# ESG and Sustainability Quarterly Report – December 2021

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Happy new year to all our readers. In this edition of our ESG and Sustainability quarterly, we discuss some of the potential implications from the 2021 United Nations Climate Change Conference (COP26)(Environmental), comment on modern slavery risk in the supply chain (Social), and summarise our activity and observations of the 2021 AGM season (Governance). As always, your feedback is welcomed and encouraged.

**Environmental: Key takeaways from COP26 Climate Change Conference**

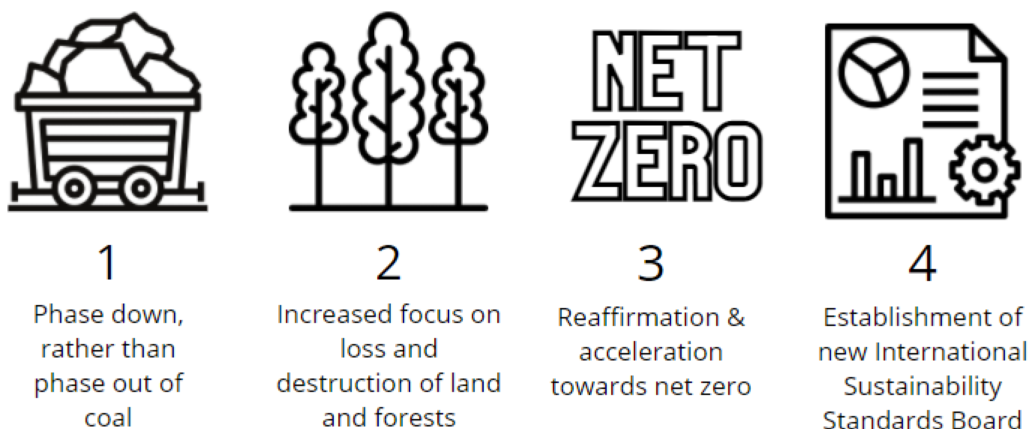
The most notable news during the December quarter was the much awaited COP26 Climate Change Conference in Glasgow. The conference was a notable one in that it was the first meeting since the Paris Agreement in 2016 which set out a requirement to improve pledges to reduce carbon every five years via the "ratchet mechanism".

The Glasgow Climate Pact, which is the outcome of COP26, has been acknowledged by the UN Secretary-General as a compromise, with commentators suggesting that the commitments coming out of the conference lagged expectations.

> *"The approved texts are a compromise… they reflect the interests, the conditions, the contradictions and the state of political will in the world today. They take important steps, but unfortunately the collective political will was not enough to overcome some deep contradictions."*
>
> UN Secretary-General António Guterres on COP 26

Our four key takeaways from the conference are:

**Figure 1: Antares' key takeaways from COP26 Climate Change Conference**




Source: Antares Equities, UN Climate Change Conference UK 2021

1. **Softening language on fossil fuels:** The future of fossil fuels was perhaps the most contentious issue at the conference. Within the Glasgow Climate Pact, the clause to phase out coal and end fossil fuel subsidies was substituted by a compromise to accelerate a "phase down" of unabated coal power and phase-out of inefficient fossil fuel subsidies. We have watched with interest as the capital strike on coal over recent years has led to second order impacts such as record coal prices and higher energy costs. Parties to the conference ultimately gave regard to the impact the phase out of coal has on the poorest and most vulnerable nations, and the need for a just transition.

   In our view this highlights the challenges in navigating the transition in a manner that considers both the social and environmental impacts. We also see the current debate on uranium and gas being designated as "green" in the EU as a function of these considerations. As we discussed in our March and June 2021 quarterlies, navigating this energy transition presents both risks and opportunities for investors On the latter, some examples of stocks that may benefit through a transition include companies that provide services to clients going through transition plans (Worley, Downer), companies producing materials that are critical in transition (Lynas, Oz Minerals, Paladin) or provide valuable technology that enables transition (Ecograf).

2. **Increased focus on loss and damage:** On the flip side, the Glasgow Climate Pact has an increased focus on loss and damage of biodiversity resulting from climate change in its text. At COP26, 141 nations (covering >90% of the world's forests) signed a declaration to halt and reverse deforestation and land degradation by 2030.

