Across all portfolios we have excluded investment in producers of thermal coal producers (10% revenue threshold[2]). This is based on the poor long-term outlook for thermal coal as the world de-carbonises, and the associated investment risk for coal-producing companies. Our sustainable portfolios take this a step further and exclude all fossil fuel producers[3] (5% revenue threshold for the Global Sustainable Equity Fund and 10% revenue threshold for the Australian Sustainable Share Fund).

We monitor the climate scenarios and relevant information published by the International Energy Agency (IEA) and the Intergovernmental Panel on Climate Change. We also reference other scenarios like those published by NGFS depending on the nature of our assessment. At this stage we have not completed detailed scenario analysis using these inputs, however, intend to do this by the end of 2024 at the latest.

The Alphinity investment process uses both fundamental and quantitative analysis to select stocks that have the potential for earnings surprise. Investment managers are all responsible for considering climate change risks and opportunities in their fundamental analysis of a stock. This includes considering the potential physical and transition risks and opportunities associated with climate change.

Assumptions

The following key assumptions underpin our assessment of stock risks for climate change. These assumptions are Alphinity's view based on our understanding of relevant climate scenarios, engagement with companies and industry experts, and ongoing monitoring of this issue over time:

- The net zero transition will continue to be disorderly in nature and varied by region and industry. We expect that large-emitting countries will introduce more structures over time to support the development and uptake of new low-carbon technologies, however the timing for these changes is unclear.
- We believe private industry, including companies, investors, and researchers, will continue to lead the development of new technologies and solutions. Research, pilots and trials will continue to be the focus until 2030.
- We expect an ongoing reliance on some fossil fuels, especially gas, in the short to medium term while advanced renewable energy solutions (eg green hydrogen) are being developed, and that developing nations will gradually switch their electricity generation from coal to renewable energy. Advanced renewable energy solutions will start gaining traction from 2030 after which point gas use will peak and start to decline steadily until 2050 when use will plateau.
- Gas typically has a lower emissions intensity compared to thermal coal when generating electricity. As such, it will be the preferred transition fuel for some regions. After 2030, at which point we expect advanced renewable energy solutions will reach sufficient scale in the global energy market, we expect that the global gas market will start to consolidate in Australia and globally, resulting in a more competitive environment for low cost and low emissions gas.
- Technology solutions to capture and store carbon will be an important part of the low carbon transition (for example, carbon capture and storage, direct air capture). Most climate scenarios reference the use of these technologies, however there is still significant concern related to the technical application, costs, environmental and social impacts from the long-term storage of carbon, and the use by gas companies to promote ongoing generation of fossil fuels.
- Industry will focus on 'low hanging fruit', energy efficiency, and renewable electricity as the first step to decarbonise. Fuel switching and major technological changes to reduce greenhouse gas emissions will likely become more common post-2030. Nature-based offset projects will form a key part of company transition strategies.
- There will be ongoing demand for metals and minerals that support the low carbon transition such as iron ore, copper, nickel and lithium. The demand outlook for each commodity is dependent on the region and supply chain.

2 Assessed using revenue information from company annual reports (published at end of financial year).

3 Exclusions related to fossil fuels for our sustainable funds:

- Fossil fuels such as thermal coal, natural gas and oil which we consider environmentally destructive and for which sustainable and affordable alternatives largely exist, unless the company has a clear and credible commitment to reduce its emissions (including Scope 3) in a manner which is compatible with the Paris Accord (i.e. net zero by 2050).
- Companies involved in high-impact fossil fuels such as coal seam gas, oil sands and those drilling in Arctic regions, regardless of any emissions commitments they might make
- Electricity-producing companies which have more than 10% of their energy coming from fossil fuels.

- Government support and funding is needed to drive the uptake of new technologies for consumers, particularly where there is additional cost, or behavioural change is needed (eg electric vehicles).
- Global investors will continue to lead the action on climate change and encourage global markets to decarbonise.
- There is a possibility that global carbon pricing will be put into place by western governments, however, the timing and nature of these pricing mechanisms is still very unclear.

Scope 3 emissions

Scope 3 emissions are an important metric for companies to disclose and for us as investors to consider. We believe companies that have influence over their supply chain and are contributors to global emissions should be accountable for their total value-chain emissions impacts and therefore integrate targets and commitments for scope 3 emissions into their climate strategies. As such, we engage with companies on their scope 3 emissions, especially where this footprint is material and can be influenced (for example, oil and gas companies).

Risk Management

Risk identification

We identify climate-related risks on a stock-by-stock basis using our ESG materiality framework. This materiality framework is used to analyse and identify the most material ESG risks and opportunities for each company across our portfolio's.

In this context, we actively seek to identify and consider risks related to the transition to a low carbon economy, and the physical impacts of climate change. We also consider threats and opportunities when completing this analysis.

When a potential risk is identified, we complete further additional analysis, research or company engagement as required to better understand the extent of the risk, timeframes, and how the company is managing, or planning to manage, the issue.

The following table presents the high-level climate related threats (T) and opportunities (O) that are relevant across our portfolio's and guide our assessment of stock level climate related risks.

