Environmental, Social & Governance Policy

Guiding Principles

Karara Capital is an active manager of Australian equity portfolios applying a fundamental approach to selecting stocks and building portfolios.

As an investment manager, Karara has a fiduciary responsibility to deliver the highest possible return on our client's investments while effectively managing all foreseeable risk factors.

In Karara's experience those companies that best manage environmental, social and corporate governance (ESG) risks, impacts, and opportunities are more financially sustainable in the longer term and positioned to deliver better long-term financial performance and returns to our clients.

Consequently, we believe that the ESG performance of the companies we invest in is not only a proxy for the quality of management and the sustainability of the business model, but is also relevant to the overall performance of our client's investment portfolios.

As a result, we believe that the integration of ESG into our investment analysis and investment decision-making is essential.

In addition to financial considerations Karara believes that companies, as a matter of principle, should act in a socially responsible manner. They should conduct their business in a way that recognizes their responsibilities to employees and other stakeholders, as well as to the broader community and the environment.

Purpose

The purpose of this ESG policy is to formally outline Karara's commitment and principles in relation to the integration of ESG considerations into investment processes and decision making.

Definitions

ESG; refers to Environmental, Social, and Governance (ESG) factors. ESG Investing is also known as Responsible Investing. ESG risks tend to share a number of characteristics which distinguish them from traditional financial and business risks, namely; they typically manifest over the medium to longer-term, they are qualitative in nature and not easily quantifiable in monetary terms, often emerge as high profile issues of public concern, reflect externalities not yet well captured by market mechanisms, and are the focus of increasing community awareness or government regulation.

Environmental; refers to issues affecting the natural environment. Environmental issues include climate change, waste management, resource and water scarcity and damage to biodiversity.

Governance; refers to issues regarding how companies or assets are run or 'governed' and in particular the alignment of a company's board and management with the ultimate owner of the company, its shareholders. Governance issue include board composition and skills, executive remuneration, accounting and audit practices.

Long-term investing; a research orientated investment approach that addresses all material risks to the business and which has a focus on protecting and enhancing investments, minimizing risk and seeking positive returns over the long-term business cycle.

Social; refers to issue affecting individuals whether they are employees, customers, suppliers of community. Social issues include human capital management, work place health and safety, supply chain management, and managing community relations.
Socially Responsible Investing (SRI); typically refers to an approach that applies negative screens to exclude companies exposed to questionable business practices or industries. In contrast, ESG based investing is about integrating a set of non financial factors into the investment analysis to generate better long term returns.

Investment Process
Karara believes the evaluation of ESG factors is integral to the fundamental analysis of a company. The key role played by Karara’s consideration of ESG factors is principally as a risk mitigant. While our investment process actively seeks to invest in companies with sustainable practices and attractive prospects, we are particularly looking to avoid investing in those companies assessed as having poor sustainability practices which we see impacting negatively on the company over our investment timeframe.

Formal consideration of ESG issues is codified in our stock selection thesis templates which forms the basis of our analyst’s evaluation of a company.

In addition, within our smaller company investment process, due to the large size of the small company investment universe and given the higher stock specific risk in smaller companies, Karara’s Small Company team applies a high level quality screen that filters the investment opportunities to a more manageable level. This quality screen targets, inter-alia, the identification of ESG issues at an early stage of the investment process.

Our analysts draw upon their experience and research to consider ESG factors and the sustainability of a company’s practices and operations as part of their qualitative assessment of a company. This assessment includes other factors such as management quality, balance sheet strength, competitive advantage, industry structure, return on investment and sustainable cash flow generation.

In completing this assessment, our analysts may from time to time, draw on externally maintained ESG databases as well as broker derived ESG research. As a general proposition, however, we believe that outsourcing ESG judgments to an ‘investor ready’ service is problematic due to data quality, data completeness (i.e. breadth of sustainability considerations) and the nuances of sustainability in relation to the circumstances of individual companies.