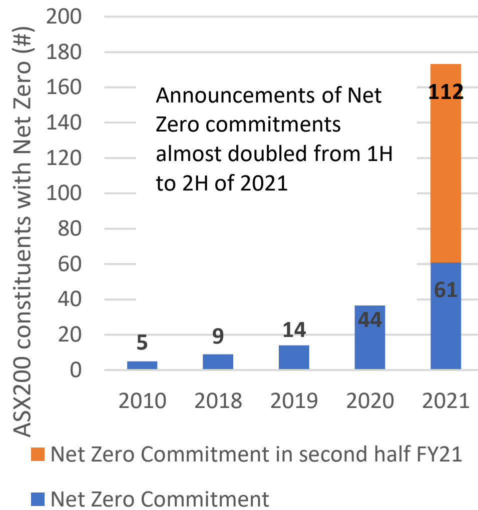
   We see this as particularly relevant in various parts of Australia where biodiversity risk is present yet regulation is either lacking or poorly enforced. As such we expect this area to receive increasing attention in coming years and will become an increasing focus of engagement with affected companies in our universe (particularly in the mining and agriculture sectors).

3. **Net zero targets:** The parties to the conference reaffirmed that the impacts of climate change will be much lower at a 1.5°C than a 2.0°C increase vs preindustrial levels, and resolved to pursue efforts to keep warming to 1.5°C. Accompanying this was a statement by the Glasgow Financial Alliance for Net Zero that US$130 trillion of private capital has been committed to transforming the global economy towards these climate goals.

   In addition, several major international banks committed to ending all international public financing of new unabated coal power by the end of 2021. Alongside these we believe the Australian banks will continue to step away from financing fossil fuels projects and redirect financing towards energy transition initiatives. We expect this weight of capital will see continued adoption and acceleration of net zero targets globally as companies seek to ensure continuity of access to capital with the UK now requiring listed companies to have net zero transition plans by 2023.

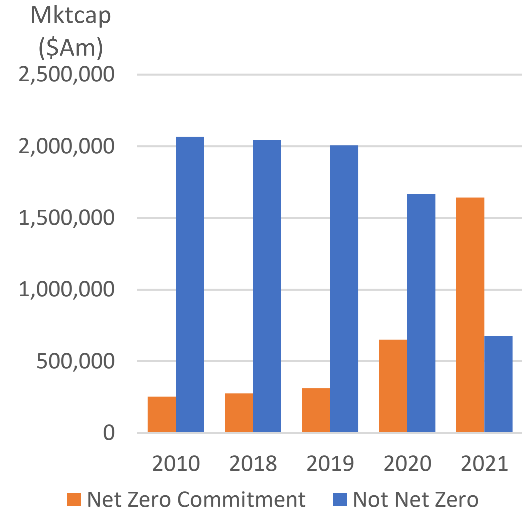
   We note that in 2H FY21 there was an acceleration in net zero commitments in the ASX300 coinciding with COP26, and for the first time the majority (70%) of market capitalization of the ASX300 has made a commitment to net zero by 2050 at the latest. That said, there remains a large number of companies (183/300) who have not yet announced net zero targets.

**Figure 2: Cumulative number of net zero announcements in the ASX300**




Source: Company announcements, Jefferies, Jan 2022

**Figure 3: Split of ASX300 market cap by whether net zero commitment made**




Source: Jefferies, Jan 2022

Our focus of engagement with these companies is understanding why no net zero targets have been put in place yet and whether there are interim carbon reduction measures in place as policy continues to encourage decarbonization. For those companies who have announced targets, our focus remains on the efficiency of capital directed towards these initiatives and the viability of net zero plans announced.

4. **Increasing and improving disclosure:** COP26 also introduced a new International Sustainability Standards Board which will develop a comprehensive global baseline of sustainability-related disclosure standards. This is an encouraging development and as we wrote in our June 2021 report, standardisation of ESG reporting enables better comparisons to be made between companies at a time where climate risks are being increasingly scrutinised by the investment community. In our view, these developments are likely to put increasing pressure on companies to report more consistently and robustly on their sustainability credentials going forward. However, notwithstanding the improving availability and quality of data, we continue to believe that depth of knowledge and insight is required to understand material ESG issues relating to each company. This is where we believe Antares has a competitive advantage given our bottom up approach to stock analysis and the significant experience and relationships our team has with companies in our investment universe.

