

## SGH Group approach to ESG integration

### Responsible Investing within the culture of SG Hiscock & Company

SG Hiscock is founded on the values of Integrity, Respect and Curiosity and a commitment to partnering with our clients to pursue their long-term financial goals through providing best-in-class investment solutions. A practical application of these values is the consideration of Responsible Investing and Environmental Social and Governance (ESG) issues in the way we conduct our business and undertake our decision making.

SGH is a signatory to the Principles for Responsible Investment (PRI). The Principles provide the framework for our approach to responsible investment and comprise the following objectives:

- We will incorporate ESG issues into investment analysis and decision-making processes.
- We will be active owners and incorporate ESG issues into our ownership policies and practices.
- We will seek appropriate disclosure on ESG issues by the entities in which we invest
- We will promote acceptance and implementation of the Principles within the investment industry.
- We will work together to enhance our effectiveness in implementing the Principles.
- We will report on our activities and progress towards implementing the Principles.

### SGH Investment Philosophy

SGH's investment philosophy is based on an active management approach which combines in depth valuation analysis with a rigorous approach to company research, market fundamentals and insight. Our primary goal is to generate the best long-term outcomes possible for our clients. By embedding ESG analysis into our active equity investment process we aim to enhance potential value for our investors, reduce risk and invest in companies that can contribute positively to the world.

SGH, as an Investment Manager, recognises the role it can play in supporting and influencing the consideration and impact of ESG issues, whether it be through active engagement with companies or investment decisions. The belief is that over time, good ESG practices deliver both direct and indirect positive impacts on shareholder value and provide a broader public community benefit.

### How SGH integrates ESG factors into its investment decision making

At SGH, we apply the PRI definition of ESG integration which is summarised as “the process of including ESG factors in investment analysis and decisions to better manage risks and improve returns”. By embedding ESG analysis into our active equity investment process we aim to enhance potential value for our investors, reducing risk and investing in companies that can

contribute positively to the world. As well as better-informed investment decisions we also want our clients to benefit from active ownership of these assets.

The integration of ESG analysis into our investment process is a fundamental part of the investment and risk assessment process. The manner in which our approach to ESG integration is applied by our investment teams is largely consistent however each team is ultimately responsible for identifying, assessing and integrating materially relevant risks and opportunities into their investment decision-making process. Where differences in the approach exist, this is indicated below.

## **SGH ESG Integration Process**

1. ESG research and assessment
2. Integrate ESG assessment into investment decision
3. Stewardship
4. Reporting and review

### **1. ESG research and assessment**

Our investment process is driven by fundamental research, combining analysis of relative value and total return potential. As part of this analysis, we identify risks and opportunities that may impact a company's performance, including ESG factors.

Our fundamental research and subsequent assessment are informed by company disclosure, ESG data providers, third-party and broker research and our direct interaction with company management, boards of directors and in house sustainability teams. We actively seek to identify material issues which drive our company engagement, where relevant.

Whilst we don't explicitly exclude companies or sectors on ethical grounds, we are seeking to identify companies with good governance that are aware, engaged and actively managing material ESG issues.

#### **A. SGH High Conviction Australian Equities**

We assess ESG risks and opportunities for each company to determine how well the company is addressing, embracing and engaged in managing environmental, social and governance issues. This assessment underpins our internal ESG assessment which draws from both qualitative and quantitative factors.

- Qualitative assessment includes those ESG risks and opportunities that could threaten and enhance company fundamentals and ultimately competitive positioning, corporate performance, cash flows and asset values either positively or negatively.
- Quantitative assessment involves reflecting our assessment of ESG issues in our underlying financial assumptions and forecasts (profit and loss, cashflow and balance sheet) and valuation.

Many ESG issues cannot be expressed quantitatively with precision. In these cases, their potential positive or negative impacts are expressed in our ESG assessment process where the

primary stock analysts rate companies using a proprietary Quality Assessment framework which generates an Earnings quality, Business quality, Management quality and ESG quality assessment score for each company. The ESG quality score specifically looks to determine how well the company is engaged in managing environmental, social and governance issues. Scores are typically reviewed on an annual basis but may be adjusted more frequently if there are material changes in circumstances.

## **B. SGH Property Securities – Australian REITS**

Dedicated investing in one sector allows the property securities investment team to deepen its knowledge of pertinent topics and enables more readily available comparisons between property securities. Our fundamental research culminates in a proprietary ESG score for every property security under coverage. We have increased our emphasis towards identifying improvers in ESG matters. We believe improvers in ESG are likely to be rewarded by the market over time, over those that maintain or regress on ESG practices, as well as influencing positive change within our investment universe.

Our ESG score is a weighted average of five pillars under consideration. Each pillar has a score of 1 through 5 (with 5 the highest score). Current Environmental, Social & Governance policies, achievements and practices form three pillars. The last two pillars are focused on scoring the rate of change within a company's ESG and sustainability practices.

In determining a score, our current weighting of the five pillars is more heavily skewed towards governance factors (existing and rate of change) versus environmental and social pillars, as we believe governance has the strongest influence in achieving superior risk adjusted returns.

