ECP

Sustainability Report 2023

Redefining Active Investing
ecpam.com

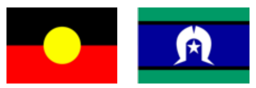
Welcome

At ECP, our purpose is to Redefine Active Investing. For us, our philosophy guides everything we do, meaning to fulfil our purpose we not only have to deliver to our clients, but more importantly, to all stakeholders and communities in which we operate. We are committed to creating value that extends beyond financial gains, ensuring a positive impact on society and the environment.

For us, we invest in companies in the growth stage of their life cycle, and therefore need to balance their narratives and their numbers - we value potential, not just performance. However, over the past few decades, equities have experienced a stellar run, characterised by steady production growth and minimal demand shocks.

This report illustrates how our focus on sustainable, high-quality investments is crucial in navigating these shifts, ensuring we not only achieve superior financial outcomes but also maintain a positive impact on the broader market landscape. For any investor, aligning with a core philosophy that allows them to "sleep well, rather than eat well" is paramount.

Furthermore, we highlight our stewardship activities, our commitments to the community, and the exemplary individuals within our firm who embody our principles and values. At our firm, sustainability initiatives start with our people and represent a continuous, multi-year process of improvement. We hope this report provides you with a clear sense of our performance in this regard, and we look forward to taking you on this journey with us.

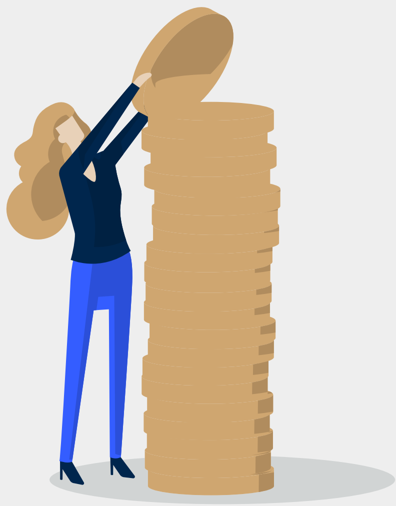


ECP Asset Management acknowledges First Nations Peoples as the Traditional Custodians of the land on which we operate, the Gadigal people of the Eora Nation. We recognise and honour their enduring connection to the land, waters, and culture. We pay our respects to their Elders past, present, and emerging.

Contents

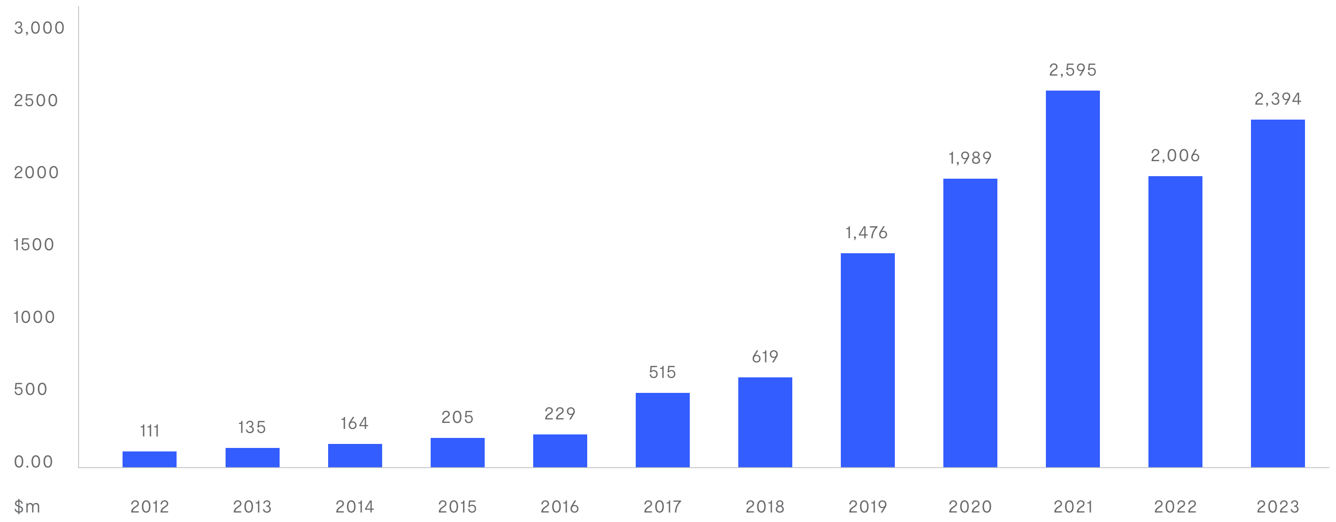
Snapshot

01



Financial Performance

FUM as at 30 June



Portfolio Performance to 30 June 2023

	3m	6m	1y	3y	5y	Inception
ECP Growth Companies	0.88	8.44	16.55	8.31	10.37	12.07
S&P ASX 300 Accum	0.99	4.36	14.4	11.07	7.12	8.31
Alpha	-0.11	4.08	2.15	-2.76	3.25	3.76

1, 2

	3m	6m	1y	3y	5y	Inception
ECP Emerging Companies	-0.79	3.45	15.60	6.85	12.50	13.69
S&P ASX 300 Accum	-0.54	1.32	8.45	5.16	2.25	5.81
Alpha	-0.25	2.13	7.15	1.69	10.25	7.88

1, 3

[1] Past Performance is not a reliable indicator of future performance. The total return figures quoted are historical, calculated using end-of-month prices and do not allow the effects of tax or inflation. Total returns for the benchmark do not incur costs. Returns assume the reinvestment of all dividends.
[2] Inception of the ECP ALL CAP strategy composite is 29/04/1998. 3y, 5y and Inception figures are annualised.
[3] Inception of the ECP Emerging Growth Strategy is 01/08/2013. 3y, 5y and Inception figures are annualised.

Social Performance

Carbon footprint of portfolios

	Total Carbon Emissions	Relative Emission	Weighted Average Carbon Intensity	Relative Carbon Risk
Growth Companies	51.0 tCO2e	-29.0 tCO2e	36.6 tCO2e	-73.4 tCO2e
ASX 300	80.0 tCO2e	-	110.0 tCO2e	-

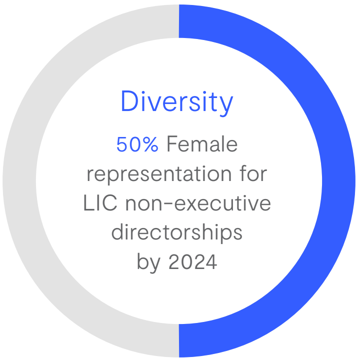
	Total Carbon Emissions	Relative Emission	Weighted Average Carbon Intensity	Relative Carbon Risk
Emerging Growth	2.0 tCO2e	-53.0 tCO2e	7.9 tCO2e	-59.0 tCO2e
ASX Mid Cap 50	55.0 tCO2e	-	66.9 tCO2e	-

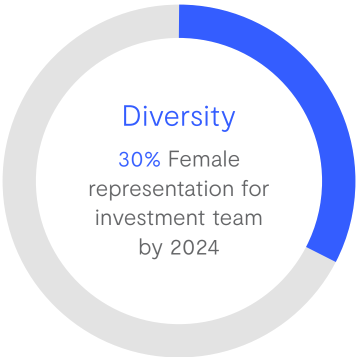
Diversity Representation

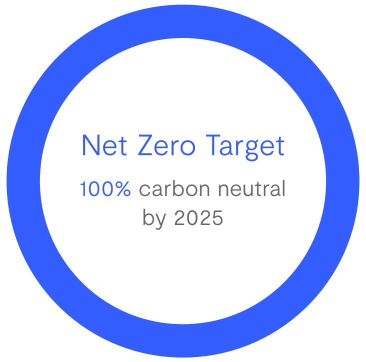
Gender	Male	Female
Group	56%	44%
Investment Team	78%	22%
Distribution	50%	50%
Admin & Support	20%	80%
Non-Executive Directors		
ECP Asset Management	50%	50%
ECP Emerging Growth	100%	
Flagship Investment	50%	50%
Global Masters Fund	50%	50%

Nationality	Australian	International
Group	50%	50%
Investment Team	67%	33%
Distribution	50%	50%
Admin & Support	20%	80%

Targets & Goals







Active Ownership

Engagement

	Portfolio Engagements	Average Per Company
Company Engagements	180	6
Other Engagements	200	6
Total	380	12

	Portfolio Engagements	Average Per Company
Pestle	137	4
ESG	85	3
Dynamic Capability	118	4
Total Sustainability	303	11

Voting

	For	Against	Total
Number	213	10	223
Percentage	95.5%	4.5%	100%

Credentials

Leadership & Certifications

Responsible Investment Association of Australasia (RIAA) Leader

Responsible Investment Association of Australasia (RIAA) Certification

RIAA's RI Certification Symbol signifies that ECP Asset Management Pty Ltd offers responsible investment products; has undertaken continuing professional development on responsible investment; and conducts inquiries regarding client concerns about environmental, social, governance or ethical issues. The Symbol also signifies that ECP Asset Management Pty Ltd has adopted the operational and disclosure practices required under the Responsible Investment Certification Program for the category of Investment Management Service. ECP Asset Management Pty Ltd is assessed against Responsible Investment Standard and Assessment Note-Sustainability Classifications.

The Certification Symbol is a Trademark of the Responsible Investment Association Australasia (RIAA). Detailed information about RIAA, the Symbol and ECP Asset Management Pty Ltd can be found at www.responsiblereturns.com.au, together with details about other responsible investment products and services certified by RIAA.

Climate Active

Lonsec Sustainability - 5 Bees

The Lonsec Rating (Assigned September 2023) presented in this document is published by Lonsec Research Pty Ltd ABN 11 151 658 561 AFSL 421 445. The Rating is limited to "General Advice" (as defined in the Corporations Act 2001 (Cth)) and based solely on consideration of the investment merits of the financial product(s). Past performance information is for illustrative purposes only and is not indicative of future performance. It is not a recommendation to purchase, sell or hold ECP Asset Management's product(s), and you should seek independent financial advice before investing in this product(s). The Rating is subject to change without notice and Lonsec assumes no obligation to update the relevant document(s) following publication. Lonsec receives a fee from the Fund Manager for researching the product(s) using comprehensive and objective criteria. For further information regarding Lonsec's Ratings methodology, please refer to our website at: www.lonsecresearch.com.au/research-solutions/our-ratings.

Principles for Responsible Investment Signatory:

Policy Governance & Strategy
★★★☆☆

Direct - Listed Equity - Active Fundamental - Incorporation
★★★★☆

Direct - Listed Equity - Active Fundamental - Voting
★★★★☆

Products

Lonsec Highly Recommended™

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Zenith - Recommended

The Zenith Investment Partners ("Zenith") Australian Financial Services License No. 226872 rating (assigned June 2022) referred to in this document is limited to "General Advice" (as defined by the Corporations Act 2001) for Wholesale clients only. This advice has been prepared without taking into account the objectives, financial situation or needs of any individual. It is not a specific recommendation to purchase, sell or hold the relevant product(s). Investors should seek independent financial advice before making an investment decision and should consider the appropriateness of this advice in light of their own objectives, financial situation and needs. Investors should obtain a copy of, and consider the PDS or offer document before making any decision and refer to the full Zenith Product Assessment available on the Zenith website. Zenith usually charges the product issuer, fund manager or a related party to conduct Product Assessments. Full details regarding Zenith's methodology, ratings definitions and regulatory compliance are available on our Product Assessment's and at https://www.zenithpartners.com.au/RegulatoryGuidelines.

Independent Investment Research: Recommended

Independent Investment Research: Recommended+

Our CEO & Chairman

02

Sustainable Business Is Good Business

The past 20 years have been a stellar run for equities, characterised by steadily expanding production and few demand shocks. At times, this exuberance was impacted by sourcing sentiment and occasional collapses in spending, which have been managed by central banks through carefully raising or cutting rates.

The current environment, however, indicates this environment is changing - production constraints, triggered by the pandemic and accelerated by the invasion of Ukraine, have driven inflation worldwide. We are now living in a world that is shaped by supply, with the current inflationary environment being driven by these supply-related issues as opposed to excessive demand.

Investors can expect continued market volatility as the market continues to react to these announcements. In times of stress or periods of change, investors are best placed when identifying sustainable investments. Understanding macro-environmental factors that may emerge, combined with resilient investment companies, will position equity portfolios well over the long term.

Warren Buffett, in his Letter to Shareholders (1989), commented that "time is the friend of the wonderful business, the enemy of the mediocre". For investors, identifying these quality companies is the true secret to success in growing one's long-term wealth.

To invest in a company in the growth stage of its life cycle, it is important to balance the company's narrative alongside its numbers. It is vital not to get caught up in the hype and noise of the internet and daily market movements.

A sound investment philosophy sets out several 'rules' or 'procedures' to fall back on when the market noise gets too loud. Companies with a Sustainable Competitive Advantage (SCA) will always be well-placed to withstand short-term headwinds, regardless of market conditions, maintain market share and ultimately find new ways to grow.

Throughout reporting season, we continue to drill down into a company's financials and growth plans in a careful, considered and committed way. This process ensures we identify the quality stocks that will prosper over the long term whilst remaining resilient through testing times.

Companies that are flexible and move quickly in taking advantage of opportunities while capitalising on market trends and demand will continue to succeed competitively and provide long-term opportunities for investors. Through times of market volatility, these investments are those that have been proven to outperform.

At ECP, our primary focus is investing in quality businesses within the growth phase of their lifecycle. For investors, the material derate of equity valuations, particularly for growth-oriented stocks, and the expected ongoing volatility present an opportunity for those investing in resilient, Quality Franchises - it's time to step in and invest.

Dr Manny Pohl AM
CIO & Chairman

To Our Stakeholders

03

The Resilience of Quality

In an ever-volatile financial landscape, investments anchored in solid fundamentals and proven execution have historically been the most resilient. Quality stocks, characterised by robust individual performance, strong fundamentals, and the ability to withstand macroeconomic fluctuations, remain pillars in challenging times.

