Airlie Funds Management Stewardship Report 2024

AIRLIE AUSTRALIAN SHARE FUND (ASX:AASF)

We are pleased to provide an update on Airlie Funds Management's Proxy Voting and Engagement for the year 30 June 2024. This Review sets out Airlie's ESG philosophy and implementation of our stewardship activities along with the primary details and statistics on our engagement and proxy voting activities.

Airlie is committed to responsible investment and believes that successful investing is about identifying and owning companies that can sustainably generate excess returns on capital for years to come. We aim to act as responsible stewards of our clients' investments by integrating Environmental, Social and Governance (ESG) issues into our investment process, exercising our proxy voting rights and having open dialogue with portfolio companies on a broad range of issues. Airlie's investment process considers the cash flow and valuation materiality of ESG risks and opportunities over our longer-term investment horizon.

Our investment team diligently engages with companies on these risks and opportunities with the aim of strengthening our conviction in portfolio risk management and improving investment outcomes.

Matt Williams

Head of Australian Equities

Emma Fisher

Deputy Head of Australian Equities

ESG PHILOSOPHY

Our objective at Airlie is to provide long-term capital growth through investment in Australian equities. Airlie seeks to achieve this objective by focusing on the quality and financial strength of existing and potential investments.

ESG factors play an important role in our assessment of a company's business and management quality, as well as a consideration in valuing a company. As long-term investors, an assessment of ESG risks and opportunities are an inherent part of our investment process as gaining a robust understanding of these issues is a key part of assessing the outlook for future cash flow generation and risks of an investment.

We aim to act as responsible stewards of our clients' investments by exercising our proxy voting rights and having open dialogue with portfolio companies on a broad range of issues, including ESG-related issues.

For further information on our policies:

- ESG policy
- Proxy voting policy
- Climate stewardship policy

INTEGRATING ESG CONSIDERATIONS IN THE AIRLIE INVESTMENT PROCESS

Airlie's investment process weighs up four factors in considering a potential investment:

1. **Financial Strength**
   A judgement call on whether the company possesses the appropriate financial structure for the industry and operating environment, incorporating analysis of solvency, liquidity, liabilities, future cash needs of the business and the ability to withstand an economic downturn.

2. **Business Quality**
   Assessment of industry position, cash generation, returns on capital and reinvestment opportunities.

3. **Management Quality**
   Assessment of alignment, governance, capital allocation and track-record.

4. **Valuation**
   Assessment of the fair value of a business based on future cash flows and returns.

Analysis of ESG factors forms part of the suite of issues that affect the Business and Management Qualities of companies. It is also considered when assessing Valuation. Gaining a robust understanding of these issues is a key element in the assessment of the outlook for, and risks to, future cash flow generation.

When assessing ESG factors, Analysts will consider the issues faced by the industry in which the company operates and the company's own practices. When undertaking investment research, Analysts consider a list of Environmental, Social and Governance issues, included as part of an ESG workbook completed for each company.

This list is not static and is updated with the evolving ESG landscape. Primary responsibility rests with the relevant Analyst to determine which issues are material to that company and how these issues will be incorporated into the valuation and investment thesis. These are then considered and assessed by the Portfolio Manager.

Stewardship is integral to our investment process

The focus of this Review is on Airlie's stewardship activities related to our proxy voting and engagement activities. These activities can enhance long-term value for our investors by seeking to reduce risks and enhance opportunities both prior to investing and during our period of ownership.

Engagement with companies

Airlie's long-term investment horizon enables us to engage with companies over an extended period on issues that are important to protecting and creating shareholder value. Airlie aims to engage with portfolio companies on a broad range of ESG themes that investment analysts assess to be material to those companies.

Engagement has two primary objectives, designed to have a positive impact on shareholder returns over time:

1. **Risk assessment and management**

   Continue to expand our knowledge and understanding of the risks and opportunities through discussions. As long-term investors, we build up knowledge and insight, which we discuss, and challenge management during engagements. These discussions further deepen our understanding within and across industries.

2. **Influence**

   Encouraging and supporting change to a company's approach or the setting of targets as required. As long-term investors, we build constructive relationships that better enable us to drive positive change at the company.

The level of engagement is also considered in the context of the relative size of Airlie's investment. We will seek a deeper level of engagement with firms when we own a greater portion of a firm's equity, and therefore have a more meaningful opportunity and responsibility to engage.

ENGAGEMENT – ESG FOCUS AREAS

ENVIRONMENTAL

- Climate (Transition Risk & Opportunity) 45%
- Climate (Capital Allocation) 28%
- Climate (net zero/emissions reduction) 18%
- Other 9%

Environmental issues discussed in our engagements in FY24

Climate change and the transition to a low-carbon economy is a key ESG risk for many portfolio companies. There has been a continued focus on understanding company strategies to reduce emissions and meet their climate targets.