## Social: Delving into the incidence of modern slavery in Ansell's supply chain

Ansell supplier Brightway receives Withhold Release Order from the US

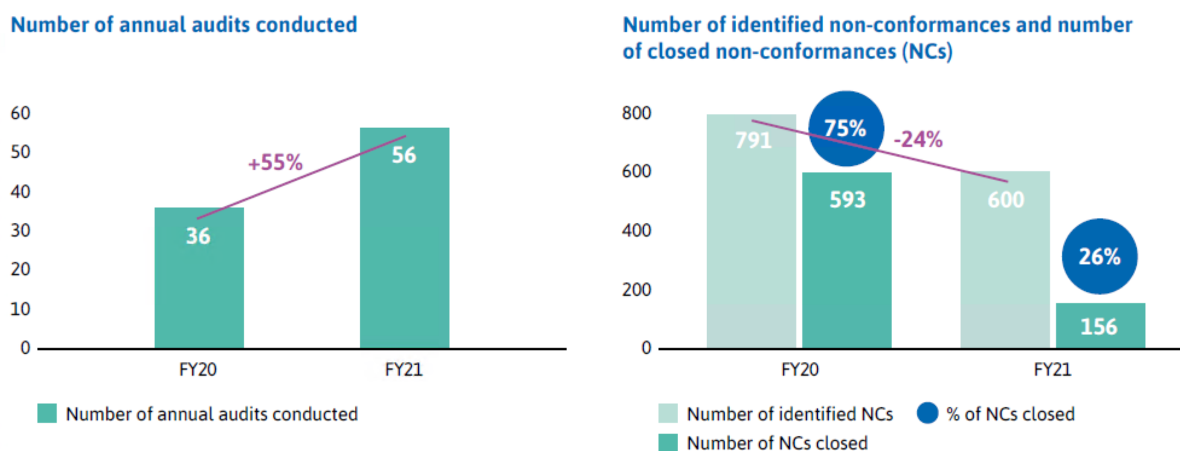
In December 2021, Brightway, one of Ansell's suppliers had its imports banned by United States Customers and Border Protection through a Withhold Release Order (WRO). The action taken was the latest in a string of bans by the US against Malaysian manufacturers found to have poor labour practices. It followed reports that workers at Brightway had reported

having to pay excessive recruitment fees, had passports confiscated and their freedom of movement was restricted - all of which are recognised indicators of modern slavery.

Our previous investigation into Ansell's supplier practices

In March 2021, we wrote about our increased confidence in Ansell's supplier standards following a discussion with Ansell on its unwillingness to compromise in the face of strong demand during the pandemic. We also received third party verification on its stringent standards. This was particularly important at the time as a lack of travel due to the onset of the pandemic made audits difficult. Ansell has conceded this in the 2021 Modern Slavery Statement, noting that despite conducting more audits, it identified fewer non-conformances and closed fewer of these cases in FY21 vs FY20 due to mobility restrictions.

**Figure 4: Ansell identified and closed fewer non-conformances in FY21 due to mobility restrictions**




Source: Ansell 2021 Modern Slavery Statement

A matter of risk, not materiality

Brightway is one of sixteen Malaysian finished goods suppliers to Ansell, and whilst the company has publicly stated that Brightway is not a major supplier, a key principle in modern slavery legislation in Australia (arguably the most advanced in the world) is that risk to people, rather than materiality is the starting point. In this regard, the incidence of modern slavery in Ansell's supplier base is not something to be written off as immaterial.

As investors, our key focus from a regulatory and stewardship perspective is how companies are mitigating modern slavery risk in their supply chains, as well as remediating non-conformances when found. In our view, best efforts in mitigation and remediation are the most appropriate expectations investors can have of companies. Modern slavery in most countries is illegal, hidden, and often suppressed and therefore difficult to detect. As with most risks, complete elimination based on the efforts of a single actor can prove near impossible. We therefore look for frameworks and assurance on how these risks are being mitigated to the best extent possible. In this regard, Ansell introduced a new Supplier Management Framework in 2021 (prior to the US ban on Brightway) for the purposes of evolving its framework to mitigate modern slavery risk and drive meaningful change in its supply chain. The pillars of this new framework are set out below:

**Figure 5: Ansell's Modern Slavery Framework**

Source: Ansell 2021 Modern Slavery Statement

As can be seen above, the framework begins with a risk-based approach (rather than a materiality approach) and seeks to strengthen partnerships, measures and mechanisms to mitigate and remediate systemic modern slavery risk.

Why doesn't Ansell delist such suppliers immediately?

