EthicalPartners
FUNDS MANAGEMENT

# Ethical Partners Australian Share Fund

**AUGUST 2021**

Ethical Partners Funds Management is a boutique Australian fund manager which is fully owned by its staff. We have a dual focus on performance and investing ethically over the long term. Our approach directly manages risk for our clients, provides the ability to invest in line with your values and actively advocates for change. Investors in the Fund invest alongside the owners and managers of Ethical Partners. The Fund has adopted a Net Zero Emissions by 2050 target.

| | INVESTOR CLASS | CLASS A | CLASS B | CLASS C | CLASS E |
|---|---|---|---|---|---|
| Unit Price 31/8/21 | $1.0881 | $1.0881 | $1.0920 | $1.0691 | $1.0856 |
| APIR code | EPF9951AU | EPF9964AU | EPF3813AU | ETL8683AU | - |

**INCEPTION DATE**
8 August 2018

**RESPONSIBLE ENTITY**
Equity Trustees (ASX:EQT)

**BENCHMARK**
S&P/ASX 300 Accum. Index

**UNIT PRICING**
Daily

**DISTRIBUTIONS**
Every six months

**BUY/SELL SPREAD**
0.20%

**MANAGEMENT FEE (PDS)**
0.95%

**PERFORMANCE FEE (PDS)**
15% of outperformance

**MINIMUM INVESTMENT**
$25,000

**INVESTMENT DIRECTOR & CEO**
Nathan Parkin & Matt Nacard

**GOOD INVESTING PODCAST**
Link to the latest episode

**NET ZERO 2050 TARGET**
Read about Net Zero 2050 here

NetZero 2050 AUSTRALIAN SHARE FUND

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Link to PDS

## MONTHLY COMMENTARY

During August 2021 the Fund returned 6.10% versus the S&P/ASX 300 Accumulation Index of 2.61%, outperforming the market by 3.49%. An overweight position in Consumer Staples, particularly Agriculture, and underweight position in Iron Ore stocks contributed to relative performance while an underweight position in Technology, notably Afterpay, detracted from relative performance during the month.

Over the last 12 months the Fund has returned 32.98% versus the market at 28.58%, outperforming by 4.39% (after fees). Financial results season is always our report card on the accuracy of our team's earnings estimates and positioning. Key stocks during reporting season were:

**Graincorp (overweight):** While the company does not finalise its official year end until 30 September it reported a better than expected outlook based on efficiency measures that have been implemented at the same time as a record east coast grain crop. The stock rallied 21.2% during the month and our earnings estimates for FY22 are still above consensus.

**Iron Ore (underweight):** Lower steel production in China, significant weakness in the iron ore price and BHP's (-14.7%, not held) corporate restructuring (to offload the oil and gas assets to Woodside) lead to the UK/Australian dual-listed company spread collapsing and compounded the stock's underperformance during the month. Other iron ore players Rio Tinto (-10.7%, not held) and Fortescue (-15.7%, not held) also underperformed.

**Australian Clinical Labs (overweight):** Recently listed, the stock traded below its $4.00 issue price for much of its first three months. The company beat their already upwardly revised prospectus forecasts and guidance was above consensus

## SIGNIFICANT HOLDINGS

Australian Clinical Labs (ACL)
Bega Cheese (BGA)
Graincorp (GNC)
IGO Limited (IGO)
Insurance Australia Group (IAG)
OZ Minerals (OZL)
Macquarie Group (MQG)
Meridian Energy (MEZ)
NobleOak Life (NOL)
Westpac (WBC)

**Performance as at 31 August, 2021**

| INVESTOR CLASS | 1 MONTH % | 3 MONTHS % | 6 MONTHS % | 12 MONTHS % | SINCE INCEPTION (ANNUALISED %) |
|---|---|---|---|---|---|
| Fund (after fees) | 6.10 | 8.67 | 17.88 | 32.98 | 4.93 |
| S&P/ASX 300 Accum | 2.61 | 6.08 | 15.13 | 28.58 | 10.48 |
| Excess | 3.49 | 2.59 | 2.76 | 4.39 | -5.56 |

estimates for 1H22 by more than 100%. The stock rallied 16.2% during the month.