This has included discussions with companies on managing their transition risks and opportunities as well as discussing capital allocated to projects to progress and deliver their climate strategies.

SOCIAL

- Responsible Gaming / Gambling 33%
- Worker Health, Saftey & Wellness 33%
- Indigenous Consultation / Cultural Heritage 17%
- Other 9%

Social issues discussed in our engagements in FY24

During the year we engaged with companies to understand how they address problem gambling risk. This engagement helps us assess the sustainability of their practices, identify potential business risks, and evaluate the impact of adverse regulations.

We engaged on worker safety to understand policies and practices in place to ensure worker safety is linked to remuneration.

GOVERNANCE

- Board and Management 25%
- Capital Allocation 25%
- Remuneration 20%
- Culture 20%
- Other 10%

Governance issues discussed in our engagements in FY24

During proxy voting, we engaged with companies where we planned to vote against management recommendations. This is to understand the company's rationale and to share our perspective. Particular attention was given to egregious remuneration practices and director re-elections where we feel they have a poor track record of capital allocation at other companies.

We also engaged with companies during the year on Board composition, management succession, and organisation culture.

Engagement examples

CLIMATE CHANGE

Climate change can represent both a risk and an opportunity for companies. We consider exposure of the company to risks and opportunities as a result of the transition of the global economy towards net zero emissions.

We look for:

- Net zero targets
- External validation of targets where available
- Credible plans to meet targets

ENERGY TRANSITION

Case study: Ampol

Ampol is a transport fuel supplier, convenience retailer and an integrated oil refining and marketing company. The company sells petrol and convenience store goods through a national network of Ampol-branded petrol stations. As Australia's leader in transport fuels, Ampol has a material exposure to the energy transition, which is considered to be both a risk and an opportunity.

We have been seeing increasingly positive evidence from Europe on the rollout and take-up of electric vehicle (EV) charging at petrol and convenience stores. As part of our investment process, we have engaged with top convenience store counterparts in Europe, which saw strong demand for on-the-go charging, a healthy charging economic model, improved contribution to shop sales and strong fuel performance. Our discussion with an American counterpart yielded similar results.

As for Ampol, we had discussions with company management several times and believe Ampol can achieve a strong return on its EV investment, given the scale and high-quality real estate. We have a positive view on the company's strategy to build a convenience retail business and its proactive approach to prepare for the shift from traditional fuel consumption to EV.

Link to investment case:

As many countries have committed to transitioning their economies to net zero by 2050 and expectations from stakeholders, including investors, regulators and governments, increase, Airlie wants to ensure that companies in our portfolios remain resilient and take advantage of opportunities.

Engagement examples

LABOUR MANAGEMENT

Employees are often core to the success of a company executing their strategy. Employees who feel safe at work, who are paid fairly and supported by a positive culture can be more productive and likely to stay with the company.

How we view the management of the risks and opportunities:

- Policies and procedures
- Low staff turnover
- Low injury rates and zero fatalities
- Minimal labour-related controversies

WORKER SAFETY

Case study: BHP

Over the prior 18 months, there had been three fatalities reported at BHP sites. We engaged directly with company management to raise our concern regarding the fatalities and to understand the circumstances contributing to the fatalities as well as what actions BHP were taking to minimise further fatalities and improve safety at their sites. Management remuneration is linked to safety outcomes and Key Management Personnel were undertaking site visits globally to reinforce safety standards.

We will continue to monitor and engage with BHP on their safety record.

Link to investment case:

The primary concern is worker health and safety. Additionally, safe operations often lead to more efficient and productive work environments. Worker accidents and fatalities can also lead to disruptions leading to downtime and financial losses.

Engagement examples

CUSTOMER WELFARE

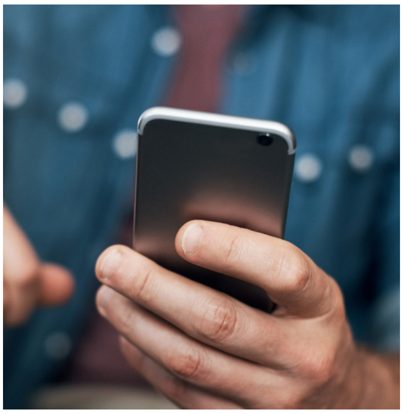
Responsible gaming is both a key risk and an opportunity. We assess companies' efforts to mitigate risks and promote safe gaming practices.

We look for:

- Clear responsible gaming commitments
- Effective customer protection measures
- Leadership to promote best practices
- Comprehensive staff training

RESPONSIBLE GAMING

Case study: Aristocrat Leisure



Aristocrat produces gaming content and platforms and systems, including electronic gaming machines, digital social games, casino management systems and free-to-play mobile games. It also provides cabinets and gaming products. The company operates and sells globally but predominantly in the USA and Australia.