Conclusions drawn from our assessment forms the basis of our estimate of each company’s valuation. In theory, the value a company is a function of the level of cash earnings expected adjusted for the level of confidence in their delivery and the time value of money. Accordingly, conclusions drawn from our assessment of a company’s ESG risks, along with other risks, will directly affect Karara’s valuation through both the level of cash earnings forecast and our confidence (reflected in the beta) in the deliverability of those cash earnings.

The expected excess return that is derived from our valuations is a key input into our portfolio construction. In building our investment portfolios, individual company positions are largely a function of our expected excess return and our confidence (riskiness) of that return.

All things being equal, a company which has a weak ESG assessment will result in the company’s valuation being marked down as well as lower confidence in that valuation, thereby reducing the company’s chances of being included in a Karara portfolio.

Long Term Investor
A key tenant of our investment philosophy is that investors are often swayed by short term considerations at the expense of longer term economic value considerations. The consequence of this is the potential disconnect between corporate responsibility/sustainability and the actual behaviour of investors. We believe we are less exposed to this disconnect.
Issues of sustainability are clearly central to our investment process, with our portfolio turnover at around 25% to 30% pa which is at the lower end of comparative averages we are typically investing in companies for 3 to 5 years. Given our below average portfolio turnover and thus longer than average holding period, over investment approach weights longer term factors, including ESG factors, higher than many other investors in the market.

We believe that integrating ESG considerations into our investment process enables Karara to more effectively understand and manage the risks and returns that face longer term investors as well as ensuring the long term performance of a business is not overlooked in the pursuit of short term financial returns.

**Engagement**

As a matter of policy, Karara seeks to engage directly with company management and Board members on ESG issues to ensure the risks are being appropriately governed and to encourage change where we believe the company’s management of an issue is potentially detrimental to shareholder value creation.

In our experience, constructive dialogue with company leadership is the most effective means of influencing corporate behaviour and ensuring that companies understand our perspective on good practice and governance as a means to enhance shareholder value.

Karara aims to meet at least once, and preferably twice each year, each company in which shares are held in Australian equity portfolios. More frequent company visits will be made if required. Meetings are usually undertaken by the analyst responsible for researching the company in question and one other team member.

Meetings are generally held with management representatives from the company; typically Chief Executive Officer, Chief Financial Officer, or Operational Head. However, if significant matters concerning Board structure, shareholders rights, executive remuneration or adherence to best ESG principles are at issue, contact will be made with independent or non executive directors or the Chairman of the Board as appropriate.

As part of this engagement process Karara will on occasion send a letter to the Chairman of a Board outlining our concerns or thoughts on a Corporate Governance issue related to that company. We find that irrespective of our shareholding size this formal communication is taken very seriously by boards and usually results in company initiated discussion, often directly with the Chairman.

We believe that our relationship with companies and our constructive engagement practices are not only a competitive advantage that underpin our standing as a shareholder of integrity, but are also intrinsic to building our understanding of a company and its management. Largely for this reason, Karara does not engage third parties to represent our views.

We reserve the right to sell a company's shares to protect our client's economic interests in the event we are dissatisfied with a company's response to managing the ESG risks facing it.

We expect companies to provide an ESG statement as part of their annual reporting. In addition, we encourage broking houses to provided ESG analysis by allocating a portion of our panel brokerage to reward brokers for ESG themed research.
**Staff**

The evaluation of ESG issues is undertaken by the analyst responsible for that company. Every company in the S&P/ASX300 index is covered by a dedicated analyst who is responsible for its fundamental analysis and making investment recommendations.

When assessing ESG issues, Karara’s analysts draw upon their extensive experience and research to make an assessment of the sustainability of a company’s operations as part of their analysis of each company. In addition, our analysts present their completed analysis (including ESG issues) at the investment peer review meeting.

All staff are qualitatively assessed on their commitment to sustainability as part of their annual performance appraisal. This score feeds into their remuneration.

**Resources**

Consistent with Karara’s integrated approach, ESG analysis is undertaken by all (10) members of the investment team.