**PSC Insurance (overweight):** The company delivered strong earnings growth driven by organic and acquired growth and rallied 14.5% during the month. It remains a strong founder-led business with a solid platform to continue expanding with a quality management team.

**Blackmores (overweight):** Despite a well-flagged weaker result which is coming off a low base in the prior year, management outlined a significant and credible plan for a step up in revenue and margins over the medium term. The stock returned 37.8% during the month.

**Qantas (overweight):** The stock had been weak into the result on rumours of an imminent capital raising but we had a more constructive view of the company's financial capacity. Management's commentary on forward bookings, cost savings and market structure were all better than expectations and the stock rallied 10.9% during the month.

FY21 reporting season concluded with the market delivering 26.5% earnings growth (driven mainly by large upswings in Banks +33.3% and Resources +54.8%) and a market return of 28.6% over the twelve months to 31 August 2021. Now all eyes are on FY22 earnings growth. Banks (over 20% of the local market cap) start the year with a more normalised earnings base and good provisioning levels and Resources (just less than 20% of local market cap) start the year with a mixed outlook depending on the underlying commodity and with some key commodities still in reasonable supply deficit. Industrials (ex-Banks & Property) earnings growth expectations have come back from over 25% to less than 15% (split 7% Domestic Industrials and 28% for International Industrials. So overall earnings growth expectations for the market are more modest and in our view, realistic at 10.4% for FY22 (Source: Macquarie equities).

Conclusions from reporting season and Fund positioning:

- The market is clearly looking through current challenges (lockdown and COVID delta strain) to an ongoing sustained cyclical recovery.

- We expect that fiscal stimulus will continue globally. The US Federal Reserve continues to be supportive of markets to aid recovery and stoke inflation.

- Corporate balance sheets are in a healthy position: dividends and capital management were both higher than expected across the market including Commonwealth Bank, Woolworths, Bluescope, NAB, ANZ Bank, BHP, Rio Tinto and Fortescue Metals. Banks and insurers (both general and health) have solid provisioning levels for future claims.

- Covid winners, nominally Consumer Discretionary, produced record results and had high expectations that were hard to live up to, but outlook statements that were uncertain and higher inventory levels to manage.

- Companies are more conscious than ever on carbon emissions, setting and fine tuning net zero targets and attune to stranded asset risk. We are seeing large corporate reorganisations taking pace to address this.

- Globally, shortages remain driven by disruption in labour, trade, materials & shipping. Supply chains are still affected by COVID disruptions, while at the same time demand levels are recovering.

- For now this means we want to own the sources of inflation but not those affected by it. This includes green metals or transition commodities, renewable energy producers that can facilitate alternative power sources, asset rich companies, companies in industries with declining capacity, financial services providers and primary food producers, amongst others.

- There is still opportunity in our view in companies that will prosper during the next stage of re-opening of economies and see earnings recovery, especially in services (rather than goods).

- But companies with high expectations are still a risk with respect to valuations with potentially rising rates and the alternatives that are opening up to achieve earnings growth elsewhere. Stocks such as Wesfarmers, REA Group, Goodman Group, Cochlear, Ansell, Magellan, Commonwealth Bank, Healius, Breville, Kogan, Reece, Appen all fell upon reporting results.

**ESG AND ENGAGEMENT COMMENTARY**

**Ethical Partners is Carbon Neutral**

Ethical Partners is pleased to share that we have just received our carbon neutral certification from Climate Active. This means that we have a zero carbon footprint for our own operations.

We have reduced our internal carbon emissions as much as possible, and have then invested in an offset program with Gold Standard called the Cambodia National Biodigester Program. This program provides a way for individual households with livestock to reduce their dependence on polluting firewood and expensive fossil fuels for cooking and lighting. The project also provides additional benefits with the bio-slurry providing a great means for fertilizing and improving local agricultural production. As well as environmental benefits it also provides health, livelihood and employment improvements, and addresses SDG's 2,3,5,7,8 and 13.These offsets also have a special alignment with our Tatrai Giving Fund, which is named after our first project, a school in a remote rural village in Cambodia. You can read more about our chosen offsets here.