Recent years have seen the global economic landscape reshaped by unexpected events such as a global pandemic, financial crises at major institutions, and dramatic shifts in central bank policies. With interest rates rising to combat inflation, we've entered a period of higher rates, marking a departure from the previous era of low rates.

As businesses grow, they encounter more complexities and vulnerabilities due to environmental and societal disruptions. To this end, sustainability is critical for long-term competitiveness, shifting focus from solely financial growth to enhanced operational sustainability.

In this unpredictable environment, investors are increasingly turning to ESG (Environmental, Social, Governance) factors for sustainable returns. ESG has evolved from an ethical consideration to a crucial risk management tool, aiding investors in safeguarding their portfolios against significant risks and adapting to future opportunities and challenges.

The Federal Reserve's significant rate hikes since March 2022 signify a proactive monetary approach. These measures, though aimed at controlling rampant inflation, also expose weaknesses in the financial system, as seen with institutions like Silicon Valley Bank and Credit Suisse. This suggests a possible new era of market volatility.

Central banks worldwide face the dilemma of addressing long-term inflation while maintaining macroeconomic stability. With the global labour market at its tightest in two decades, aggressive rate hikes risk exacerbating economic challenges, potentially fueling further market instability.

Quality stocks have proven to be resilient and exhibit strong growth, especially during inflationary periods. They have consistently outperformed other investment styles by showing superior earnings growth. Characterised by high return on equity, stable earnings, and low leverage, Quality stocks effectively shield against inflation and rising interest rates.

In the face of slowing global growth, persistent inflation, and the uncertainty of earnings forecasts, Quality and low-risk companies appear to be the likely beneficiaries. Since the global financial crisis inception in 2007, Quality has outperformed the broader index for 11 of the last 15 years. This consistent performance, coupled with its attractive valuation, solidifies the case for a larger allocation to Quality stocks in investment portfolios.

At ECP, we recognize that these fundamentals of the economics of businesses drive long-term investment returns. We focus on high-quality, growing companies capable of generating predictable, superior economic returns. Sustainability is integral to our investment philosophy, as we view ourselves as business owners rather than mere share traders, prioritising sustainability and competitiveness in our investment analyses.

In these uncertain times, investors must anticipate and prepare for unpredictable changes, including black swan events, by structuring equity portfolios that are resilient to such disruptions. Aligning portfolios with quality characteristics offers a robust defence against inflation and other macroeconomic challenges.

Looking ahead, with rising inflation and significant policy decisions on the horizon, focusing on quality is crucial for achieving growth, managing leverage effectively, and ensuring exceptional profitability. Quality stands out as a beacon for outperformance.

Jason Pohl
Head ESG Officer

About This Report

In this report, we delve into the environmental, social, and governance (ESG) aspects relevant to both our firm's operations and investment portfolios. This commitment extends not only to the companies we invest in but also to our identity as ECP.

At ECP, we know ESG factors affect performance. To protect our clients' capital, therefore, we've always insisted on understanding ESG holistically to gauge investment potential. We also hold our own operations to these standards.

Recent events have served as catalysts for positive transformations, while also spotlighting areas where collective efforts are needed to address global challenges and fulfil our responsibilities as stewards of our clients' investments.

As an active manager, we continuously evolve our processes while staying true to our core values and purpose. Through our ESG program, ECP actively engages in initiatives that drive positive change. We have been signatories to the Principles of Responsible Investment (PRI) since 2017, and engaged with the Responsible Investment Association Australasia (RIAA) in 2022.

Our commitment to responsible investing was reaffirmed in 2023 when we were honoured as a Responsible Investment Leader for the second year in a row, joining a distinguished cohort of asset owners and managers. We remain steadfast in our support of the UN Sustainable Development Goals (SDGs) and compliance with the United Global Compact.

In terms of our engagement, we seek to understand and influence corporate behaviour where appropriate, fostering improved investment outcomes. Given the economic, trade, and environmental disruptions witnessed this year, macro-environmental factors (PESTLE) and Dynamic Capabilities have garnered significant attention in our engagement.

Our engagement activities, along with proxy voting, serve as mechanisms to voice our perspectives to the companies we invest in, facilitating constructive dialogue and alignment of interests. We expect in the coming year that we will continue to develop our engagement frameworks, with more targeted and portfolio-wide engagement on core issues.

When investing, we prioritise sustainability and strong governance in our portfolio construction, favouring businesses with low carbon intensity. As a committed supporter of the Task Force on Climate-related Financial Disclosures (TCFD), we adhere to its climate reporting guidelines, which include disclosing our carbon emissions, reducing our carbon footprint, and identifying climate-related risks and opportunities.

We are acutely aware of our operations' environmental impact and the significant risks climate change poses to the economy, financial markets, and our community. Our approach focuses on reducing our emissions and compensating for residual emissions through projects that reduce or avoid carbon and provide community benefits.

Notably, we have completed our Climate Active certification—a partnership with the Australian Government to encourage voluntary climate action. Expected by the end of the year, this certification recognizes businesses that achieve carbon neutrality by measuring, reducing, and offsetting emissions, underscoring our leadership and commitment to sustainable practices.

Furthermore, in line with our commitment to our community, ECP and associated entities, including the Pohl Foundation, have continued our tradition of charitable contributions. During FY23, we supported various initiatives such as the Art Gallery of New South Wales, Bond University, and A Sound Life, while also organising our 4th Annual Ambrose charity golf day in aid of the Taronga Conservation Society of Australia, raising A$50k.

As we remain committed to delivering sustainable practices as our firm, our investment process remains geared towards identifying high-quality, growing franchises that deliver resilient performance through time. Many of the initiatives mentioned above have been years in the making, underscoring our enduring dedication to advancing sustainable practices. The following sections provide an overview of our past efforts and outline our aspirations for the future.

Who Is ECP?

04

Introduction

Our Business

ECP Asset Management (ECP) is a boutique equities fund management firm that oversees more than A$2 billion in assets for institutional, retail, and high-net-worth clients. Our firm is dedicated to Redefining Active Investing with the goal of maximising long-term client wealth.

Our investment philosophy centres on the principle that the economics of business drive long-term investment returns. Our philosophy guides everything we do.

We're relentlessly transparent, honest about our capacity and vigilant in applying our process. We do this because there's simply no other way we can deliver on our promises. For us, every aspect of our process and philosophy is geared towards long-term growth. In both how we conduct ourselves and how we invest, we firmly believe that it is better to sleep well, rather than eat well.

The report outlines our commitment to leading with best practices and maintaining our status as thought and market leaders in the industry. The only way to grow wealth that is resilient and sustainable, is to invest money in a careful, considered and committed way.

Redefining Active Investing

Our Core Values

Beliefs and process are first and foremost

Our beliefs and our process guide everything we do. Internally, this manifests in an idea meritocracy, where every person has the capacity to suggest, research and reject an idea.

Sleeping well before eating well

We are a highly ethical team, committed to good investing. We're relentlessly transparent, honest about our capacity and vigilant in applying our process. We do this because there's simply no other way we can deliver on our promises. ECP is committed to Responsible Investment and is a signatory to the UN-backed PRI.

Mutual respect and recognition

We encourage and promote a culture of respect and support for all members of our team where their new ideas, different perspectives and skills are respected and recognised.

A genuine long-term approach

We believe in nurturing strong relationships in every part of our business – with our customers, between colleagues and with our portfolio organisations – because, in order to deliver sustainable growth, we need to think long-term.

Diverse ways of thinking

To create our high-performing portfolio we need to be capable of thinking methodically and discerningly, but also broadly and openly.

Demystifying active investing

It's so important to us that all our customers understand why we make the investment decisions we do, that we see another essential role for us, as an educator. We want to show everyone the how's, why's and where's of active investing, in the simplest, most digestible way possible.

Being a Responsible Money Manager

Our Philosophy

At ECP, we believe it's important to understand both the narrative of an investment and the numbers that support it.

Investing in narrative alone ignores reality. Investing on numbers alone ignores potential. We tie the two together, so we can best capture long-term potential while ensuring that we do not overpay for the value we see.

Valuing potential, not just performance

We invest in companies in the growth stage of their life cycle and therefore need to balance their narratives and their numbers. This balance informs our investment hypothesis.

Choosing high-quality growing businesses

Markets are notorious for undervaluing high-growth businesses because they cannot see their potential. High-quality growing businesses tend to find new ways to grow. Finding these businesses and backing management to deliver allows us to capture some of that potential through time.

Ignoring temporary market turbulence

Markets are also notorious for overreacting to temporary themes. Our long-term approach means we see turbulence as a normal part of the market which means we can capitalise on this market feature.

Our Promises

At ECP, the consistency of our offering is most important, and we are focused on delivering on our three key promises at all times.

Sustainable Performance

We deliver, quite simply, the best quality growth in the business. It is truly sustainable and truly resilient and has been proven again and again.

Ethics

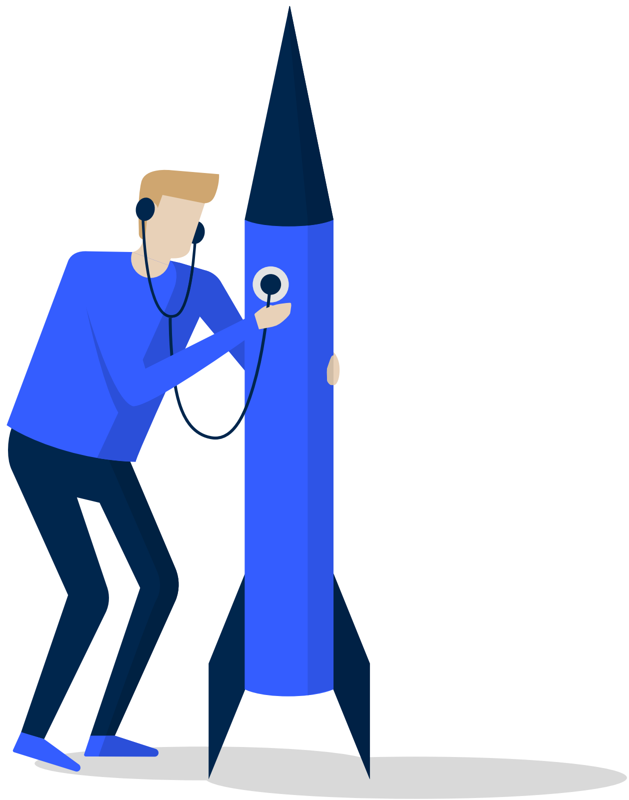
We'll not only make you feel you're in good hands but in safe hands too since we're a highly ethical, transparent and honest manager.

Empowerment

We want to make sure you understand how true active investing works and why it's the safest way to invest your money.

To this end, being a responsible investor requires a number of commitments which we outline in our Responsible Investment Policy, our ESG and Sustainability Policy and our Board Engagement Guide. Moreover, we highlight our commitments to our planet through our Climate Change Position Statement and have recently published our Task Force on Climate-related Disclosures Annual Report.

"At ECP, we believe it's important to understand both the narrative of an investment and the numbers that support it."



Year in Review

05

Scorecard

To maintain consistency in our reporting the following allows for comparability with data from previous years. In FY23, we have updated our metrics to align with key areas of focus for our business, being engagement monitoring, Net Zero ambitions, diversity targets, as well as underlying portfolio company objectives. While we provide a summary of our progress here, comprehensive details are available throughout this report.

Our Firm	FY22	FY23
5 Yr Growth Companies Fund Performance Above Benchmark	+4.1%	+3.3%
5 Yr Emerging Companies Fund Performance Above Benchmark	+8.6%	+10.3%
Diversity - Investments (Male/Female)	100%	78+22%
Diversity - Distribution (Male/Female)	50-50%	50-50%
Diversity - Back Office & Support (Male/Female)	20-80%	20-80%
Diversity - Group	64-36%	54-44%
Diversity - Non-Executive Directors (Male/Female)	16%	37%

Our Net Zero Ambitions	FY22	FY23
Portfolio Carbon Intensity (Growth Companies Fund) compared to benchmark	-52.8%	-32.1%
Portfolio Carbon Intensity (Emerging Companies Fund) compared to benchmark	-97.7%	-96.3%
ECP Operational Emissions (Scope 1 + 2)	26.6*	8.9
ECP Operational Emissions (Scope 1 + 2 + 3)	93.1*	220.5
Offsetting Operational Emissions (Carbon Offsets)	0%	0%

* Calendar Year

Our Companies	FY22	FY23
Modern Slavery Policy		84%
TCFD Compliant	–	35%
Disclose Scope 1 + 2 Emissions	–	68%
Disclose Scope 3 Emissions	–	63%
Responsible Sourcing Policy	–	71%
ESG-Linked to remuneration	–	52%
Executive Diversity - Women >30%	–	71%

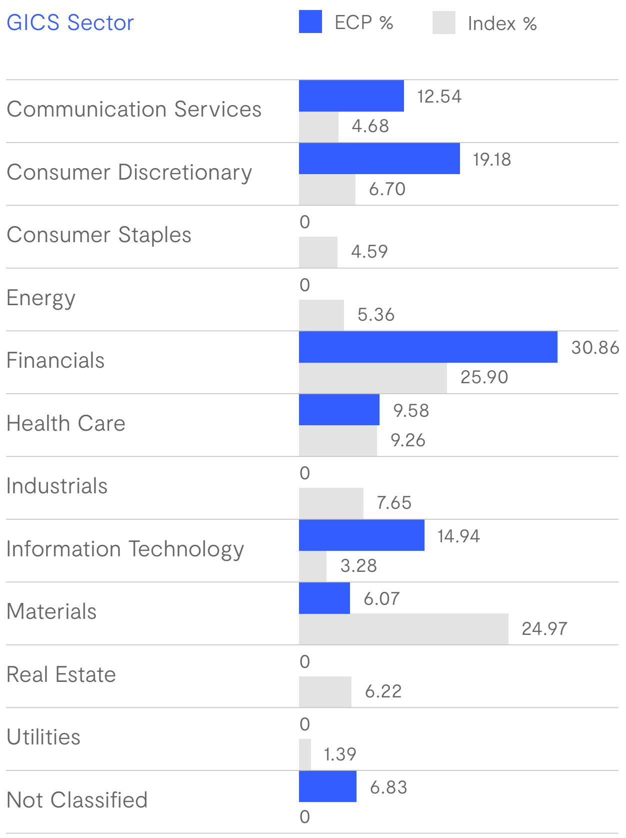
Our Stewardship	FY22	FY23
Total Engagements (investments and other entities)	375	380
Sustainability Engagements (investments and other entities)	303	340
Divestments based on Sustainability or Stewardship	–	1
Votes Cast For	95.5%	97.3%
Votes Cast Against	4.5%	2.7%

Our Community	FY22	FY23
ECP-hosted Active Community Events	1	2
Community organisations supported	4	3

Where We Invest

Our investment strategy is markedly distinct from conventional funds, primarily due to our emphasis on sectors that not only champion sustainable and ethical practices but also advance innovation and efficiency. Consequently, our portfolio predominantly features investments in sectors like Education, Healthcare, and Technology. This strategic allocation starkly contrasts with our minimal presence in sectors such as Materials, Energy, and Consumer Staples, setting our holdings apart from typical index portfolios. Our benchmark unaware approach also typically results in high active share and tracking error relative to the benchmark, a reflection of us investing only where we have the highest conviction.