Type		Risk Description
Short term (3-5 years)	T	Changes to global climate policies (for example, a carbon border tax) impacts the regulatory environment and operating conditions for investee companies, potentially affecting the cost of capital, reducing revenue and/or lifting costs, and prompting earnings downgrades, which could lead to share price declines.
	T	Investee companies fail to appropriately plan for and estimate how the potential impacts of climate change (physical or transition) may limit their future earning potential, leading to a loss of shareholder confidence and reduced financial performance.
	T	External pressure to set a net zero commitment, encourages investee companies to make false or misleading statements leading to regulatory or legal action.
	O	Strategically considering climate change drivers as a business opportunity rather than a threat creates opportunities for new markets and/or revenue streams for investee companies. This increases shareholder confidence and reduces the likelihood that the low carbon transition will have an overall net negative impact on the business.
Longer term (5+ years)	T O	Changes to global climate policies and global weather patterns, significantly impacts macro-economic factors like import/export markets, government investments, tourism and migration, and consumer behaviour, which significantly change global market conditions.
	T	Changes to global climate policies affects global trade and impacts Australia's position as a major exporter of minerals and energy.
	O	An accelerated transition to a low carbon economy creates new market opportunities, which continues to benefit businesses that are actively seeking to participate in the transition.

Table note: **T** = Threat, **O** = Opportunity

Risk Management

Across our portfolios we manage a number of specific climate-related threats and opportunities through investment decision making, valuation and modelling, and company engagement. These risks vary by sector and depend significantly on each company's operating model, operational or asset locations, energy use, supply chains, and the specific low carbon pathway in place.

Our understanding of relevant climate risks has been developed based on our knowledge of investee companies and their strategies, participation in industry groups like the Investor Group on Climate Change (IGCC), and consideration of relevant climate scenarios (for example, the IEA Sustainable Development Scenario).

In response to climate-related threats and opportunities, and to support the transition to a low carbon economy, we implement the six core actions (see below graphic).

Stewardship

We engage with companies on an ongoing basis in relation to climate change. There are a number of reasons for these engagements, including to gather further information about climate risks and management, to influence and support improved outcomes, to encourage enhanced disclosure, and to mitigate investment risks.

Specific engagement objectives are developed for each company where relevant. The following are high level examples and give a sense of the usual engagement objectives related to climate change:

- Improve disclosure on emissions and any commitments or targets [greenwashing risk]
- Set climate goals that are realistic, achievable, and based on a range of possible scenarios [investment risk]
- Align capital allocation frameworks with any commitments and disclose the capital expenditure required to achieve short to mid-term targets [investment risk]
- Clearly communicate benefits of products and services towards net zero [social licence opportunity]
- Invest in low carbon solutions and opportunities [investment opportunity]

See the Alphinity Stewardship Policy for more information on engagement, escalation and proxy voting.

Actions to manage climate change risk

Risk analysis	Benchmarking	Carbon footprints	Stewardship	Investment case considerations
• We consider climate related risks as part of our fundamental approach to ESG management • This analysis includes transition and physical risks	• We use the CA100+ indicators to assess company specific performance • We complete portfolio wide assessments on climate risk and opportunity to compare and benchmark	• We measure the carbon intensity and absolute carbon footprints of our portfolios to identify large contributors to our portfolios • We report regularly to our clients on portfolio emissions	• We participate in collaborative engagements (eg CA100+) • We encourage companies to reduce their emissions and improve their strategic direction, targets and disclosure • We track progress against engagement objectives and report outcomes	• We invest in companies supporting the low carbon transition • We consider climate change factors in our investment case considerations when relevant

Metrics and Targets

We use a range of carbon-related metrics across our portfolios to help assess overall carbon exposure, sector or company level risks, and progress towards net zero. These metrics are useful indicators of a portfolio's potential exposure to transition risks such as policy intervention or changing consumer behaviour.

Unless specifically requested by an investor we do not manage our portfolios with an upper carbon limit in place. The purpose of measuring and tracking carbon emissions for each fund, and then at an aggregate level across all portfolios, is to identify and manage companies with high emissions intensity and therefore high exposure to emissions-related risks like carbon pricing.

Metrics that are tracked and reporting both internally and externally are:

- Weighted Average Carbon Intensity: Portfolio's exposure to carbon intensive companies, expressed in tonnes of CO_2 equivalent emissions per $US million revenue ($TCO_2e$/$USm)
- Total Carbon Emissions: The absolute greenhouse gas emissions associated with a portfolio, expressed in tonnes of CO_2e (tonnes)
- Carbon Footprint: Total carbon emissions for a portfolio normalised by portfolio market value, expressed in tonnes of CO_2e per $AUD million invested ($CO_2e$/$AUDm).
- Number of climate related company engagements and relevant outcomes
- Percent of portfolio that has climate management measures in place:
  - Net zero commitments
  - Interim targets
  - TCFD disclosure

Further information

See our annual ESG and Sustainability Report for disclosure against the above listed metrics. This report also includes case studies and highlights for engagement and climate risk management across the year

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