Through Climate Active we are also honoured to join a collective network of like-minded climate leaders who are taking credible climate action, and making good decisions today for a brighter and more sustainable future tomorrow. You can read more about the Climate Active Network and the Climate Active Certification here.

**ESG and FY21 Reporting Season: Major acceleration**

This reporting season it was very clear to see the acceleration of ESG issues across the entire ASX, which was obvious in the marked increase of the discussion of ESG issues in reporting season presentations and on earnings calls. Far from being the domain of the investor meeting with the sustainability team, or the once-a-year.

A recent report by Pimco in May this year found that the mention of ESG issues on corporate earnings calls had skyrocketed since the onset of the pandemic. Pimco found that on their analysis of 10,000 global companies that before 2018, less than 1% of Earnings Calls mentioned ESG. In 2019 that rose to 5% of earnings calls, and in May 2021, that rose again to 19% of earnings calls.

It was very clear to us that there was an even bigger increase this reporting season though, so we thought we would conduct some internal analysis. Our sustainability team then reviewed every FY21 Full year Financial Results presentation for all S&P/ASX 300 companies that reported, to see whether ESG was included and found that the mentions of ESG issues has shot up again to 61%.

Pleasingly, we found that in our Ethical Partners Australian Share Fund, 85% of our portfolio companies discussed ESG during their reporting season presentations (78% discussing ESG in a detailed way with another 7% mentioning ESG in a more general way). We believe that this reflects the higher ESG focus of our portfolio companies and is a pleasing nod to the success our EPORA process of screening for companies leading in their attention to ESG.

Our finding that 24% more of our portfolio companies discussed ESG in their reporting season presentations than across the whole S&P/ASX 300 was even more pleasing when we consider that we are significantly overweight the small cap end of the market.

We also are pleased to say that we have already engaged with the three of our portfolio companies that did not discuss ESG in their earnings presentations (one of which is a new float) on the need to improve their ESG disclosures and attention.

**The energy transition**

Decarbonisation and the move to a low carbon economy was front and centre of the reporting season presentations with companies from Origin to Santos, to Woodside & BHP, to name just a few.

This reporting season saw Origin report a big downturn in core profit, post a statutory loss, tell shareholders that it will turn off generation at Eraring for extended periods to keep the plant profitable, and that “the transition to renewables has occurred and the question now is how to navigate this reality with as little financial pain as possible”. AGL also posted over $2 billion in statutory losses, and discussions centred around the influx of cheap wind and solar creating a weaker outlook for energy prices, and their demerger. Whitehaven Coal has also removed from their mining plans and impaired the values of multiple coal reserves and South 32 discussed their divestment of South Africa Energy Coal as they work towards new decarbonisation targets.

**Net Zero Targets**

Ethical Partners was pleased to see two of our portfolio companies included in these new Net Zero Targets – BlueScope and SCP. We also saw two property companies Dexus and Charter Hall Retail REIT bringing forward their net zero targets to 2022 and 2025, and previous portfolio company Goodman Group reaching their carbon neutral target four years ahead of schedule.

These new commitments mean that 59% of our Ethical Partners Australian Share Fund Portfolio is now covered by Net Zero commitments, which is particularly pleasing noting once again the small cap tilt of the fund (54% of the ASX 100 is now committed to Net-Zero Targets but this number is much lower across the S&P/ASX 200/300). Concerningly, there are still seven of the most emissions intensive companies across the ASX without a target, but we are pleased to note that none of these companies are included in our portfolio.

**ESG driven M & A**

The AFR also reported that the biggest trend of reporting season was the “merger fever” of the fossil fuel industry in the face of mounting ESG pressures. The wave of consolidation across the sector has been further described by the AFR as also being described as a “kodak” moment, “a business school case study before our eyes” and an “existential moment” for the sector.

Just in reporting season we have seen the BHP share price negatively impacted through their proposed divestment of their oil and gas assets to Woodside, the proposed acquisitions of Western Areas by IGO, BHP and Andrew Forrest, and the proposed acquisition of Meridian’s Australian Assets by Telstra & Ampol and the merger of Oil Search and Santos, driven by ESG concerns or opportunities. We believe this is a trend that will only accelerate as divestment and decarbonisation pressures increase.

