Environmental, Social and Corporate Governance (ESG) Policy

August 2024

Introduction

The purpose of this policy is to outline the Environmental, Social and Corporate Governance (ESG) and responsible investment philosophy of Lennox Capital Partners (Lennox, we, our).

ESG has been an integral part of our investment process since inception. At Lennox we are committed to making responsible investment decisions through our investment strategies. As fundamental investors with a long-term investment horizon we recognise that the ESG performance of companies in which we invest are relevant to the value, performance and reputation of our investments.

UN Principles for Responsible Investment

Lennox is a signatory to the United Nations Principles of Responsible Investing (UNPRI). Lennox is committed to the following principles:

Principle 1 – We will incorporate ESG issues into our investment analysis and decision-making processes.

Principle 2 – We will be active owners and incorporate ESG issues into our ownership policies and practices.

Principle 3 – We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Principle 4 – We will promote acceptance and implementation of the principles within the Investment industry.

Principle 5 – We will work to enhance our effectiveness in implementing the Principles.

Principle 6 – We will report on our activities and progress towards implementing the Principles.

ESG considerations incorporated into the investment decision-making process

There are four means by which we incorporate ESG and responsible investing into our investment process:

1. Explicitly exclude industries that are inconsistent with responsible investing
2. Assess and exclude companies that do not meet a minimum ESG requirement
3. Engage with the management and boards of investments to improve the ESG outcomes of their business
4. Conduct top-down portfolio construction and management to explicitly target improved ESG outcomes from Lennox portfolios.

Figure 1: Lennox Capital Partners' Investment Process

Step 1: Idea Generation | **Step 2:** Quality Score | **Step 3:** Fundamental Research | **Step 4:** Portfolio Construction

Step 1: Idea Generation

- **Investment universe excludes companies from industries:**
  - Animal cruelty
  - Armaments
  - Environmental degradation
  - Fossil fuel reserve ownership
  - Gambling
  - Human rights abuse
  - Nuclear power
  - Pornography
  - Tobacco
- **Identify change and potential mispricing**

Step 2: Quality Score

- **Use business qualities and ESG factors to identify investment grade companies**
- **Engage with the management teams and Boards to improve ESG outcomes**

Step 3: Fundamental Research

- **Undertake in-depth research and financial modeling**
- **Assess short term earnings risk**
- **Construct long term earnings forecasts**
- **Value the business on long term forecasts**

Step 4: Portfolio Construction

- **Construct a portfolio with:**
  - High conviction investments
  - Strong risk management
  - Targeted ESG outcomes

1. Explicitly exclude industries that are inconsistent with responsible investing

Prior to new ideas being generated, Lennox will exclude companies from industries deemed inconsistent with our focus on sustainable investing. This means that we will not allocate our investors' capital to companies that derive their revenue from the manufacture or production of the following industries (in alphabetical order):

- **Animal cruelty**
- **Armaments**
- **Environmental degradation**
- **Fossil fuel reserve ownership**
- **Gambling**
- **Human rights abuse**
- **Nuclear power**
- **Pornography**
- **Tobacco**

2. Assess and exclude companies that do not meet a minimum ESG requirement

Following this upfront screening, we conduct a detailed qualitative review of all companies that are considered as potential investment opportunities. This qualitative screening process allows us to specifically assess a company's governance structure as well as the environmental and social impact of its business operations.

We examine four factors to assess the quality of a company: Management, Sustainability, Earnings Quality and Industry.

Table 1 lists the assessment questions in each quality score factor. The questions highlighted show how material ESG issues are integrated in Lennox's qualitative assessment of a company.