In the Energy sector, we employ exclusion-based screening to restrict our investments, especially in fossil fuel companies, which make up a significant part of this sector. This deliberate approach aims to reduce our exposure to industries associated with high environmental impacts. Additionally, within the Materials sector, our involvement is notably limited, primarily focusing on areas that do not involve the extraction of non-renewable resources. We maintain a singular investment in the mining sector with Rio Tinto, a company we regard as a pivotal player in the global transition due to their industry leadership and strong commitment to sustainability.



The Top Down

Looking Back

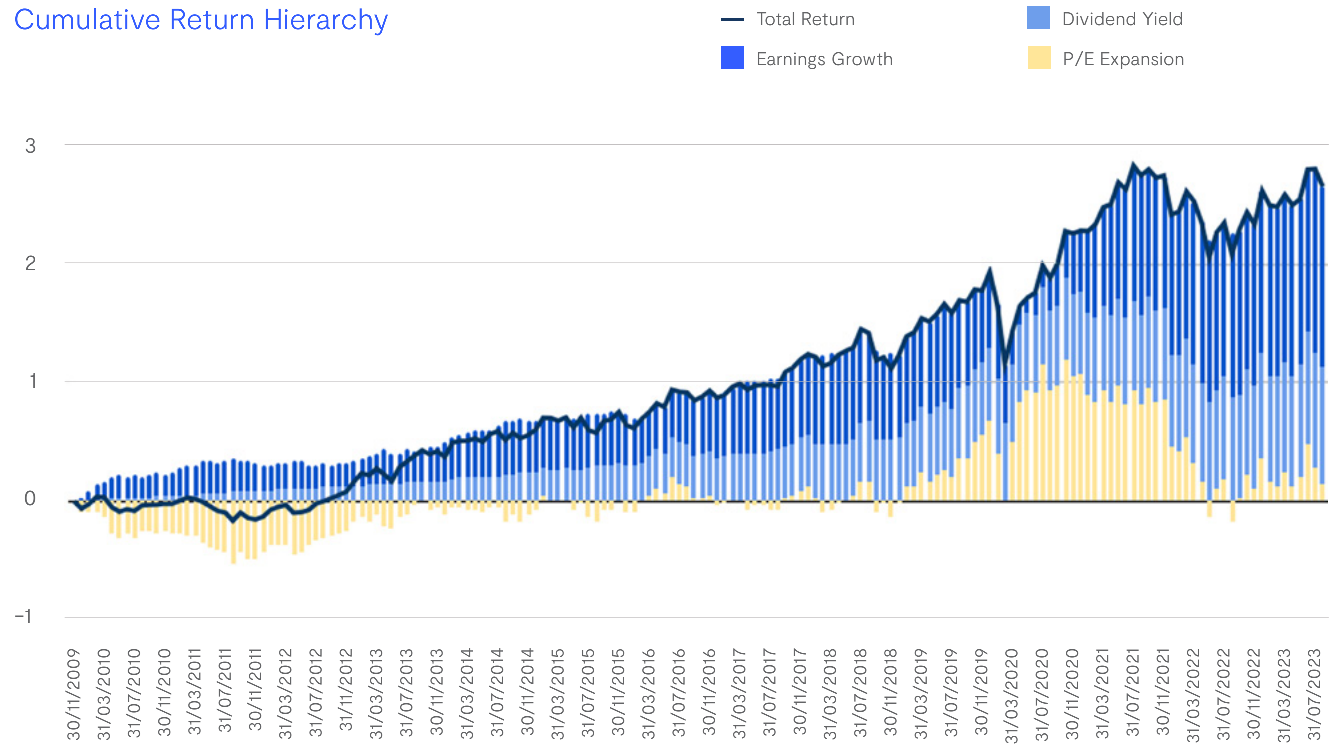
Despite a number of news items, FY23 has been a much more stable year than the prior year, especially for growth investors. The world has moved on from the pandemic, but following on from that Governments and Central Banks have had to deal with a number of challenges, economically and politically.

Inflation emerged as a major concern during FY23. A number of factors, including supply chain bottlenecks, strong consumer demand, and loose monetary policies, led to an increase in inflation in many countries. To combat inflation, central banks around the world began raising interest rates in FY23. This more hawkish central bank behaviour has tightened credit conditions significantly and has started to slow down economic activity.

While it seems the US has done a pretty good job of reigning in the inflationary pressures, Australia has not been able to attack inflation as effectively. The 5Y5Y inflation swaps suggest US inflation will settle at around 2.5%, which has been relatively stable over the past twelve months. In Australia however, this has gapped up significantly moving from around 2% at the end of FY22 closing at around 2.8% in FY23.

The main drivers of inflation have differed between the two countries. In the US, the primary driver was demand-pull inflation which was fueled by strong consumer spending and government stimulus. In Australia, however, the main driver has been cost-push inflation, due to factors like rising energy prices and a reducing productivity and a tight labour market in the economy. Despite a very clear transmission mechanism in Australia, Monetary policy is more effective at combating demand-pull inflation than cost-push inflation, which explains why it has had a more muted effect in Australia.

Cumulative Return Hierarchy



The aforementioned macroeconomic variables have impacted the valuation of companies we were invested in, primarily in the first six months of the year. You can see in the above figure, that the yellow bars - which account for the valuation contribution to total returns - have almost completely reduced back to where they were in late 2019.

While we were affected by the multiple compression which occurred as rates increased, the quality of the businesses we own meant that these companies have continued to deliver operationally. The earnings power of these businesses have carried them through the drawdown that has occurred - as shown by the blue bars in the above figure - and should continue to drive performance into the foreseeable future. Any reduction in interest rates to stimulate the economy will provide the portfolio with a tailwind on valuation as multiples should expand accordingly in that environment.

The shift of central banks away from supporting economic growth to controlling inflation has made growth all the more scarce. Now that things have settled down, and macroeconomic variables seem to be more stable, the market will start to distinguish between businesses which are higher quality and have a higher potential for growth than those that don't.

Themes Impacting Investments

Aside from the geopolitical issues caused by the ongoing Russia Ukraine war, and the recent Israel Hamas conflict, the two major themes that have had ongoing structural impacts on our investments during FY23 are the rise of AI/Large Language Models, and GLP-1s.

Artificial Intelligence

Artificial Intelligence has been around for a while. OpenAI released ChatGPT this year and it showcased how disruptive this technology could be for nearly every industry globally. This set off an AI arms race, with all the major players in the tech world releasing their versions of ChatGPT this year. While it is still early days with respect to the technology, what is clear is that it will touch nearly all the aspects of an organisation's operations.

Early use cases have included customer service chatbots and co-pilot productivity tools. Models that leverage corporate data to drive insights and strategic decisions will probably take longer to come through given corporate inertia and risk aversion, particularly with respect to privacy and data concerns - imagine a client service chat bot surfacing internal company memo by accident! While AI offers tremendous benefits, it's crucial to address ethical concerns and ensure responsible development and deployment.

AI is undoubtedly the defining technology of our time, and its impact on companies is only going to accelerate in the years to come. By embracing AI and harnessing its power responsibly, companies can unlock significant competitive advantages and drive sustainable growth in the ever-evolving marketplace. Our current position is that those companies with dominant market positions and more data on their customers are much better positioned than their competitors to capitalise on these technologies, which should widen the gap between them and their competitors.

GLP-1s

GLP-1 agonists are a class of medications that mimic the actions of GLP-1's. Glucagon-like peptide-1 (GLP-1) is a naturally occurring hormone produced in the gut in response to food intake. It plays a crucial role in regulating blood sugar levels by stimulating insulin secretion, slowing down stomach emptying, and reducing appetite. These drugs have been shown to effectively lower blood sugar levels, promote weight loss, and improve overall glycemic control in patients with type 2 diabetes. Additionally, GLP-1 agonists have also been linked to cardiovascular benefits, reduced risk of kidney disease, and improved cognitive function.

Primarily GLP-1s have had an impact on the medical device companies in our portfolio like Resmed and Fisher & Paykel. The sell off in the names was as a result of benefits of weight loss on sleep apnoea, which has a high correlation with obesity. Initially there was quite a debate about what the impact would have been on our portfolios. All the work that we did on the subject suggested that the market has over capitalised the impacts of the drug on the sleep apnoea market.

Essentially, the core issues that need to be addressed for investors with respect to GLP-1s are the following:

1) The benefits to OSA patients that take GLP-1s - its is still not clear whether the taking of GLP-1s will reduce OSA or reduce the need for CPAP therapy;
2) The longer-term funding proposition - who is going to pay for these drugs? They are currently expensive in the US and are only approved for use with certain medical conditions;
3) The side-effects of taking GLP-1s over a long period of time. Short-term side effects have been well publicised but it is still too early to know what the long-term side effects might be. This will be something that needs to be monitored.
4) The rate of growth in obesity cannot be underestimated and the longer-term impacts this will have on many areas of the health system are unknown. While GLP-1s might assist with OSA, obesity itself is growing at a very fast rate and at a rate that surpasses OSA diagnosis and treatment.

While different, AI and GLP-1s are both similar in the structural changes that they are bringing to the markets that they touch. No company is immune to these effects, it's how they respond to them that matters - we refer to this as a company's Dynamic Capabilities. How easily they adapt to the changing environment around them. Another term for this is antifragile, or resilience.

Enduring Through Change

2023 has been a year of identifying investments that provide for stability and adaptation, moving past the pandemic while facing new economic challenges like inflation. Central banks globally responded with higher interest rates to manage economic overheating, impacting market valuations and economic activities. Despite these challenges, the quality of our investments allowed for continued operational success, with potential rate reductions poised to further bolster our portfolio's valuation.

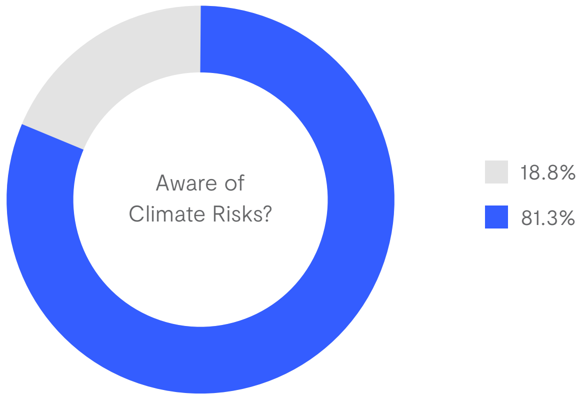
Emerging thematics have brought both opportunities and challenges. AI promises to reshape industries but requires careful consideration of ethical and privacy concerns. Similarly, the medical implications and economic impacts of GLP-1s continue to stir debates within the healthcare sector. For us, we remain steadfast in assessing the economics of each business model, to ensure that these exceptional franchises appropriately manage these transformations, remaining resilient and adaptable to the rapidly evolving market landscape.

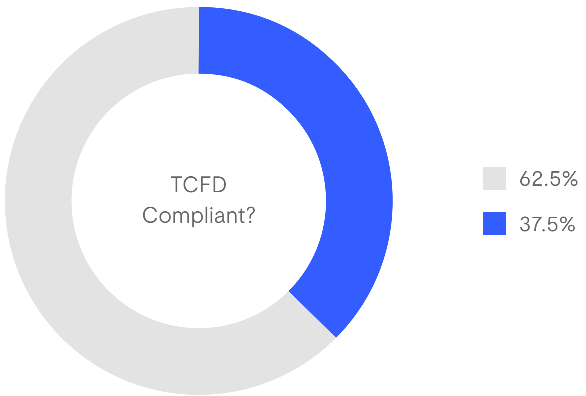
The Bottom Up

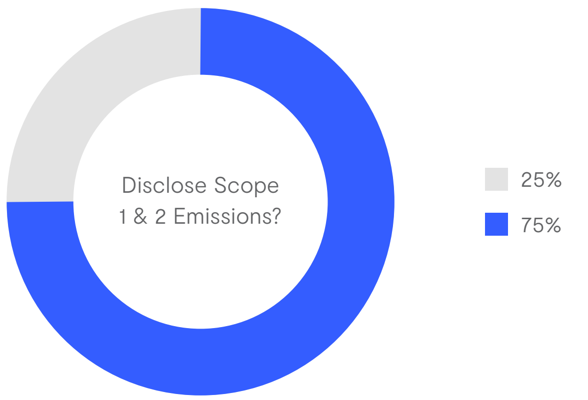
Engagement Insights

In FY23, over 90% of our portfolio companies embraced responsible sourcing policies or supplier codes of conduct, with more than 80% conducting or engaging in climate risk assessments. Despite ongoing labour market changes and significant organisational transformations, nearly all companies reported minimal social issues, reflecting their strong commitment to ethical practices and environmental responsibility.