## **C. SGH Emerging Companies Fund, SGH Opportunities Fund and SGH Medical Technology Fund**

As institutional investors who work with Emerging Companies in the Australian market, we acknowledge there continues to be a lack of ESG disclosures and general practices at the small end of the market. To counter this, we undertake an active approach to increase the information that is available to us by issuing an annual ESG questionnaire to our portfolio companies. This questionnaire seeks to understand how ESG has been integrated into each business at a corporate level, then drills down into specific ESG measures that are in place.

Our survey aims to:

1. Understand the nature and extent of ESG implementation within investee companies
2. Encourage investee companies to properly consider ESG factors in their daily business operations to ensure their ongoing success
3. Identify ESG improvers within our portfolio as an indicator of long-term sustainability

## **2. Integrate ESG assessment into investment decision**

We assess ESG risks and opportunities for each company to determine how well the company is addressing, embracing and engaged in managing environmental, social and governance issues. This assessment underpins our internal ESG assessment.

### A. SGH High Conviction Australian Equities

The extent to which our ESG assessment impacts investment decision making is dependent upon the nature of the ESG risk or opportunity identified for each company. We separately assess each company, allowing for objective and transparent consideration of the ESG risks and opportunities material to that company.

Ultimately our assessment helps to provide greater alignment and confidence in management actions and execution and is reflected in our quality assessment, earnings, valuation, overall company assessment and positioning and sizing. Where there is demonstrated lack of action, confidence or concern that is material it can result in us reducing or exiting a position or avoiding a company altogether.

### B. SGH Property Securities – Australian REITS

Embedding the ESG score into the valuation framework is achieved through adjustments to the discount rate used in every security's internal valuation. A strong ESG score will lower the discount rate, whilst a weak score will increase the discount rate used in the valuation. At present, there is approximately a 5-8% spread between weak and strong scores and we believe this adequately reflects the impact of ESG factors on a security.

Depending on the impact of this process on the score assigned to a security we may undertake further research, engage with the company based on pre-determined outcomes, exercise voting rights, adjust portfolio weights or avoid a company altogether.

### C. SGH Emerging Companies Fund, SGH Opportunities Fund and SGH Medical Technology Fund

The investment team utilises the outputs from qualitative and quantitative assessment of available information (including from the ESG questionnaire sent to portfolio companies) as the basis of its investment decision making. From a quantitative perspective, the team make beta adjustments based not only on current company practices, but also from a process perspective. From a qualitative perspective, the team may make exclusions, sell existing positions and reduce portfolio weightings based on these assessments.

It is also key to consider that progress in ESG practices can lead to improved financial outcomes, and based on this, may influence the teams decision to include a company in a portfolio or increase weightings based on qualitative and quantitative assessments, where applicable.

## 3. Stewardship

Within the context of our approach to integrating ESG analysis into our investment processes, our stewardship activity involves company engagement, collaborative engagements (where relevant) and proxy voting activity.

**Company engagement** is an integral part of our fundamental research process, providing a framework for dialogue between SGH and our portfolio companies. Although engagement objectives specific to a company may change over time, the primary purpose of our engagement

is to inform our research, encourage good practice in investee companies and ultimately improve long term company share price returns.

When formulating our engagement approach, we consider the following factors:

- Frequency of engagement – our engagement schedule allows us to regularly reiterate our views with investee companies. We believe that actively raising ESG issues during our visits will allow us to gain a greater ‘share of voice’ and the attention of key decision makers.
- Engagement stakeholders – our engagement schedule includes meetings with senior management, executives and Boards and increasingly with sustainability and ESG teams.
- Progress over time – our approach to engagement recognises that corporate teams and their boards are often on different ESG journeys and operate at a varying pace. We approach our engagement with a realistic timeframe target for changes to be achieved, and place emphasis on recognition for progress towards longer term goals.

Advocators with a long-term view – we often find that businesses with less developed corporate governance and poorer management of ESG risks tend to have a lower level of understanding of material ESG issues. We are proud of the stewardship role we perform and are happy to share our views and knowledge, and consistently have an eye out for the longer-term sustainability and longevity of our portfolio companies.

We consider **proxy voting** rights to be an important form of influence, which, if exercised diligently, can enhance client returns over the long term. We intend, wherever possible and practical, to vote on every resolution put to shareholders. Our primary objective when voting will be maximising the value of our clients’ investments.

Ultimately, the decision to exercise proxy voting rights rests with the Portfolio Manager. In exercising its voting discretion, SGH may consider the following:

- The nature of the resolution at hand
- Ensuring companies act in the best interests of shareholders
- Improving corporate governance of investee companies
- The ability of SGH to influence the outcome of a resolution
- Whether SGH’s participation will advance investment objectives

All proxy voting decisions are made via consultation within the investment teams. Consultation may also be sought with the ESG Committee. In addition, the SGH Group may utilise the services of a proxy voting research company to provide information to aid in the decision-making process.

Further information on our approach to proxy voting and company engagement is available in [our Stewardship policy](#).

## 4. Reporting and review

As part of our commitment to implement the Principles for Responsible Investment, we report annually on the progress made during the year in meeting the objectives commencing 2024.

### **Application of this policy**

This policy applies to all SGH Group products (including Individual Portfolios).

### **Policy review**

This policy is reviewed every two years or more frequently as required by the SGH ESG Committee and approved by the SGH Group Board.

Date of Board review: 6 June 2024