Table 1: Assessment questions asked as part of the qualitative screening process

Lennox's Four Factors

	Assessment	Pass/Fail
Management	Are management suitably experienced and skilled?	
	Do management understand their business and industry and can they are articulate their strategy clearly?	
	Does the remuneration structure align senior management with minority shareholders?	
	Do management have the appropriate level of experience, skill and incentivisation?	
Sustainability (ESG)	Is the business structure overly complex or opaque?	
	Environment	
	Does the business have materially negative environmental consequences that may result in regulatory change?	
	Does the business have a negative impact on local environment and risk management?	
	Does the business' operations have high carbon intensity and consequent exposure to carbon pricing?	
	Is the business impacted by climate change?	
	Is the business impacted by water supply and management?	
	Does the business' operations involve waste disposal?	
	Does the business' operations involve pollution and contamination?	
	Does the business' operations involve natural resource use and degradation?	
	Does the business' operations involve energy use and renewal energy generation?	
	Social	
	Does the business have materially negative social consequences that may result in regulatory change?	
	Is the business' corporate culture and conduct appropriate?	
	Does the business have a good OH&S record?	
	If the company operates within the gambling industry, do they exceed minimum standards for risks related to Responsible Gambling, Corruption & Instability, Privacy & Data Security, and Labour Management?	
	Does the business' operations involve the exploitation of human rights and child labour?	
	Is the business impacted by workplace relations and working conditions?	
	Is the level of community impact and engagement appropriate?	
	Is there workplace diversity in the business?	
	Are there supply chain management issues in the business?	
	Governance	
	Is the governance structure that is currently in place protect minority shareholders and safeguard against wrongdoing?	
	Is the Board independent?	
	What is female representation on the board?	
	Board composition – are the board suitably experienced and skilled?	
	Board composition – what's the average tenure of the board? Have less than 20% of the board been members for more than 10 years?	
	Is employee remuneration appropriate?	
	Are there any issues with bribery and corruption?	
	Are there any conflicts of interest within the business and are there policies in place for accountability and compliance?	
	Is the business well governed, structured to protect minority shareholders and devoid of significant regulatory risks?	
Earnings	To what degree are earnings cash backed? (Use 5 year average OCF/EBITDA cash conversion or similar metric)	
	Are earnings easily forecastable / overly complex?	
	Is there a reliance on "underlying earnings" or can earnings be manipulated by management assumptions?	
	Is future revenue / earnings growth organic or through acquisition?	
	Are earnings forecastable and a true reflection of cash generation?	
Industry	Does the product / service have a significant competitive advantage over peers?	
	What are the barriers to new market entrants and are they significant?	
	Is cyclical / structural change a tail or headwind for the industry?	
	Does the industry benefit from cyclical/structural changes and does its structure protect/aid future company earnings?	
Quality Score	**Summarise the quality of the business**	

After the questionnaire has been completed a company will be categorised into one of the below gradings:

- **Investment grade: possible investment eligible for fundamental research;**
- **Investment grade – engagement: possible investment eligible for fundamental research, with an expectation of improving quality factors monitored through engagement; or**
- **Sub-investment grade: not eligible for fundamental research or investment.**

3. Engage with the management and boards of investments to improve the ESG outcomes of their business

We will engage with the management teams and boards of investments that are categorised as 'investment grade' to seek further clarification and provide feedback on ESG issues and help them understand how we think about ESG in the context of our investment process.

For companies categorised as 'investment grade – engagement', we will actively push for improvements in ESG deficiencies with management and board members.

All ESG engagement with companies is formally managed within internal systems as part of our record keeping process. At Lennox investment committee meetings where investment ideas are proposed, the quality screening process for a prospective investment is discussed and reviewed by the whole team. For the investment to go ahead, the two portfolio managers need to unanimously agree the investment passes our qualitative ESG factor assessment.

In addition to company engagement, we vote all general meetings for the companies held within our portfolios.

As an investment manager, we take our ownership responsibilities seriously and we believe the right to vote as proxy is an important and powerful asset.

Lennox recognises that ESG issues are not static and are likely to change over time. It is the responsibility of our team to engage with the management and board of all companies in our portfolios and all prospective investments. The aim of this engagement is to ensure ESG assessments are current and in order to influence key decision makers within a company to seek a better ESG outcome.

4. Conduct top-down portfolio construction and management to explicitly target improved ESG outcomes from Lennox portfolios

Lennox constructs its portfolios in order to achieve improved ESG ratings and outcomes when compared to the relevant benchmark. The below list details the inputs into our portfolio ESG assessment:

- **Environment**
  - Carbon Emissions (including Scope 1, 2 & 3)
  - Climate Change
  - Environmental Opportunities
  - Natural Capital
  - Pollution & Waste
- **Social**
  - Human Capital
  - Product Liability
  - Social Opportunities
  - Stakeholder Opposition
- **Governance**
  - Corporate Behaviour
  - Corporate Governance

The portfolio and benchmark are independently assessed on each of these factors, with an overall view on ESG formed from these factor scores.

Company reported carbon emissions and Sustainalytics ESG research estimated company emissions are used to construct the carbon emissions and intensity of the Lennox portfolio and its relevant benchmark.