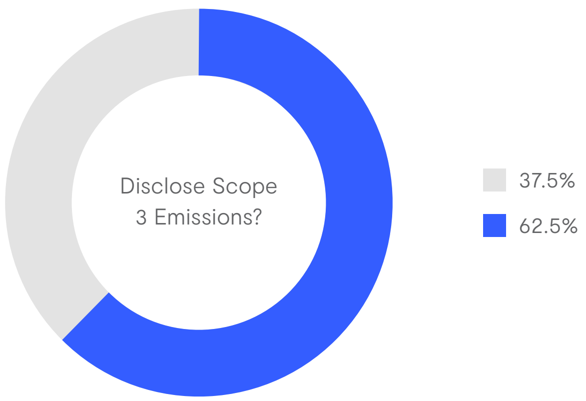
In terms of emissions reporting, 75% of our portfolio companies disclose their scope 1 and 2 emissions, while over 60% report on scope 3 emissions. Currently, nearly 40% of our portfolio complies with TCFD requirements, a figure we anticipate will increase as these companies transition from smaller entities to larger organisations in the coming years.







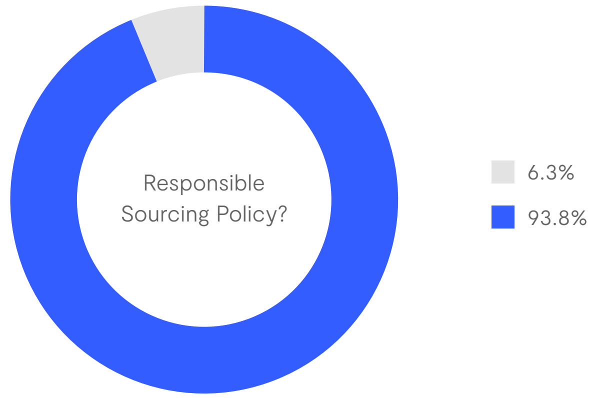
> "Over 90% of our portfolio companies embraced responsible sourcing policies or supplier codes of conduct."

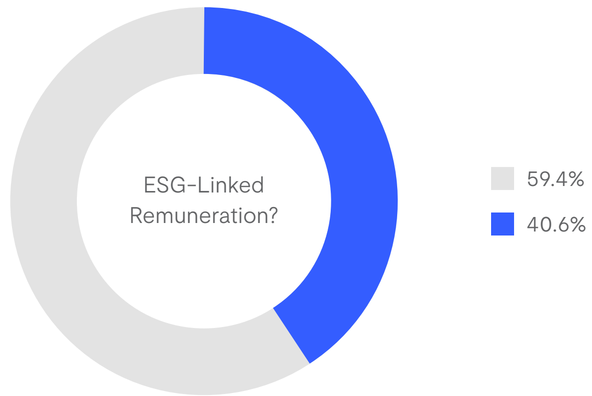


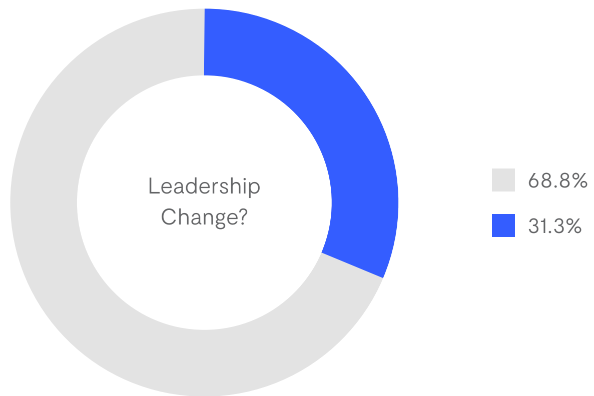
In terms of governance, a stable leadership structure marks our portfolio, with only a third experiencing leadership changes this year. Such changes can significantly impact business strategy and continuity, yet the evolving governance practices in our portfolio — including 40% of companies linking ESG considerations to executive compensation — demonstrate a commitment to sustainable leadership principles that can bolster long-term investment returns.

On key ESG issues, particularly modern slavery and cybersecurity, our portfolio shows strong compliance and improvement. Nearly all companies have a responsible sourcing policy, reflecting year-on-year progress, and all are managing cybersecurity risks effectively. This commitment not only secures operations but also enhances the long-term sustainability and ethical integrity of our investments, contributing to stable and potentially increasing returns.

> "A stable leadership structure marks our portfolio, with only a third experiencing leadership changes this year."





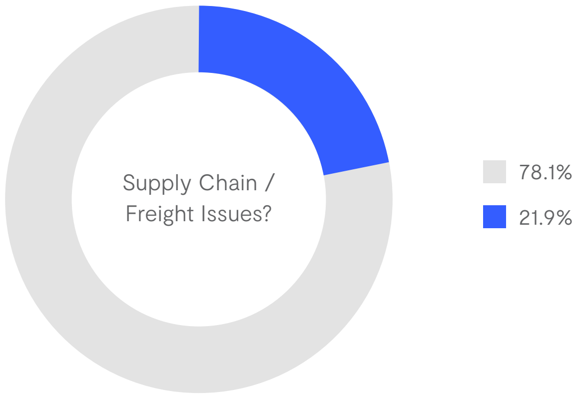


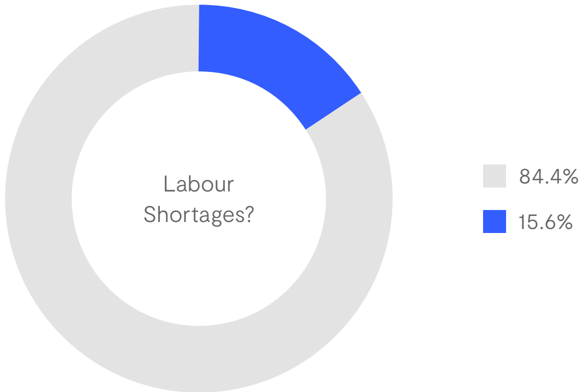
The Bottom Up

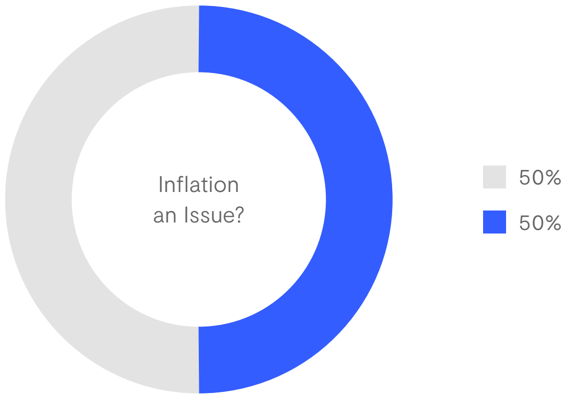
Over the past year, we've seen promising signs that macroeconomic pressures on our portfolio are easing, particularly in supply chain disruptions, which have significantly decreased from their 2022 peak. In 2023, supply chain issues impacted only about 20% of companies, a decline from 35% the previous year. Similarly, labour shortages now affect only 15% of our portfolio, down from 30%. This improvement in operational challenges supports the long-term stability and growth potential of our investments.

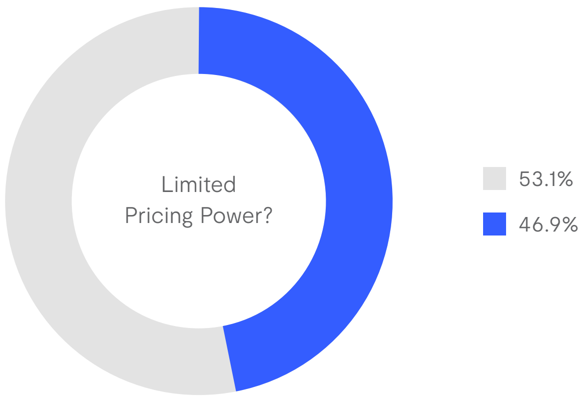
However, inflationary pressures remain a concern for half of our portfolio companies, prompting them to implement strategic pricing adjustments. Despite these efforts, nearly half of these companies are approaching the limits of their pricing power, highlighting a critical need for continued innovation and the development of new value propositions to remain competitive and sustain long-term investment returns amidst economic fluctuations.

"We've seen promising signs that macroeconomic pressures on our portfolio are easing."





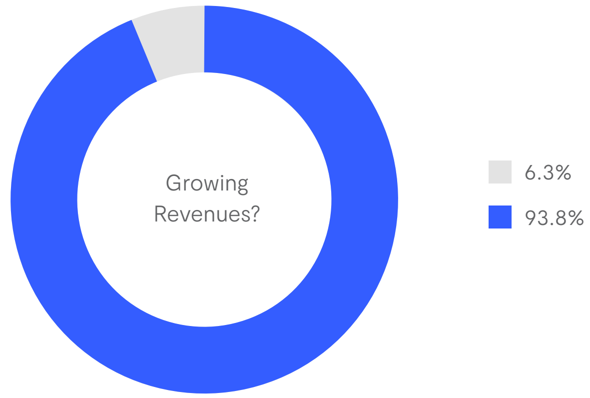


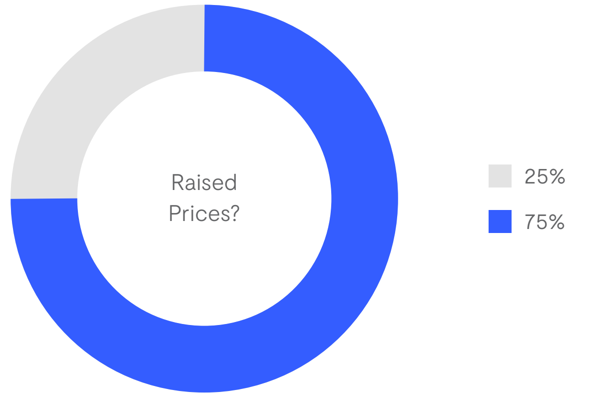


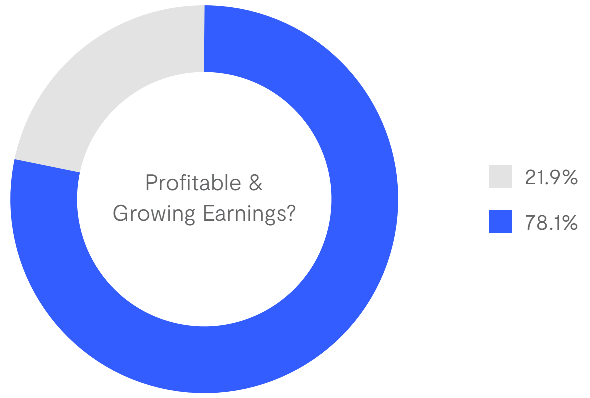
Despite challenging economic conditions, nearly all of our companies have successfully grown their revenues over the past year. Three-quarters of these companies benefit from a recurring revenue model, which bolsters their financial stability. Remarkably, only one company in our portfolio did not see revenue growth from the previous year, following an exceptional period of performance. This is considered a highly positive result within the current macroeconomic environment.

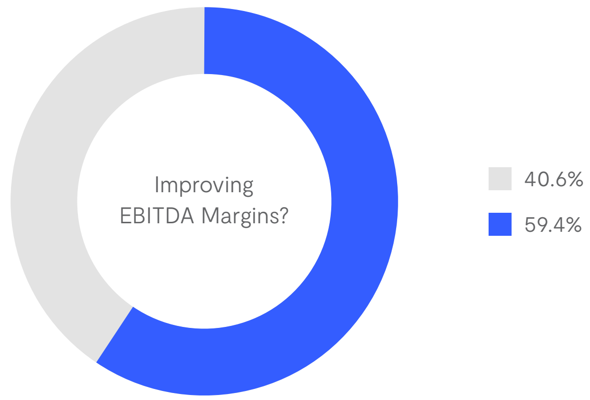
Financial management across our portfolio has also been proactive; 75% of companies raised their prices last year, with nearly 80% reporting profitability and earnings growth in FY23. This robust performance highlights our portfolio companies' adaptability and strength, with many improving their EBITDA margins by leveraging market-leading positions and superior pricing power, alongside broad efficiency improvements. However, while a majority have posted improved EBITDA margins, it's notable that the number of companies achieving operational leverage has declined from 2022, pointing to evolving challenges in sustaining growth margins.

"Despite challenging economic conditions, nearly all of our companies have successfully grown their revenues."





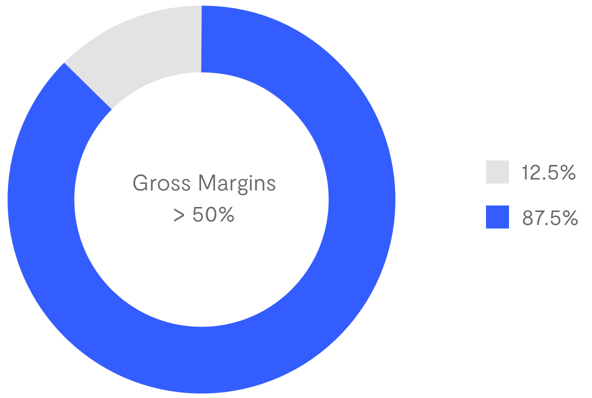


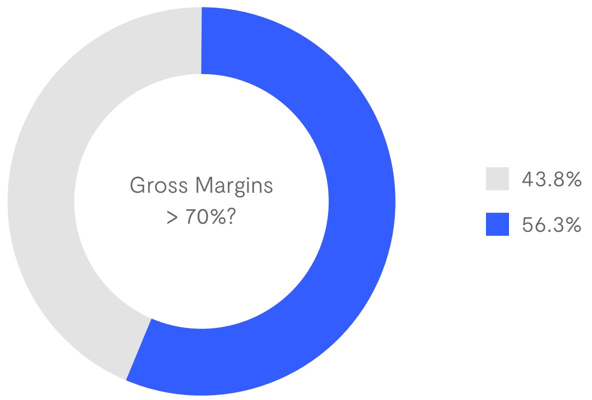


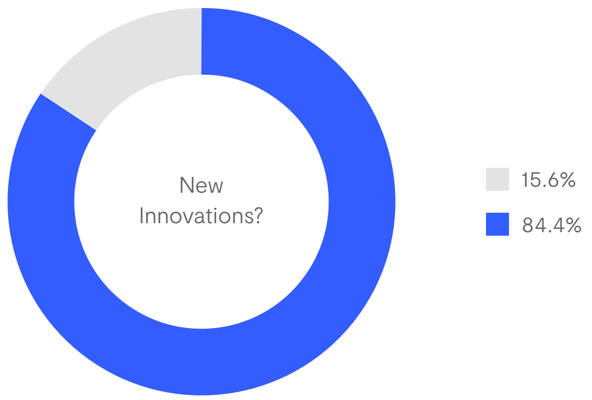
The Bottom Up

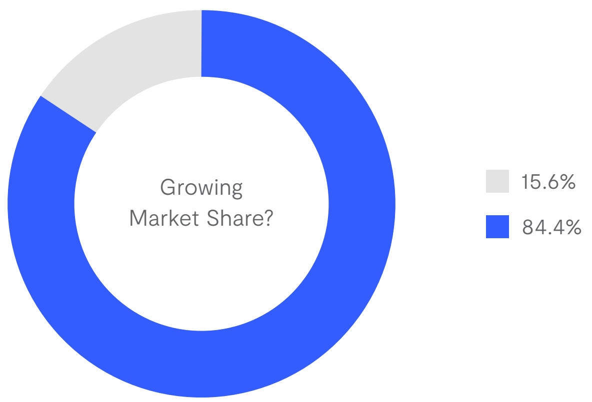
Quality franchises stand out due to their superior business models and attractive unit economics. Approximately 90% of our portfolio boasts gross margins over 50%, with the majority exceeding 70%. This strong financial footing allows them to address industry challenges and capitalise on growth opportunities while maintaining competitive advantages. High gross margins provide a buffer against external pressures, enabling businesses to absorb cost fluctuations. Moreover, it supports reinvestment in innovation, marketing, and operational expansion, essential for sustainable growth.