We engage with Aristocrat several times a year to discuss the developments in responsible gaming. Aristocrat has increased its focus on responsible gaming, recently hosting its first investor day where it showcased tools like its App that allows for pre-commitment amounts, session times, push notifications and to lock in winning features. Aristocrat remains focused on coordinating efforts between suppliers, regulators and operators.

Link to investment case:

Poor responsible gaming outcomes can lead to regulatory interventions that impose stricter compliance requirements, reduce market access or increase operational costs, ultimately harming the business case for the product. Although Aristocrat is somewhat insulated from such regulatory changes due to its role as a supplier rather than an operator and its regulatory diversification across global jurisdictions, persistent regulatory pressures could still indirectly affect demand for its offerings and strain its partnerships with operators.

Engagement examples

REMUNERATION

Compensation should motivate, incentivise and aim to retain key management personnel. It should also align with shareholder experience and support the delivery of the strategy.

We consider:

- Shareholder alignment
- Remuneration structure and performance linked incentives

REMUNERATION

Case study: Sigma Healthcare

We engaged with Sigma before the 2024 Annual General Meeting (AGM), as we had concerns that short-term incentive outcomes for FY24 were near the maximum in a year which produced the lowest adjusted Net Profit After Tax (NPAT) performance for Sigma since FY12. We also note this adjusted NPAT included multiple positive one-off items including gain on sale of hospital operations but excluded negative one-off items such as the Chemist Warehouse merger costs. We were also concerned by the use and quantum of one-off cash retention payments to the CEO vesting purely based on service.

After discussing our concerns with management before the AGM, our concerns were not alleviated, which led to Airlie voting against the remuneration report.

Link to investment case:

Improving the metrics and hurdles, in our view, will contribute positively to the creation of long-term shareholder value and encourage better alignment with shareholders.

SPOTLIGHT ON CLIMATE

Assessment of climate-related risks and opportunities in our investment activities

We want to ensure that our portfolio companies remain resilient to the impacts of climate change and the transition to a low-carbon economy. As such, we identify and assess climate-related risks and opportunities in portfolio companies over our investment time horizons as part of our company research through analysis of physical risks of changes in climate along with the transition risk arising from global responses to climate change.

When considering climate-related risks, two elements of our stock analysis and selection process are pertinent to assessing exposure to climate-related risks and opportunities. These include performing climate-related stress testing on companies where we deem scenario analysis integral to assessing long-term value.

Indirect considerations:

As part of our assessment of business quality and financial strength we seek companies that are able to earn significantly more than their cost of capital for an extended period. This favours companies with strong balance sheets that will be able to finance the capex required by the business to transition to a lower carbon economy.

Direct considerations:

The Airlie investment analysts' assessment of portfolio companies considers ESG risks, including climate-related risks, as well as the possibility of government/social intervention; for example, the impact of a carbon price. Where these risks are elevated, further modelling is undertaken to try to fully understand the possible impact on the company (such as including carbon prices in our valuation of a company or assessing the financial impact of remediation works or transitioning fleets to alternative fuel sources).

Because of the process described above, there are few instances where we consider climate-related risks to have a material impact over our investment time horizon.

Climate risk management in our portfolios

We believe that climate-related risks can be financially material to our investment activities. As part of the investment team's ongoing research, physical and transition climate risks are considered from a bottom-up, case-by-case basis. Climate-related factors are then incorporated into a long-term investment thesis where climate risk is material.

As part of an annual climate risk assessment, the investment team assesses all portfolio companies' alignment to net zero. In identifying climate risks, we leverage our internal ESG investment research including direct company engagement and, when appropriate, external data providers.

Our climate risk assessment for portfolio companies considers:

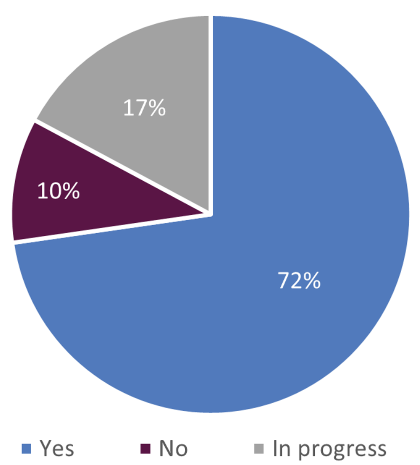
1. **Ambition:** A commitment to net zero by 2050.
2. **Targets:** Near- and medium-term emission reduction targets with a preference for external validation.
3. **Strategy:** Alignment to reporting in accordance with the recommendations of TCFD and have a credible climate strategy to achieve targets.