In addition, Karara subscribes to ISS and uses its Governance and Proxy Voting research as a reference and sounding board to our internal analysis. We also read the research of, and meet with, sell side ESG analysts and recognize the value of this research by allocating brokerage to the ESG sector within our broker panel process.

**Exclusions**

Karara acknowledges there maybe non-financial motivations for incorporating ESG considerations into investment processes and decision making. However to reiterate, reflecting our fiduciary responsibility the incorporation of ESG considerations into Karara’s investment process is predicated on obtaining better risk adjusted returns for our clients. Consequently, we do not exclude particular companies on moral or ethical grounds such as screening out investments in tobacco, alcohol, gambling, nuclear, or other controversial exposures.

Karara believes that some elements of the ESG decision are ultimately the preserve of the client and some clients may wish to exclude companies from the investment universe for non-financial reasons. We are happy to accommodate client driven stock exclusions through an adjusted investment benchmark. Senior members of the Karara investment team successfully managing such an excluded portfolio for over 15 years.

**UNPRI**

Karara acknowledges that the UNPRI is a voluntary, aspirational initiative that provides a framework for integrating ESG considerations into in investment decision making. We recognize that ESG factors, amongst others factors, may impact shareholder value and as such became a signatory to the UNPRI in July 2013. Karara is committed to working towards the implementation of the six principles of the framework.

Karara uses an established process for monitoring companies and their ESG practices, and our engagement and proxy voting activities are thorough and comprehensive, and should satisfy our client’s requirements for PRI compliance.
Corporate Governance & Proxy Voting Policy

Karara’s Approach

The sole objective of Karara’s corporate governance policy is to promote the economic interests of our clients. Karara recognizes that corporate governance is concerned with ensuring that a company’s management practices are aligned with the interests of shareholders.

Karara broadly endorses the principles recommended in the Financial Services Council (FSC) Corporate Governance Guidance Note.

Karara recognizes the broader chain of accountability that exists in the proper governance of Australian corporations, and the extent and limitations of the shareholder’s role in that process. In particular, it is recognized that company management should ordinarily be presumed to be best placed to conduct the commercial affairs of the enterprise concerned, with prime accountability to the board of Directors which is in turn accountable to shareholders and to external regulators and exchanges.

The involvement of Karara as an institutional shareholder will not extend to interference in the proper exercise of Board or management responsibilities to take the calculated commercial risks which are essential means of adding value for shareholders.

While the FSC Corporate Governance Guidance Note and similar statements of best corporate practice provide a foundation for Karara’s corporate governance policy, the primary aim of this policy is to encourage a culture of performance amongst investee companies, rather than one of mere conformance with a prescriptive set of rules and constraints. Rigid adherence to a checklist approach to corporate governance issues is of itself unlikely to promote the maximum economic performance of Australian companies, or cater for circumstances in which non-compliance with a checklist is appropriate or unavoidable.

While recognising in general terms that issues concerning corporate governance practices (and other ESG factors) can have a significant bearing on the financial performance of companies, the primary criterion for the selection and retention of a particular stock in active equity portfolios remains our judgment that the stock will deliver superior investment performance for our clients based on our investment analysis. It is acknowledged that this investment approach may on occasions lead us to maintain investments in companies which do not adhere to generally-recognised best corporate governance practices in all respects, or which have failed to adopt such practices after genuine attempts have been made to effect changes through proxy voting or discussion with the board and management.

Proxy Voting Authority

Unless a management agreement or mandate from an individually managed client gives explicit instructions to the contrary, Karara will presume that a full delegation of proxy voting authority to it is intended by the client. In the case of clients who wish to place special conditions on the delegation of proxy voting powers, Karara will endeavour to accommodate those clients’ requirements as far as practical.

In considering proxy voting issues arising in respect of pooled fund shareholdings, Karara will act solely in accordance with its fiduciary responsibility to take account of the collective interests of unit holders in the pooled fund as a whole.

Karara cannot accept instructions from individual unit holders in a pooled fund as to the exercise of proxy voting authority in a particular instance.
Exercising Proxy Votes

Where Karara has full delegation of proxy voting authority we will vote in respect of all resolutions tabled – either to register disapproval of management proposals or to demonstrate support for company initiatives.