Price adjustments are a common strategy during challenging times, yet it is evident that many companies have reached the peak of their pricing power without offering additional value to their customers. This year, approximately half of our companies reported limited pricing power with their traditional products. Nevertheless, most companies have capitalised on their dynamic capabilities, with 84% expanding their market share and introducing innovative solutions.







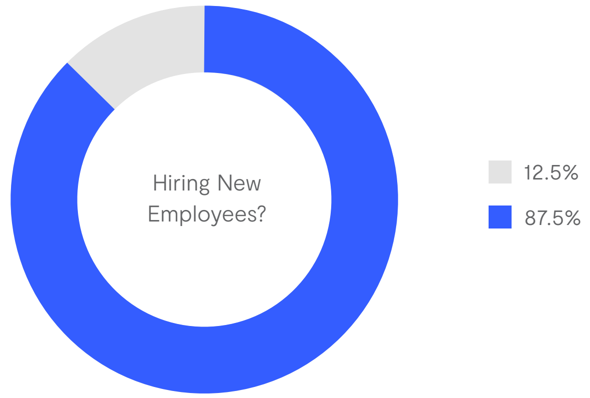


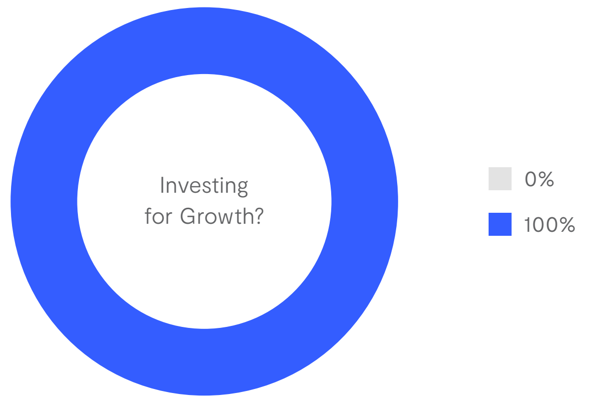
"Quality franchises stand out due to their superior business models and attractive unit economics."

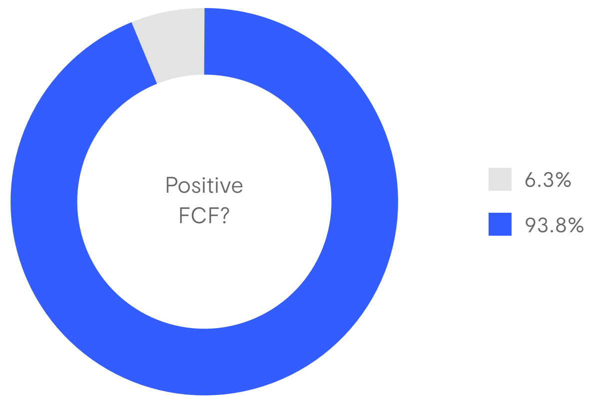
Resilient companies in our portfolio consistently invest in growth and innovation, adapting dynamically under stress. This year, all portfolio companies have committed to growth investments, a notable improvement from last year. Nearly 90% are expanding their workforce to enhance competitive positions and all are providing career development programs. However, some are strategically reducing workforce segments to optimise operations while investing in areas like international expansion. This approach focuses on retaining and leveraging top talent and streamlining business models for better efficiency and productivity.

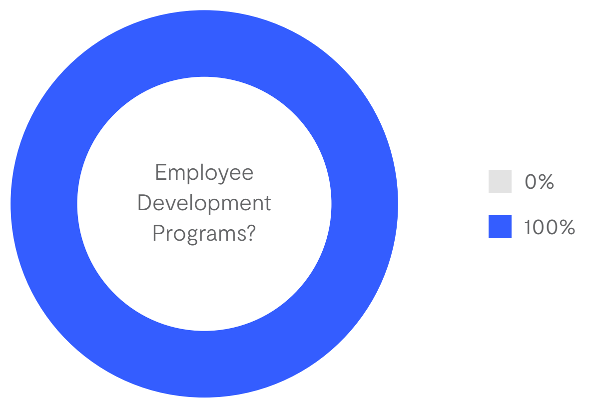
In the current environment, high gross margins and positive Free Cash Flow (FCF) are crucial. High margins mitigate cost increases and enhance reinvestment capacity, while strong FCF reduces reliance on external financing, beneficial during periods of rising borrowing costs and inflation. Few portfolio companies raised equity, as the vast majority have generated sufficient free cash flows to support their expansion, demonstrating our portfolio's robust financials and resilience in being able to invest in growth and efficiency.

"Resilient companies in our portfolio consistently invest in growth and innovation, adapting dynamically under stress."









Responsible Investment (RI)

RI Leader

This year, ECP was announced by the Responsible Investment Association Australasia (RIAA) as a Responsible Investment Leader for 2023, marking the second consecutive year we have received this distinction.

Responsible Investment Leaders are distinguished by their commitment to responsible investing, which includes the explicit consideration of ESG factors in investment decision-making, robust and collaborative stewardship, and transparency in reporting activities, particularly regarding the societal and environmental outcomes achieved.

Over the past few years, we have continually evolved our processes to better fulfil our commitments to our clients. To this end, in 2023, we achieved certification for our firm and our investment products through the Responsible Investment Association Australasia (RIAA). This certification affirms that our products are high-quality, true-to-label, and meet the Australian and New Zealand standards for responsible investing.

What Is RI?

Responsible investment is an approach to investment that explicitly acknowledges the relevance to the investor of environmental, social and governance factors, and of the long-term health and stability of the investment as a whole.

The PRI defines responsible investment as a strategy and practice to incorporate environmental, social and governance (ESG) factors in investment decisions and active ownership.

ECP became a signatory to the United Nations-backed Principles for Responsible Investment Initiative (PRI) in 2016. The principles for responsible investment provide guidance on how we can integrate the consideration of ESG factors into our investment decision-making and ownership practices.

Typically, our portfolio companies have organic growth with predictable earnings driven by a sustainable competitive advantage. These businesses have sustainable business operations with strong ESG credentials, resulting in a low carbon footprint. We find that these businesses deliver high returns on invested capital aided by a strong financial position and an experienced management team.

ESG issues are highly relevant to a better understanding of the long-term potential of an investment and its predictability of returns over time. Incorporating sustainability into one's decision-making will ultimately lead to superior investment returns. At ECP, ESG is wholly integrated into our investment process and is a defining characteristic of any Quality Franchise.

How Does ECP Apply RI?

At ECP, we know environmental, social, and corporate governance factors (ESG) affect performance. To protect our client's capital, therefore, we've always insisted on understanding ESG holistically to gauge investment potential.

The integration of ESG issues into our decision-making is an increasingly standard part of the regulatory and legal requirements for institutional investors, along with requirements to consider the sustainability-related preferences of their clients and beneficiaries and to report on how these obligations have been implemented.

Fiduciary duties (or equivalent obligations) exist to ensure that we act in the interests of beneficiaries, rather than serving our own interests. We will strive to act honestly and in good faith in the interests of our clients and to understand and incorporate ESG and sustainability assessments into our decision-making.

As a fund manager, ECP has a fiduciary duty to our clients to ensure that we adequately consider and assess any company-related risks. Since ESG is fundamental to our investment thesis, these issues are subject to intense scrutiny in our assessment of any investment opportunities - these are completed through our Sustainability Pillar within our research framework.

In our view accounting for ESG risks and opportunities can lead to more informed investment decisions. A company we assess as being investment-grade, a 'Quality Franchise', inherently requires a full assessment of these factors to ensure a sustainable business model that can generate predictable earnings growth over time.

To consider ESG factors in our investment decisions and through our active asset management to maximise long-term outcomes for our clients.

ECP is committed to responsible investment. We do this to ensure we meet our investment objectives for our clients.

Investment Objective

Our investment objective is to generate returns 2-4% p.a. above the benchmark over a rolling five year period.

Fundamental Analysis

We invest in Quality Franchises. Our definition of quality requires a low level of macro-environmental issues, good ESG practices, and Dynamic Capabilities.

Exclusionary Screens

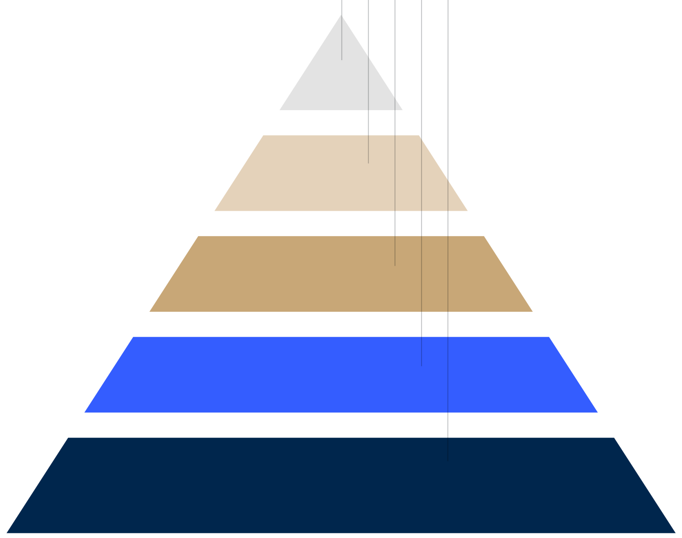
We exclude areas from our universe so that we can avoid risks to the predictability of future business performance.

Investment Universe

We consider all companies as investable, and through our investment process we whittle down this universe based on our definition of quality.

Investment Philosophy

Our investment philosophy is based on the belief "the economics of a business drives long-term investment returns."



Why Is RI related to ESG & Sustainability?

We apply negative screens to avoid the deterioration of system (business) performance. Our ESG-related exclusions aim to avoid the destruction or degradation of business performance, whether due to organisational, social, or environmental factors.

Our exclusionary principles

- To avoid risks that may present significant harm to our society and our environment.
- To avoid risks that may limit the industry growth outlook of our investments.
- To avoid ESG-related risks that may impact the predictability of investment performance.

Where we seek to exclude sectors, we have a 0% threshold allowance. The scope is based on their direct involvement in the production, manufacture or service of products in these sectors. We exclude the following due to ESG-related issues:

Environmental

- × Thermal Coal
- × Petroleum
- × Logging
- × Palm Oil
- × Pesticides

Social

- × Gambling
- × Adult entertainment
- × Weapons
- × Tobacco

Environmental

- × Systemic poor governance
- × Human rights violations

As responsible investors, we seek to understand ESG and Sustainability holistically to gauge investment potential.

We invest in companies that have...

- ✓ A low exposure to negative macro-environment factors that impact business operations.
- ✓ A low exposure to ESG risks that cannot be managed or mitigated by the company.
- ✓ Demonstrated Dynamic Capabilities that sustainably renew its competitive advantage through time.
- ✓ Trustworthy management that is capable, competent, and experienced to deliver their strategy.

We do this so that we have...

- → Confidence in the predictability of future business performance.
- → Certainty that the business is acting appropriately for all stakeholders.
- → Evidence that the business is resilient and that its competitive advantage will drive business expansion.
- → Conviction that the management team will execute their business strategy as defined.

ESG & Sustainability

07

ESG Considerations in Investing

Why Worry about ESG?

For investors, the purpose of ESG is to incorporate non-financial measures into the decision-making process and reduce or remove long-dated investment risks. By understanding a company's ESG activities, investors can better account for these non-financial aspects of performance.

When investing, the assessment of ESG considerations creates value in a number of ways, including top-line growth, cost reductions, reduced regulatory and legal intervention, employee productivity uplift, asset or investment optimisation, or brand leadership.

Typically, ESG analysis explores:

Environment (E):
How the business interacts with the natural environment, the impacts of its operations, and the actions the company takes to mitigate negative effects.

Social (S):
How an organisation's activities affect people — from its own workforce to customers, local communities and those who work in its extended supply chain.

Governance (G):
The decision-making process and the distribution of rights and responsibilities. Here investors review the policies, structures and procedures by which an organisation is run.

However, distinguishing between transient business challenges and deep-rooted ESG issues that could affect a company long-term is crucial. In today's world, characterised by volatility and rapid change — exemplified by technological advances, global pandemics, and geopolitical conflicts — this skill is more vital than ever.

While valuable, ESG analysis does have limitations. For example, standard environmental assessments like carbon footprint evaluations might overlook potential vulnerabilities to climate disasters or supply chain disruptions. Similarly, social evaluations might miss broader workforce issues exposed during crises or significant cultural shifts, such as the transition to electric vehicles.