According to a recent Deloitte Study, 30% of respondents are willing to pay a premium if the target has positive ESG attributes, so Ethical Partners also sees ESG driven M&A as a real portfolio opportunity for investors, and a

meaningful incentive for companies to improve their ESG credentials.

**Future facing commodities**

From BHP and Rio's expansions into potash and lithium to FMG's plans for hydrogen and ammonia, to race for nickel in the above-mentioned acquisitions of Western Areas, the merger of Orocobre and Galaxy, and the expansion plans for IGO and OZ Mineral, the minerals required to enable the energy transition were certainly the talk of the market.

**Emissions reductions**

Transport emissions reductions were a focus in the presentations from BHP, Fortescue Rio, S32, Oz Minerals, Northern Star Resources, Sealink and James Hardie, as well as Qantas and Adbri's discussions on sustainable fuels.

We also saw earnings calls from miners such as Newcrest and Oz Minerals focussing on renewables and electrification, Rio and Bluescope talking about opportunities in and progress towards low carbon steel, and Rio's prototypes to decarbonise aluminium.

**Decommissioning costs**

Particularly relating to the BHP and Woodside deal, notably coinciding with the passage of The Offshore Petroleum and Greenhouse Gas Storage Amendment Bill, which creates a trailing liability for offshore petroleum companies, effective retrospectively from January this year.

**Waste and Circular Economy**

With Amcor, Cleanaway and Pact Group noting their increased recycling programs and the growth opportunities presented by the circular economy. Brambles's earnings presentation noted their increased attention to regenerative supply chains, multiple afforestation projects and their development of the first closed loop upcycled plastic platform in the market. Other companies such as Ansell, Endeavour, Mirvac and Unibail-Rodamco-Westfield CDI noted programs to decrease waste to landfill and Coles and Woolworths discussed their food waste programs.

**Ethical Trade and Modern slavery**

We were also particularly pleased to see a focus on Modern Slavery and Supply chains from companies like City Chic, who provided a detailed "Ethical Trading Update" in their earnings call and announced they had mandated a ban on cotton goods from the Xinjiang region, Turkmenistan, and Uzbekistan, and have begun tracing their Tier two and Tier three suppliers. JB HiFi also noted their ethical sourcing initiatives in their reporting presentation, whilst Bluescope noted the completion of the engagement, assessment, and improvement of 230 prioritised suppliers.

**Diversity has also been a notable topic**

From board and management gender diversity and the 40:40 initiative (for which Ethical Partners is a lead investor and has been pleased to have two of our target companies - Mirvac and IGO - recently sign up); to indigenous and LGBQTI diversity noted in Woolworths reporting season presentations, disability diversity noted in Medibank's presentations and neurodiversity programs discussed by NextDC.

**Leaders and highlights from Ethical Partners portfolio companies**

We were also pleased to note that many of the Earnings/Financial End of Year presentations that we rated as leading in their ESG inclusions were by our portfolio companies, all of whom Ethical Partners has engaged deeply over the past few years on these issues. Some of these examples are listed below.

Bega's FY 2021 Reporting Season presentation opened with their sustainability vision for circularity, water, waste, soil, biodiversity, GHG emissions, nutrients, packaging and logistics and animal care. They also used the reporting call to announce their new targets for 40% reduction emissions by 2030 and net zero by 2050. The presentation also detailed the alignment of their strategy with the SDGs and discussed their initiatives on improving the nutritional profile of their range, their goals to remove 1,000 tonnes sugar from portfolio by 2025, their gender diversity progress and salary equity review and their emissions reduction roadmap.