When exercising voting authority, Karara pays particular attention to a range of material matters including; contentious issues (e.g. issues of perceived national interest, or where there has been press coverage or public comment), executive remuneration, board composition, employee and executive share and option schemes, approval of changes of substantial holdings; merges or schemes of arrangement; and approval of major asset sales or purchases.

Karara may on occasion abstain from exercising its voting rights on a contentious resolution where we are constructively engaged with the company on the issue in question. The expectation is that if progress is not made then we will vote against the resolution in future.

Where appropriate, Karara will also use voting powers to influence companies to adopt generally accepted best corporate practices in areas such as board composition, disclosure policies and the other areas of recommended corporate practice set out in the FSC Guidelines.

Karara does not rely on third party ESG research or subscribe to a proxy voting information service.

Internal Administration and Decision-making Process

Karara will consider and vote on all company resolutions where it has authority to exercise voting powers on a client’s behalf. This consideration will occur in the context of our policy Exercising Proxy Votes outlined above.

Karara administers its proxy voting activities via the ProxyEdge web-based portal. In limited cases, where a client’s appointed custodian does not use ProxyEdge we will administer voting on behalf of the client in accordance with their custodian’s proxy voting protocols.

On a weekly basis Karara’s operations team provides the investment team with a schedule of forthcoming company meetings, including resolutions and deadlines for instructions.

The initial voting recommendation will be made by the analyst responsible for researching the company in question, and is subject to review and approval by an Investment Manager.

Voting instructions are then provided via email to the operations team for execution and a record maintained of the voting decision for each shareholder resolution, and the rationale for the voting decision (including abstentions).

Voting instructions will be issued via Proxyedge or instructed directly to the custodian (where required) in accordance with the documented timeframe for completion. For custodians not using ProxyEdge, Karara will monitor the efficiency with which custodians implement voting instructions on our client’s behalf.

Where proxy voting authority is being exercised on a client’s behalf, a summary of all voting activity will be provided as part of the client’s regular quarterly report.

Karara will provide information on particular corporate governance and proxy voting issues in response to requests from clients wherever possible.
Communicating with Companies

Karara sees its role in exercising corporate governance responsibilities on client’s behalf as having two broad dimensions. The first of these is a proactive and continuous process of monitoring corporate activities and raising key issues and concerns directly with the board and management of companies in which investments are held on client’s behalf. The second is the exercise of proxy voting powers where we have been delegated by clients.

Karara’s experience is that maintaining an ongoing dialogue with companies is generally a more effective means of adding value to clients’ equity investments than the exercise of proxy voting powers. In some cases, Karara’s interaction with companies prior to an AGM is aimed specifically at resolving a contentious issue before it becomes a damaging public proxy battle.

Karara aims to meet at least once, and preferably twice each year, each company in which shares are held in Australian equity portfolios. More frequent company visits will be made if required by circumstances. Meetings are usually undertaken by the analyst responsible for researching the company in question.

Meetings are generally held with management representatives from the company; for example Chief Executive Officer, Chief Financial Officer, or Operational Head. However, if significant matters concerning Board structure, shareholders rights, executive remuneration or adherence to best corporate governance principles are at issue, contact will be made with independent or non executive directors or the Chairman of the Board as appropriate.

As part of this engagement process Karara will on occasion send a letter to the Chairman of a Board outlining our concerns or thoughts on a Corporate Governance issue related to that company. We find that irrespective of our shareholding size this formal communication is taken very seriously by boards and usually results in company initiated discussion, often directly with the Chairman.

While boards get feedback through the proxy voting process, a yes/no vote provides only limited insight into shareholder views. We have found through long experience numerous meetings; we can often accomplish more through dialogue than through the voting process.

Where we are unable to achieve a satisfactory outcome from our engagement activities, we may choose to withhold support by exercising our right to vote against shareholder resolutions. As a matter of principle, we seek to communicate with a company prior to voting against a resolution, this is important in treating management with respect and being effective in our engagement activities.