Specific ESG considerations

How we consider climate change risks and opportunities in our investments

Lennox subscribes to the scientific consensus that carbon dioxide in the atmosphere, predominantly as a result of human activity, has led to global warming with consequent changes in our climate. There has been a global move to reduce carbon emissions worldwide. The Paris Agreement, ratified by 195 countries, outlines country-specific targets for reducing carbon emissions. Lennox believes that uncertainty surrounding both the physical changes in our climate as well as the policy response around the transition to a low carbon economy can pose a risk to our investments. Equally, there will be companies that benefit from such a transition. As such, Lennox considers the physical and transition risks and opportunities of climate change as part of our fundamental analysis.

Physical risks can involve the increased frequency and severity of extreme weather events such as drought, flooding, hurricanes, heatwaves and rising sea levels. Transition risks include the risk of regulation around carbon emissions such as the introduction of a carbon tax, both within Australia and globally, which may affect demand for exports, the development of new technologies which are more aligned with a low carbon world as well as changing consumer preferences for low emission/energy efficient products.

Opportunities can arise from companies that develop technologies or solutions to deal with the physical aspects of climate change and those companies that are better prepared and less exposed to the negative effects of a transition to a low carbon economy. We consider all investee companies through this lens in our fundamental analysis.

As part of the investment process, Lennox does not exclude industries related to mining. However, a criteria for investment in those industries is that the investee company must acknowledge that a climate transition is taking place and that they have a role to play in that transition. Lennox actively engages with all companies but particularly those in industries related to mining on climate change and their transition pathway.

We encourage the companies we invest in, or are considering for investment, to assess and disclose their exposure to climate-related financial risks, adopting where possible the framework set by the Taskforce for Climate-Related Financial Disclosures (TCFDs).

How we consider nature risks and opportunities in our investments

Lennox recognizes the growing global emphasis on addressing biodiversity loss, a priority highlighted at the UN Biodiversity Conference (COP 15) in 2022 with the adoption of the Global Biodiversity Framework. This framework, along with the work of the Taskforce on Nature-related Financial Disclosures (TNFD) underscores the importance of protecting nature and ecosystem systems and need to account for nature-related risks and opportunities in financial and business decisions.

Nature-related risks are potential threats posed to companies due to its dependencies on and impacts on nature. These risks can arise from physical, transition, and systemic factors and include both shorter-term financial risks, considered material today, and longer-term risks tied to nature-related dependencies and impacts. The interconnectedness of these dependencies and impacts over time can lead to vulnerabilities in a company's earnings and cash flow, translating into broader financial risks such as market, credit, and liquidity risks.

At the same time, nature-related opportunities can arise when companies engage in activities that generate positive outcomes for themselves and nature. These opportunities can include mitigating the loss of natural capital and ecosystem services, or pursuing strategic transformations in business models, products, services and investments that actively contribute to halting or reversing nature loss.

We consider nature-related risks and opportunities in our investment process and engage with companies that are exposed to material nature-related risks.

How we consider modern slavery risks in our investments

Lennox recognises that modern slavery, as well as being a serious ethical concern, can also pose a financial risk to businesses both from a reputational perspective and from a disruption to their supply chains. We recognise that, although less common, there are still instances of modern slavery within Australia, particularly in high-risk industries such as textiles, financial services (through their supply chains), mining, construction, property, food and beverages, agriculture, and healthcare. When analysing companies in these higher risk industries Lennox will do additional due diligence to ensure the company has appropriate policies in place to manage these risks and treats its employees fairly. With companies that have supply chains in high-risk regions overseas we take a similar approach, ensuring that the investee company has awareness of the risks of modern slavery within its supply chains and has policies in place to mitigate these risks.

How we consider gender diversity in our investments

Research has shown that companies with higher gender diversity on their boards tend to deliver improved financial performance. Lennox believes that greater gender diversity (as well as other forms of diversity) reduces the risk of groupthink. This can reduce risks and boost performance in investee companies. As such we consider the number of females on boards as part of our governance assessment. Through our engagement activity, we also encourage our investee companies to improve the gender balance of their boards.

Responsibility for ESG integration

ESG integration is embedded in Lennox's investment process and every member of the investment team is responsible for ESG research and integration.

Review and Oversight of Policy

Lennox's ESG policy is reviewed annually. It is approved by Lennox's Board and senior executive-level staff, who have ultimate oversight on responsible investment activities and ESG strategy and policy.

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Next Scheduled Review Date: September 2025

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