News media play a pivotal role in the ESG space, bringing to light a number of ESG-related issues, particularly when stakeholders experience substantial losses or experience hardship through breaches of corporate governance. However, while ESG analysis is often framed as moral values versus economic value, investments motivated purely by moral values may overlook companies that are helping to drive broader societal change

As societal expectations rise, companies face increasing scrutiny over their practices, such as environmental negligence leading to product boycotts or poor labour relations causing strikes. Striking the right balance between moral commitment and economic rationale can lead to long-term wealth maximisation and peace of mind, ensuring that investments yield sustainable returns.

ESG Considerations in Investing

No Defined Rules

There are no hard and fast rules when dealing with ESG issues. Exclusion or divestment based on ESG grounds when your investment philosophy and corporate values align is sound investment practice. However, when imposing ethical values that are not in alignment with one's investment philosophy, short-termism may creep in.

We exclude a number of industries including (but not limited to) weapons, tobacco, and gambling. Our investment philosophy and corporate values steer us away from companies that have the potential to harm society, and moreover, help us avoid companies where there is a risk to the sustainability of their business operations.

Companies that act without any consideration for a broad range of stakeholders are met with severe consequences; however, in practice, it is rarely this simple. Issues of such magnitude need to be considered carefully and holistically.

When assessing investments, it is important not to single out one stakeholder as more important than another - this is a fine balancing act for any investor. Understanding ESG issues, whether historical or current, needs to be understood as interrelated and interdependent to the broader investment thesis.

Some companies that may have a chequered past cannot remain cancelled forever. Companies that engage and act to continue to improve their commitments to all stakeholders can be the types of quality companies that investors should praise.

Consider James Hardie Industries (ASX: JHX), which is a prime example of a company that fell foul to ESG issues (their ongoing asbestos liability). However, through time their commitment to engage and act on this issue has shown their commitment to all stakeholders while remaining a vital source of support through ongoing remediation.

ESG & Short-termism

It's crucial for investors to recognize that ESG principles and short-term investment strategies often conflict. Short-termism in financial markets tends to prioritise immediate gains and overlooks the creation of long-term value. ESG factors are key to understanding an investment's long-term potential and the predictability of its returns over time.

However, many investors mistakenly apply a short-term perspective to ESG, focusing on immediate ESG scores or recent events that might affect stock prices. Such a narrow view does not accurately reflect a company's overall sustainability credentials. Adopting a holistic approach to analysing a company's sustainability is essential. This includes evaluating its competitiveness and ability to adapt to unforeseen 'black swan' events, thereby ensuring resilience.

Global challenges such as pandemics, severe weather events, geopolitical tensions, and rapidly shifting fiscal policies exemplify macro-environmental shocks that test a company's adaptability. These events often spur innovation and strategic changes necessary for a company's survival.

Companies that effectively manage resources and adapt to disruptions are better positioned to sustain value creation. This resilience not only aids their survival but also enhances their long-term competitive edge.

For investors primarily focused on economic returns, integrating ESG into financial analysis and modelling is indispensable. As sustainability becomes a greater concern for consumers, ESG activities significantly influence a company's financial performance and, consequently, the returns of long-term investment portfolios.

Investors must ensure that their ESG integration goes beyond short-term market sentiments or superficial virtue signalling. By embedding comprehensive sustainability considerations into their decision-making, investors can achieve superior returns and contribute positively to long-term ESG outcomes.

What Are We Seeing?

Over the year, we have identified three pivotal ESG-related themes within our portfolio companies that highlight their commitment ESG and Sustainability.

1) First, there is a significant move towards environmental sustainability, with many companies adopting rigorous carbon management strategies and setting ambitious targets for achieving carbon neutrality.

2) Second, there is a growing focus on workplace diversity. Our companies are implementing progressive policies designed to enhance gender representation and foster inclusive practices across all levels of their organisations.

3) Lastly, in response to the ever-evolving landscape of digital threats, our companies are strengthening their cybersecurity frameworks to safeguard sensitive data and align with international compliance standards.

These themes not only reflect our portfolio companies' dedication to responsible business practices but also their proactive approach to addressing some of the most pressing challenges in today's corporate world.

Sustainability Materiality Risk Assessment

ECP remains steadfast in our dedication to responsible investment principles, continuously identifying and prioritising the most significant ESG issues in alignment with our investment philosophy. At ECP, we prioritise sustainability-related issues that are most material to the financial and operational performance of both our investments and our own operations. Recognising that our material issues generally remain consistent, we perform a detailed materiality assessment every three years.

As part of our Materiality Review Process, the following framework had been applied:

— Identification: We assessed a variety of topics crucial to both our operations and stakeholder interests, focusing on those most relevant to the modern business environment.

— Prioritisation: Key topics were ranked based on their potential to drive long-term investment performance, with our Chief Investment Officer (CIO) and Head ESG Officer, evaluating and finalising the core topics, risks and related actions.

— Validation and Disclosure: Topics were confirmed as essential elements of our ongoing assessment. The final materiality review was endorsed by our Board, solidifying its importance in our strategic planning.

The identified material topics are intricately linked to ECP's core operations and investment approaches, including portfolio management. These topics are set to shape our ESG efforts and guide our initiatives through 2024 and beyond, ensuring alignment with our broader strategic objectives and commitment to sustainability.

	Our Investments		Our Operations	
	Risk	Action	Risk	Action
Data, IP & Cyber Security Ensuring the integrity and security of data, intellectual property, and cyber infrastructure.	Exposure to cyber-attacks, data breaches, intellectual property theft, and regulatory penalties, leading to financial losses, reputational damage, and operational disruptions.	Ensuring robust cybersecurity policies and incident response strategies. Regular audit and compliance checks. Ensure transparency on cyber-related incidents. Ensure high standards relating to customer privacy. Ensure protecting IP assets (patent etc). Ensure portfolio construction takes into account data and IP related risks.	Cybersecurity failures can cause significant data losses, financial damage, and erosion of stakeholder trust.	Strengthening internal cybersecurity protocols. Conducting regular IT audits and provide ongoing staff training on data security.
Climate Change & Environmental Impacts Targeting the reduction of GHG emissions, aligning with sustainability initiatives, and minimising the impact on the environment, including biodiversity loss.	Exposure to physical risks from weather events and climate shifts, transitional risks from changes in policies, technologies, and market preferences, as well as reputational, financial, supply chain, and regulatory risks as they navigate the transition to a lower-carbon economy.	ESG & Sustainability policy guidelines on environmental considerations. Exclude companies and sectors that fall outside out policy. Ensure support of TCFD recommendations. Ensuring carbon emission reporting where relevant. Portfolio construction takes into account environmental risks.	Failure to meet our climate-related objectives set out in our Climate Change Position Statement.	Climate Change Position Statement. Climate Active Certification. Identify and disclose scope 1, 2 and 3 emissions. Carbon offsets.
Human Capital & Stakeholder Relations Actively focusing on both internal and external stakeholders to enhance human resource management and stakeholder interaction, driving sustainable growth.	Challenges in talent retention, reputational damage, reduced productivity, and stakeholder dissatisfaction, leading to reduced productivity and turnover, impacting.	Prioritising employee well-being, diversity, and career development. Policies and practices that support diversity, equity, and inclusion. Implementing programs that support career development and employee wellbeing. Transparent and engaged investor relations. Strong relations with various community and stakeholder groups. Portfolio construction takes into account supply stakeholder relation risks.	Inadequate management can lead to employee dissatisfaction, high turnover, and reduced productivity.	360 reviews. Appropriate staff policies (D&I Policy, Staff Code of Conduct, ECP Parental Leave Policy, Employment Benefits Policy). Team culture activities.

Sustainability Materiality Risk Assessment

Modern Slavery & Supply Chain

Internal and external supply chains adhere to ethical practices, emphasising the prevention of modern slavery, and minimising supply chain risks by maintaining a keen focus on supplier conduct standards.

Our Investments – Risk	Our Investments – Action	Our Operations – Risk	Our Operations – Action
Legal and reputational risks associated with human rights violations in the supply chain that can damage integrity and confidence in the company and their market position.	Engage with companies to advocate for compliance with Modern Slavery legislation.	Non-compliance can damage reputational integrity, and may result in legal risks.	Modern Slavery Policy.
	Publically report on companies that do not monitor modern slavery, and who do not have supplier code of conduct.		
	Engage with companies to ensure strong supplier code of conduct.		
	Portfolio construction takes into account supply chain risks.		

Governance, Compliance & ESG

Strong governance structures, regulatory compliance, and integration of ESG principles across operations.

Our Investments – Risk	Our Investments – Action	Our Operations – Risk	Our Operations – Action
Governance failures, non-compliance penalties, and poor ESG performance impacting investor confidence and market reputation.	Engage in active dialogue to integrate ESG strategies at senior levels.	Poor governance and non-compliance can lead to legal and regulatory penalties, affecting organisational credibility. Additionally impacts ability to achieve ESG-related aspirations.	Appointment of external compliance officer.
	Advocate for best practice board representation.		KPIs include RI objectives.
	Portfolio construction takes into account risks following significant lawsuits or regulatory penalties.		Separate oversight between the Board and the Investment Committee.

Dynamic Capabilities

A culture of innovation and adaptability by swiftly adapting operations and strategies in response to market changes and technological advancements to sustain competitiveness.

Our Investments – Risk	Our Investments – Action	Our Operations – Risk	Our Operations – Action
Inability to adapt to rapid changes in market conditions, technology, and consumer preferences can lead to market irrelevance, declining competitiveness, and diminishing investment returns.	Ensure continuous learning and development programs for employees.	Failure to adapt can result in operational inefficiencies and loss of market position.	Conduct periodic reviews of investment process and outcomes in an effort to incrementally enhance.
	Ensure a culture of innovation and flexibility within investments.		Encourage and support continuing education of staff.
	Monitor and engage on core DCs, ensuring companies hold the ability to Promote and support strategic agility and innovation through capital allocations.		Explore and invest in systems and new technology to assist staff productivity.
	Portfolio construction takes into account Dynamic Capability-related risks.		

Our Approach

How we do 'ESG'

ECP is committed to responsible investment and we believe that ESG factors have a material impact on long-term investment outcomes. The consideration of ESG factors is part of our decision-making process and is fully integrated through asset selection and portfolio management procedures.

Identifying and understanding the key drivers of risk and return is a crucial skill for any long-term active investor. Traditionally these items were defined purely in economic terms (revenue, margins, volatility of returns etc). However, as markets have evolved, it's become more evident to some participants that Environmental, Social and Governance (ESG) issues are central to understanding and framing the contextual, systematic and idiosyncratic considerations in investment analysis.

Importantly, the issues captured by the term 'ESG' are not necessarily static but may change over time as issues become more important or community values or sentiments change. ECP believes that ESG factors can have a material impact on the long-term outcomes of investment portfolios and the assets in which we invest.

A Holistic Approach

The 'Pillars of a Quality Franchise' is an integrated framework developed in-house to better mitigate our portfolio against ESG and sustainability risks. Our process places a material emphasis on sustainability, management, and firm competitiveness which leads to superior sustainability and stewardship of companies.

Sustainability

Specifically, our Sustainability Pillar encompasses three characteristics: Firstly, the business must operate in an industry with a low risk of macro-environmental factors affecting future operating performance. Secondly, the business has demonstrated strong ESG practices and holds a capacity to mitigate potential ESG issues. Lastly, the business holds Dynamic Capabilities that sustainably renew its competitive advantage through time.

By incorporating a forward-looking, scenario analysis of ESG-related affairs, we are able to better understand the risks and opportunities that lie ahead for any company, and more importantly, we assess the potential risk to the predictability of their business operations.

When assessing the business's ESG track record, we are able to measure and assess the current performance of the business in its entirety and gain conviction that in the event that ESG issues arise, management is able and willing to address these.

Moreover, a key element of our sustainable investment analysis is identifying how a company sustainably renews its competitive advantage through time. The competitive analysis provides us with conviction in our investment thesis, however, we need to identify companies that renew, extend, or create resources that continue to drive their competitive advantage.

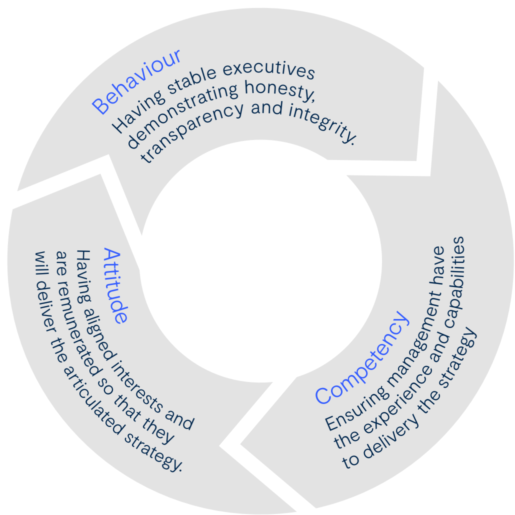
Stewardship

In terms of stewardship, there are two parts to how we approach this: firstly from a research perspective, and secondly from an active ownership perspective. At ECP, we believe that we as a business have a responsibility as a business to ensure that we are ethical in business practices and that we ensure good corporate governance; and moreover, we believe that businesses that demonstrate inadequate corporate governance will deliver poor investment outcomes.

Management Pillar

Within our analysis, our Sustainability Pillar assesses typical governance factors, these include board structure, size, diversity, skills and independence, executive pay, shareholder rights, stakeholder interaction, disclosure of information, business ethics, bribery and corruption, internal controls and risk management.

The management pillar focuses on the trustworthiness of management. This assists our mitigation of uncertainty by reducing the risk of managerial conduct or failure of business strategy execution. Our more holistic approach measures management in terms of business strategy, encompassing both the implications of business strategy for environmental and social issues and how the strategy is to be implemented.



Our Portfolio

08

Sector Allocation

We have provided the sector allocations of our investments versus the market. Our negative screens highlighted above restrict us from investing in capital in unsustainable sectors, and moreover, in areas that present material risks to the long-term business case.

The strict requirements of our process mean our investments tend to have high returns on invested capital, strong competitive advantages, strong balance sheets with low debt, and a proven sustainable competitive advantage.