In assessing the credibility of a company's climate strategy, we also consider the ambition of the targets, disclosure of emissions (scope 1, 2 and material scope 3) and the progress towards near-term and net zero emissions targets, utilising the Net Zero Investment Framework.

Companies are then prioritised for engagement based on materiality of the financed emissions and their classification of alignment to net zero. These companies are classified as 'high priority' and subject to enhanced engagement.

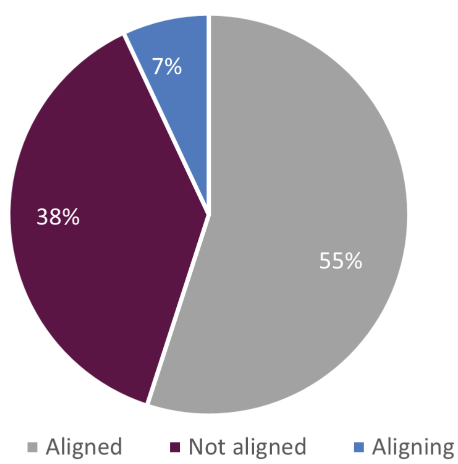
For companies prioritised for engagement, an engagement plan is developed incorporating objectives to improve alignment with net zero based on NZIF. Time-bound engagement objectives will be set considering the industry, geography, business model and alignment to net zero. These engagement objectives will be communicated to the company.

AASF: % of companies with net zero target



As at 30 June 2024

AASF: Alignment to net zero



PROXY VOTING OUTCOMES – FY24

Annual General Meetings (AGMs) enable our investee companies to present their performance and give shareholders the opportunity to vote on ballots, which comprise both company proposals and shareholder proposals.

30 shareholder meetings

180 proposals

6% of proposals voted were against company recommendation.

20% of meetings had at least 1 vote against company recommendation.

It is important to note that as long-term investors we have already carefully assessed the risks associated with stock ownership and therefore we are generally satisfied with a company's management and risks at the time of stock purchase.

Therefore, it shouldn't be surprising that our votes on ballots are often in line with the company's recommendations.

Nonetheless, we often have perspectives that risks or opportunities can be further improved and in these cases we may vote against the Board's recommendations. When we decide to vote against the company's recommendation, we inform the company of our intention, explain our rationale and allow them opportunity to present their perspective before we cast our vote.

Company proposals are generally routine in nature; for example, auditor approval, guides on compensation and voting to reappoint directors. Shareholder proposals tend to be more contentious and often include topics related to ESG.

PROXY VOTING STATISTICS IN DETAIL – FY24

Category	Number of Proposals	In line with Company Recommendation	Against Company Recommendation
Board-Related	136	94%	3%
Compensation	110	80%	7%
Capital Management	11	45%	0%
Audit/Financials	12	100%	0%
Changes to Company Statutes	3	100%	0%
Other	5	100%	0%
Shareholder Proposals	2	100%	0%
- Environment	1	100%	0%
- Social	1	100%	0%
Total Proposals	180		

May not add to 100% as Management do not provide a recommendation for all resolutions, most often due to a conflict of interest.

Examples of proposals over FY24

Company	Proposal	Company Recommendation	Airlie Vote	Rational
News Corp	Advisory Vote on Executive Compensation	For	Against	We see fixed pay materiality issues. Annual bonuses vest based on adjusted EBITDA (67%) and qualitative performance (33%). LTIs vest based on cumulative EPS (29%), cumulative FCF (29%), relative TSR (27%) and continued service (15%). Management have consistently met or exceeded these hurdles over the years – the lowest outcome for the EPS hurdle in the last 10 years was 50% and the lowest EBITDA hurdle outcome was 78%. We voted against this resolution as hurdles are not sufficiently stretching and executive pay is above peers.
CSL Ltd	Remuneration Report	For	Against	We view the exclusion of Vifor from the ROIC hurdles for the LTI vesting FY23 and FY24 as concerning. We acknowledge the FY23 impact is small but are concerned about the size of the potential benefit from excluding Vifor in FY24. Given Paul Perrault is the biggest beneficiary of this exclusion, and given he was CEO at the time that Vifor was acquired, we feel the ROIC impact of the acquisition should be included in his LTI vesting test.
Dicker Data Limited	Board Spill	Against	Against	Dicker Data received the first strike in FY22 and this resolution will be put to the meeting only in the event of a 'second strike'. The extraordinary step of voting for a board spill was not warranted in the circumstances and having regard to shareholder returns delivered by the company over recent years.

Airlie
Funds Management

Contact us

For more information on any of Airlie's stewardship activities, please visit our website **www.airliefundsmanagement.com.au/about**

Contact the Airlie ESG Manager at
adviserservices@airliefm.com.au