A question that could be asked of Ansell is: why not immediately delist all suppliers found in non-conformance immediately? We feel that such an approach is too broad brushed and akin to a portfolio manager selling any company upon any initial discovery of ESG issues, rather than working with management to encourage change and remediation. It is clearly unacceptable that modern slavery exists in the world, however we believe that Ansell has a role to play in helping to drive systemic change to reduce the incidence of modern slavery in partnership with suppliers. By persisting with these suppliers, Ansell has the opportunity to help suppliers remove such practices. The alternative, being to delist suppliers such as Brightway, may result in inadvertently pushing such practices further underground and away from companies like Ansell who are attempting to lift industry standards.

Along these lines, Ansell has stated that its preferred approach is to "work with suppliers to achieve meaningful improvement, thereby ensuring continued employment and improved conditions for workers, rather than reactively cancelling supplier contracts in response to specific events or allegations." Accordingly, the company will only seek to develop alternative suppliers in the case that suppliers do not show progress and remain in continual non-conformance with the company's modern slavery standards.

Our view is that such an approach will ultimately serve as a competitive advantage in the current landscape, but will also serve to assist Ansell's peers who may source from the same suppliers – and in some cases also drive isomorphic behavior and hence system change.

**Ansell's experience illustrates several important principles of Antares' approach to ESG. Firstly, ESG and sustainability risks (and for that matter all investment risk) is something that we as investors manage, not avoid. There is simply no such thing as risk-free investment. Secondly, our preferred approach from a responsible investing and stewardship perspective is to encourage change and progress where possible rather than immediately pursuing divestment. Thirdly, our approach to ESG and sustainability is holistic, in that investment decisions do not rest solely on ESG factors alone but are integrated into our fundamental stock analysis. Antares remain investors**

**in Ansell because the fundamentals behind the investment are attractive and we believe that despite this incidence of modern slavery in its supply chain, the company is making progress on mitigation and remediation and is trying to drive system change.**

**Governance: the 2021 AGM season**

**Antares Equities - voting activity during the December 2021 Quarter**

| | |
|---|---|
| **63** | meetings where voting rights were exercised. |
| **411** | resolutions voted.<br>Of these, 369 resolutions were voted "for", 36 were voted "against".<br>We abstained from voting on 6 resolutions |

The December quarter was a busy one for voting activity as it was AGM season. Our "against" votes during AGM season broadly fell into three categories:

1. **Shareholder initiated resolutions** for a number of companies in the financials and resources sectors, primarily relating to constitutional amendments and/or climate related proposals. We deemed most of these as potentially too disruptive and onerous on company management, or not in the best interests of companies that were already providing disclosure and showing significant progress on such initiatives.

2. **Votes against remuneration reports** that had outcomes or frameworks not aligned with shareholder interests. We also voted against several awards of shares, options and rights to directors and management where we deemed them to be overly generous or unreasonable and not in the best interest of shareholders. In several of these instances, we also voted in protest against the re-election of directors chairing remuneration committees of companies with inappropriate remuneration frameworks/outcomes and awards in FY21.

3. **Votes against board spills** – we generally believe that board spills are costly and disruptive and should only be used as a last result where engagement and progress is not forthcoming on critical matters.

We also abstained from voting on one company's resolutions following media allegations of cultural and governance failures as we believed that making judgments either way prior to investigation was not appropriate.

**AGM season summary: remuneration strikes and support for shareholder proposals grow**

According to Macquarie, the strike rate against remuneration reports in the ASX300 rose from 7.9% in 2020 to 8.8% in 2021. This was in line with our expectations given the divergent outcomes during the pandemic and an increasing weighting towards non-financial metrics in general (see our September 2021 quarterly for further discussion).

As we previously flagged, shareholder-initiated resolutions (predominantly climate related) were a growing feature of the AGM season. Whilst the majority were voted down, the average

support for such resolutions increased to 34% in 2021 from 23% in 2020. It is worth noting however that shareholder resolutions also require amendments to the company's constitution (which require a 75% voting threshold). We expect the number of these shareholder resolutions to reduce in coming years given a number of companies that have faced these resolutions are putting forward non-binding votes. BHP is the first (and only) company to put such a resolution forward and received 85% support at its recent AGM. The result of this is likely to encourage other companies facing similar pressure from shareholders to do the same, in our view.

Thank you for your interest in our ESG and Sustainability quarterly report. We trust it has provided some insight into our recent activity in the space. As always, your feedback is encouraged and welcomed.

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