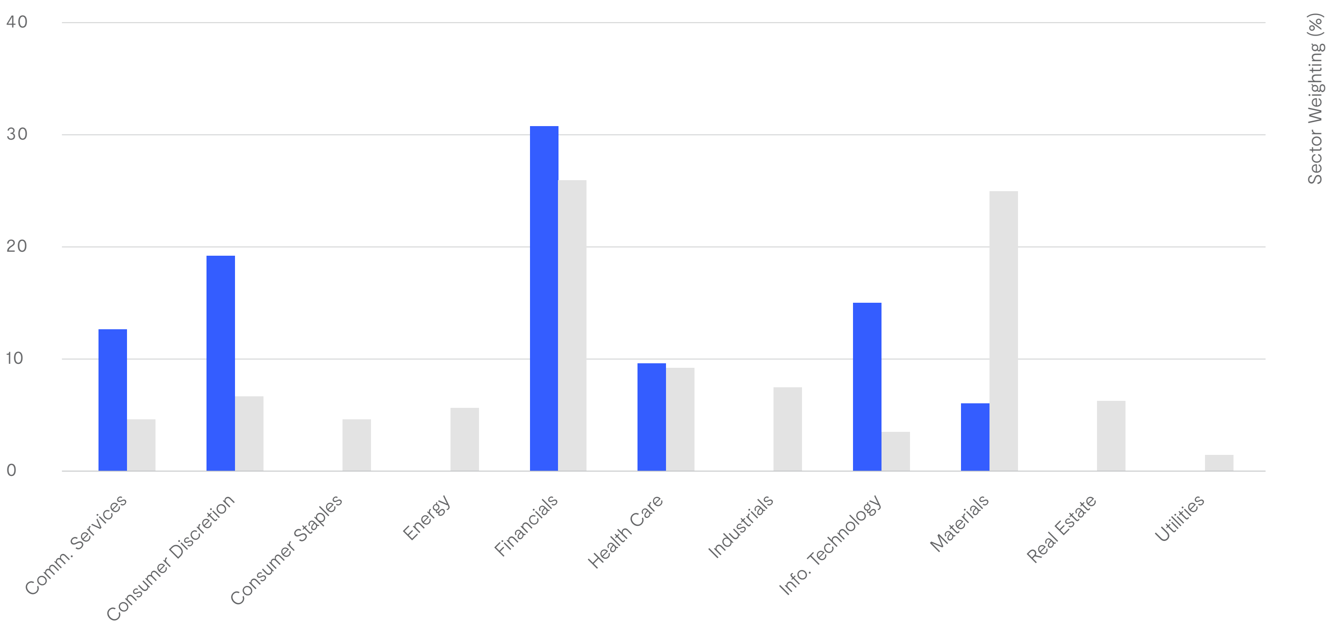
As a result of applying our responsible investment practices, through exclusionary screens and in-depth qualitative research, we have no exposure to energy, real estate, and utility industries, with lower exposure to materials sectors. By not investing in fossil fuels and miners without non-renewable sources, these sectors find it difficult to find a place in our portfolio.

"By not investing in fossil fuels and miners without non-renewable sources, these sectors find it difficult to find a place in our portfolio."

Sector Allocation

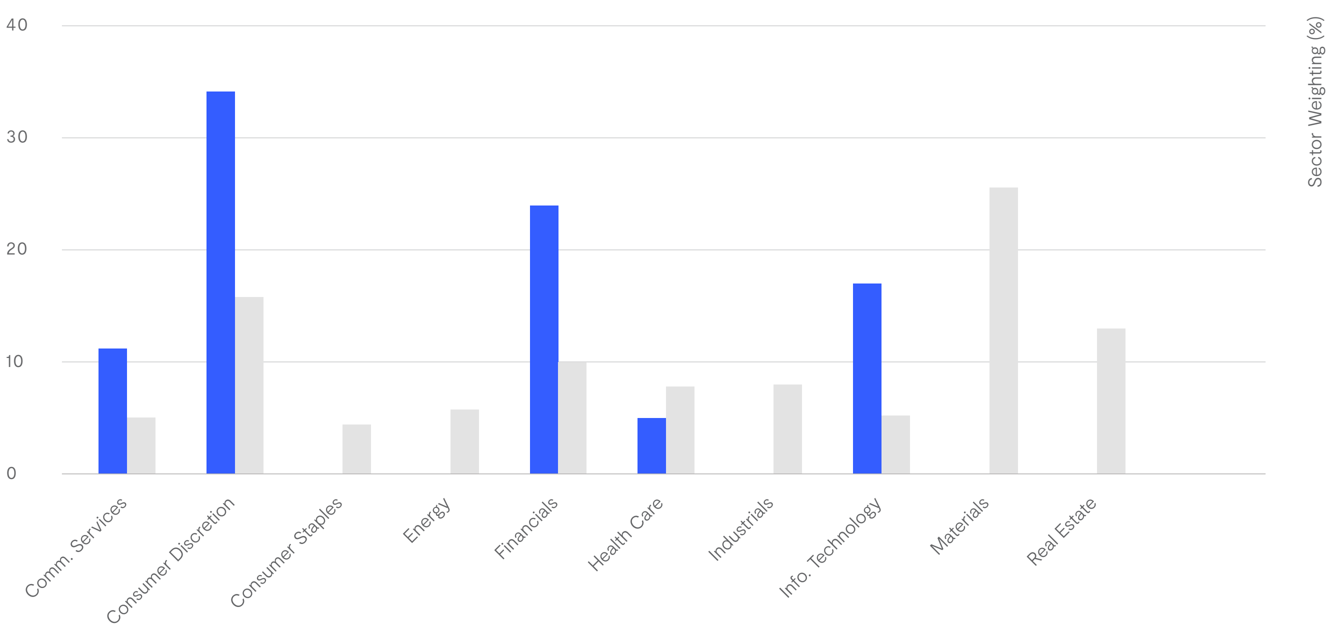
Sector Allocation of ECP Growth Companies Strategy vs The Market (30 June 2023)

ECP (All Cap)
S&P/ASX 300



Sector Allocation of ECP Emerging Companies Strategy vs The Market (30 June 2023)

ECP (Ex50)
S&P/ASX Small Ords



Carbon Exposure

Historical Carbon Footprint

The table below presents carbon footprint data over the past five years. Through time, our investment process has delivered consistently lower carbon emissions, on both total carbon emission and a weighted average carbon intensity basis.

ECP Growth Companies Strategy	2018	2019	2020	2021	2022	2023
Total Carbon Emissions* – ECP	50.0	39.1	68.5	25.4	40.7	51.0
Total Carbon Emissions* – Benchmark	115.7	106.0	117.1	76.0	86.2	80.0
Total Carbon Emissions – Relative	-64.7	-66.9	-48.6	-50.6	-45.5	-29.0
Weighted Average Carbon Intensity** – ECP	44.7	35.5	46.0	25.7	28.9	36.6
Weighted Average Carbon Intensity** – Benchmark	237.5	179.2	162.7	129.4	164.6	110.0
Weighted Average Carbon Intensity** – Relative	-192.8	-143.7	116.7	-103.7	-135.7	-73.4

ECP Emerging Companies Strategy	2018	2019	2020	2021	2022	2023
Total Carbon Emissions* – ECP	5.1	13.0	9.3	4.3	3.8	2.0
Total Carbon Emissions* – Benchmark	131.6	113.5	91.9	66.1	161.4	55.0
Total Carbon Emissions – Relative	-126.5	-100.5	-82.6	-61.8	-157.6	-53.0
Weighted Average Carbon Intensity** – ECP	18.8	23.5	13.8	12.7	11.6	7.9
Weighted Average Carbon Intensity** – Benchmark	443.1	403.5	259.5	209.5	201.8	67.0
Weighted Average Carbon Intensity** – Relative	-424.3	-380.0	-245.7	-196.8	-190.2	-59.0

* Total Carbon Emission

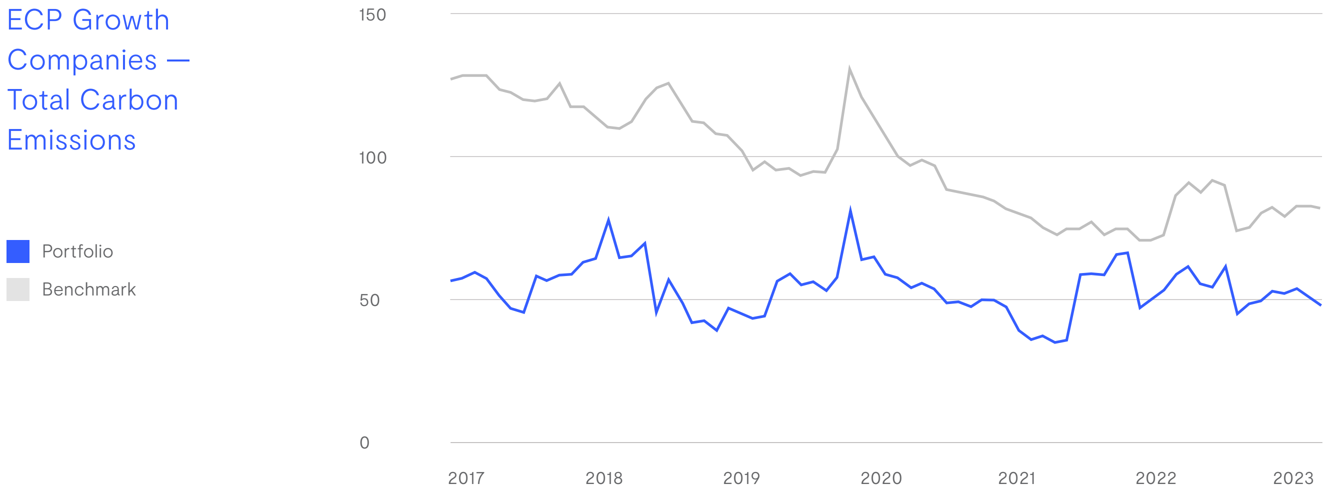
A portfolio's total carbon emission in tons of CO2e. answers the main question, "What is my portfolio's total carbon footprint at my current AUM level?". It measures the portfolio's tons of CO2e, taking scope 1-2 and scope 3 emissions into account for which an investor is responsible. It is apportioned to the investor based on an equity ownership perspective.

** Weighted average carbon intensity (Carbon risk)

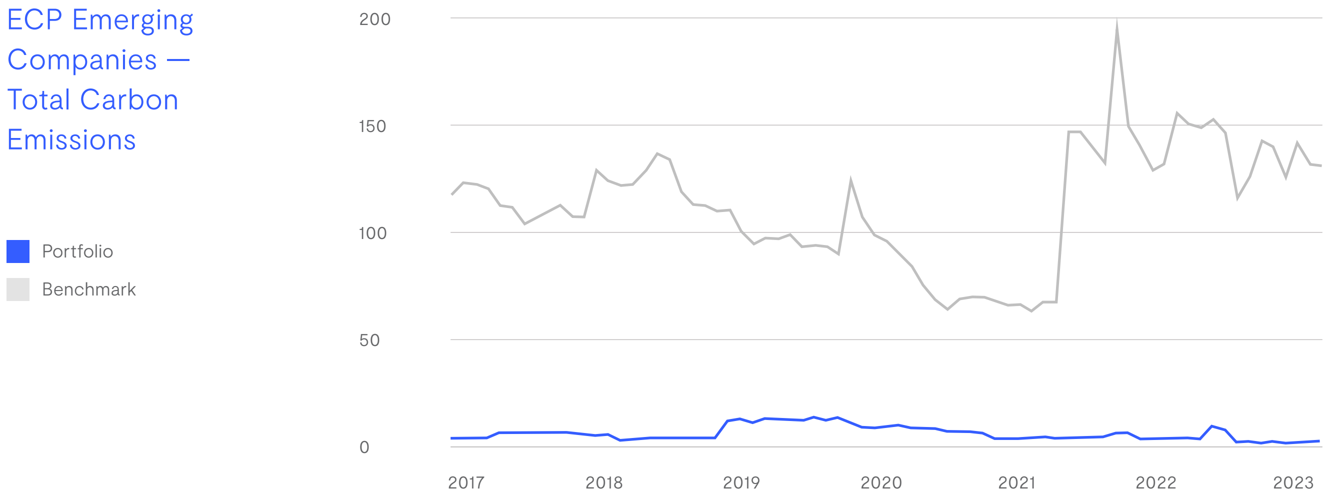
Since companies with higher carbon intensity are likely to face more exposure to the carbon-related market and regulatory risks, this metric can serve as a proxy for a portfolio's exposure to potential climate change-related risks relative to other portfolios, across asset classes or relative to a benchmark. Unlike the portfolio total carbon emission, carbon emissions are apportioned based on portfolio weights/exposure rather than the investor's ownership share of emissions or sales. The measure is, therefore, disconnected from ownership.