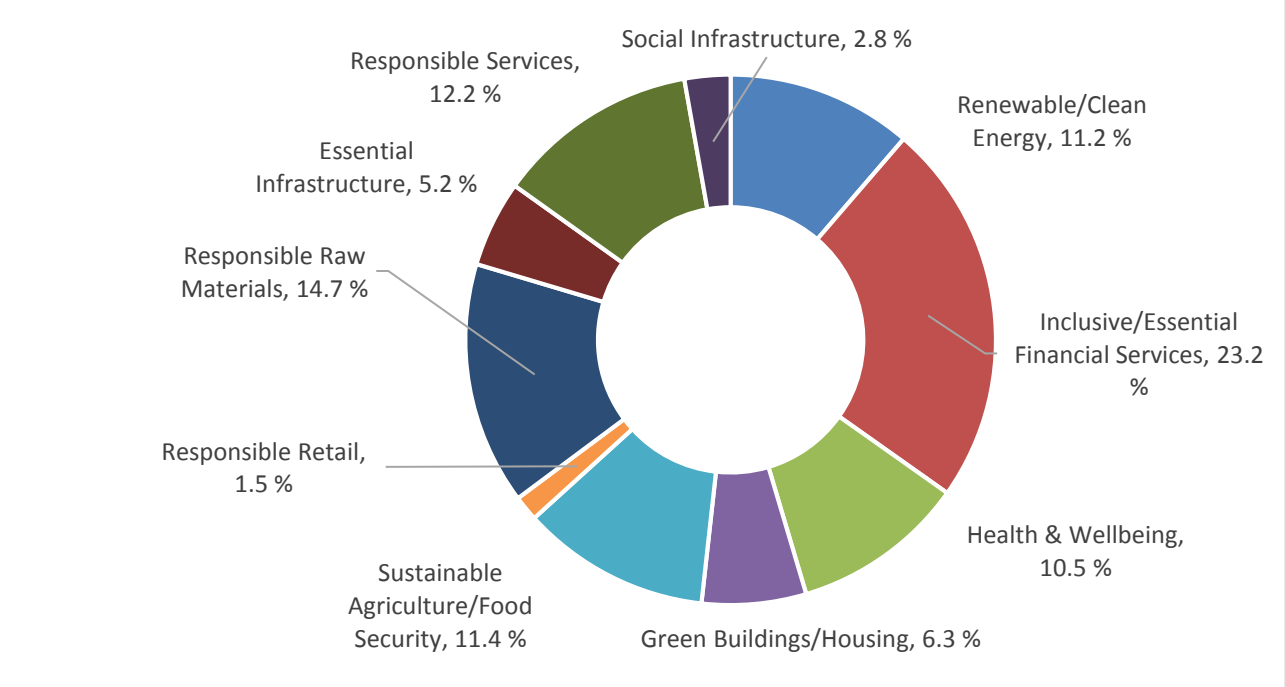
SCP's FY 21 August reporting season presentation included their announcement of their Net zero 2030 Target, and contained details of their renewable projects, climate resilience action plans at 11 high risk centres, their covid rental assistance, their 25% by 2025 water reduction targets, their 60% diversion of operational waste from landfill by 2030 targets and their target for 40;40.20 gender diversity by 2021.

Bluescope's FY 21 August reporting season presentation included the announcement of their broadened 2030 targets, their new 2050 net zero goal, details of the capex towards their initial five year climate investment program and their widened climate change team as well as their work on supply chain and inclusion and diversity.

Qantas' presentation discussed their Net Zero emissions by 2050 target, progress on waste and single use plastic, their worker protections during covid, including their staff mental health support, vaccination leadership and advocacy for stood down workers, as well as announced the creation of a new Chief Sustainability Officer role to accelerate ESG strategy, and included details of their commitment of capex to Sustainable aviation fuels and their partnerships with BP to develop production of SAF by 2025, discussed their commitments to producing an updated climate risk scenario analysis, emissions reduction pathway and interim target by 2022, and a formal internal carbon price by 2023, and also discussed their customer offsetting program.

Mirvac's presentation discussed their 80% decrease in their carbon footprint, and their 2030 targets of net positive carbon, net positive water and zero waste to landfill as well as their attainment of 5 star + ratings for 18 buildings, their 49% decrease in water intensity and diversion of 95% of construction waste from landfill in FY21, their targets for 25% recycled content, their innovate RAP, an $8 million spend in social procurement and their attainment of 50:50 board gender diversity and 40:40:20 women in senior roles.

## SECTOR EXPOSURE, AUGUST 2021





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