Carbon Exposure

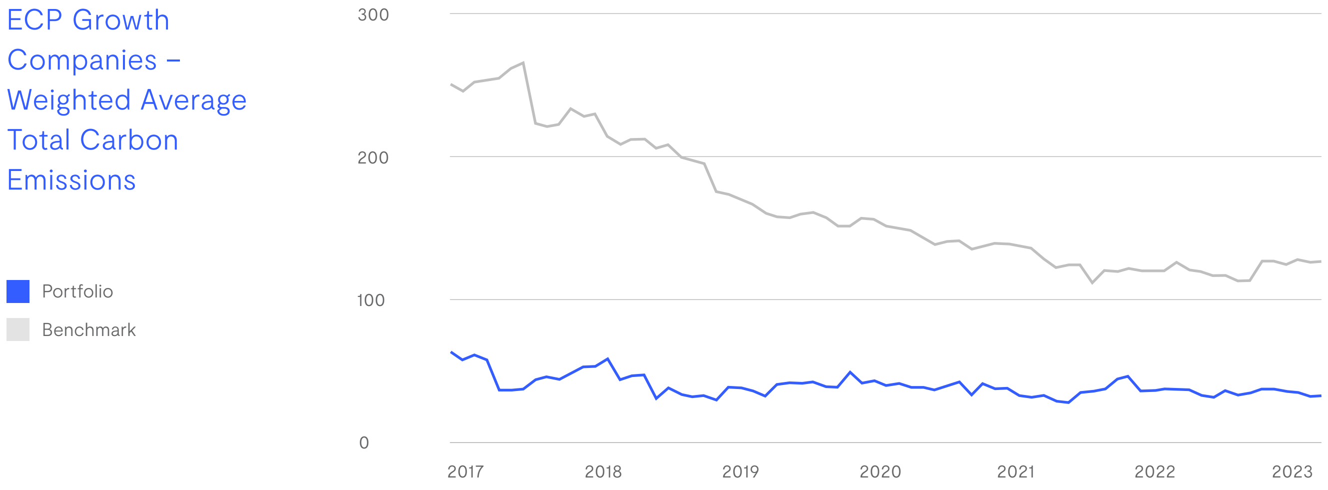
ECP Growth Companies — Total Carbon Emissions



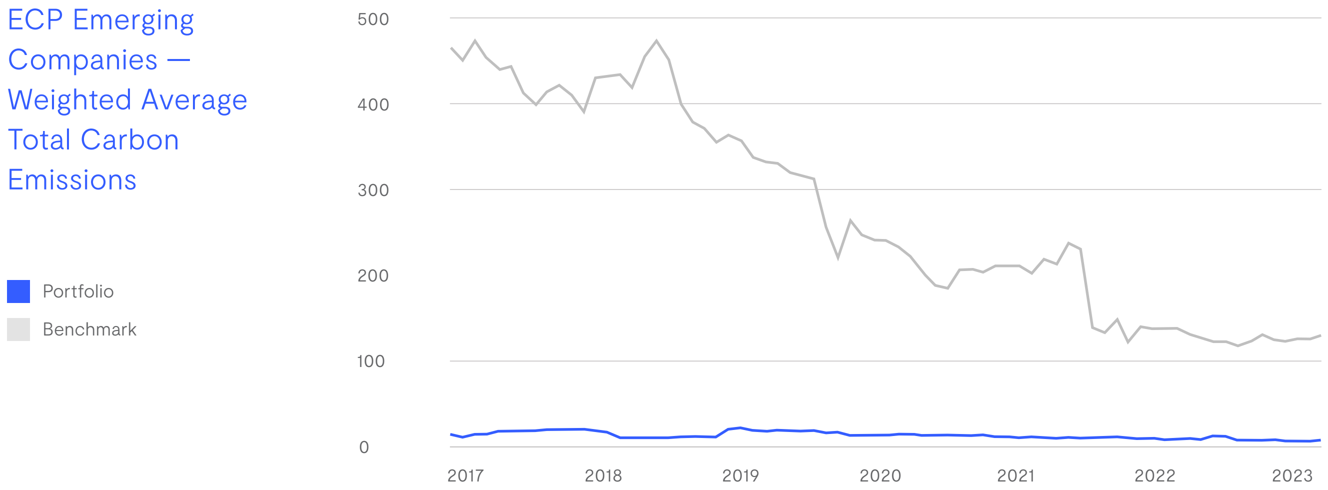
ECP Emerging Companies — Total Carbon Emissions



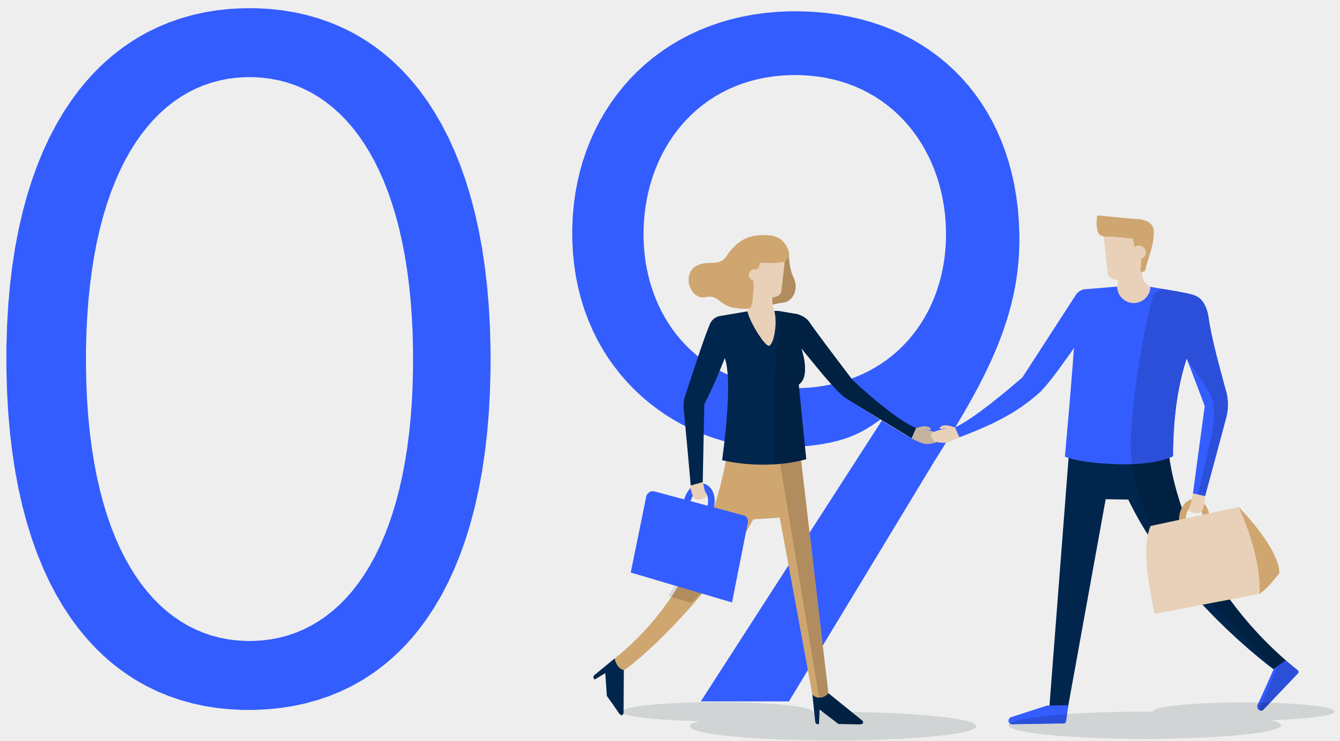
ECP Growth Companies – Weighted Average Total Carbon Emissions



ECP Emerging Companies — Weighted Average Total Carbon Emissions



Stewardship



Active Ownership

Voting

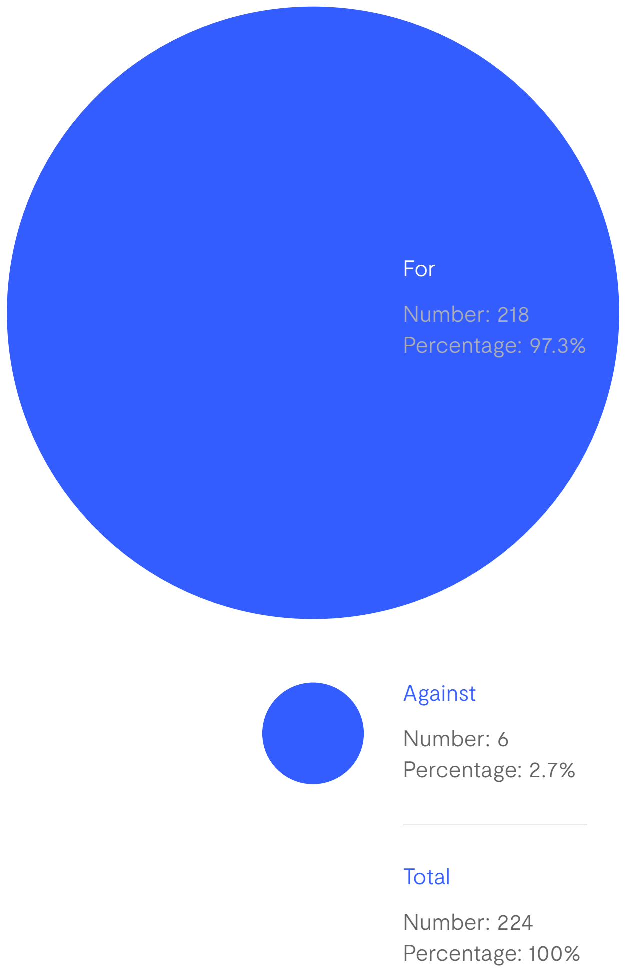
Active ownership is our opportunity to improve sustainable corporate practices and is a key way to help deliver long-term value creation for our investors. For us, we think the only way to grow wealth that is resilient and sustainable is to invest money in a careful, considered and committed way - we call this 'active' investing.

We aim to improve the long-term investment outcomes of the asset through our active stewardship and voting policy by promoting:

— Transparency;
— Accountability;
— Independence; and
— Long-term value.

Share voting remains an important tool for engaging with our companies as this is a visible and concrete expression of what may have been expressed in private discussions. Generally, these are in relation to a range of governance issues including board composition and executive remuneration. Voting is an effective way for ECP to publicly express our views on what a company is doing right, and what a company needs to improve.

We voted on a total of 224 resolutions applicable to active positions across the various portfolios ECP managed during the FY23 period, including 6 against the resolution. A record of our voting activity is available to view on our website.



Active Ownership

Engagement

Throughout the year, we have engaged with all our portfolio companies, interacting with either senior management or directly with the board, to discuss the sustainability of their business operations. In some instances, we identified ESG-related issues that necessitated further attention or discussion.

Below, we outline a summary of our engagement for FY23. The section titled 'Other Engagements' details our meetings with stakeholders outside the respective companies. The second table highlights our engagement activities focused on our three core sustainability characteristics.

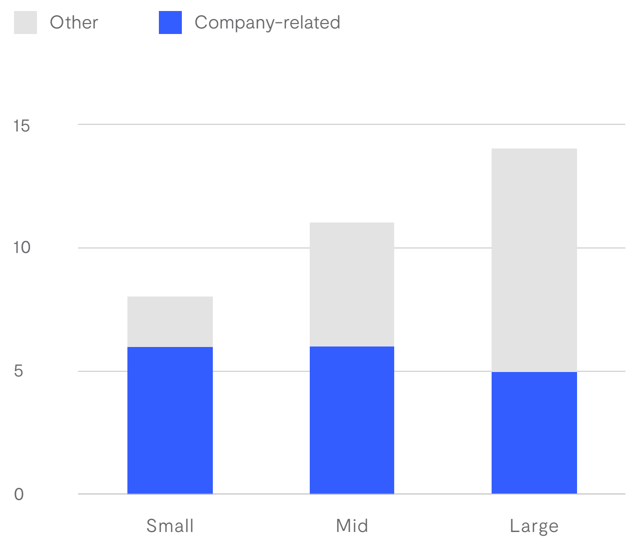
Our engagement strategy does not adhere to a set format of questions for each company. Instead, we aim to engage thoughtfully and deliberately, tailoring our discussions to the factors, issues, and events that are most relevant to our investment thesis for each company over our five-year investment horizon. The specific questions we ask are influenced by the contextual environment at the time. However, this year we have begun formalising standardised questions to streamline our engagement process going forward.

This year, our analysis has been particularly centred on macro-environmental factors (PESTLE) and Dynamic Capabilities, especially in light of significant market disruptions. We have concentrated on how companies are responding to and adapting to these challenges. Notably, there has been a heightened focus on the larger positions within our portfolio, underscoring their relative importance. Additionally, we observed a marked increase in engagements concerning ESG-related considerations. Many companies in our portfolio are now more actively reporting on initiatives related to climate change and cybersecurity.

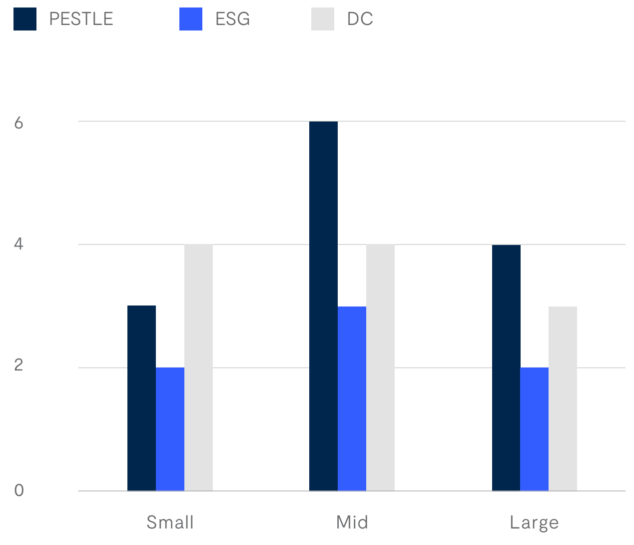
	Portfolio Engagements	Average Per Company
Company Engagements	180	6
Other Engagements	200	6
Total Engagements	380	12

	Portfolio Engagements	Average Per Company
PESTLE	137	4
ESG	85	3
Dynamic Capability	118	4
Total Sustainability	340	11

Engagements (Average)



Sustainability Engagements (Average)



Case Studies

Nuix (ASX: NXL)

Nuix provides investigative analytics and intelligence software, helping customers globally across various industries to process, normalise, index, enrich, and analyse data from numerous sources. Our investment thesis is supported by key structural drivers, notably the increasing regulatory landscape and the corresponding rise in costs for non-compliance, coupled with the exponential growth in data volumes that organisations need to manage to adhere to these regulations. Nuix, with its capability to handle unstructured data, is well-positioned to benefit from these trends.

Nuix's software has played a crucial role in high-profile investigations over the past fifteen years, including the Panama Papers and the Banking Royal Commission, making it a prominent tool for regulators and organisations worldwide. Despite facing challenges such as management changes and legal issues post-IPO, the company has undertaken significant steps to refresh its strategy and strengthen its governance. This includes the appointment of new leadership, the establishment of a board sub-committee for better oversight, enhancing board diversity, and severing ties with controversial figures.

Our engagement with Nuix began following the FY21 results, primarily through interactions with the Chairman, the Hon Jeff Leich, focusing on improving board structure and processes to address issues highlighted by the media. While the company has faced scrutiny regarding its accounting practices and disclosure, ASIC's investigations have not found any faults with its IPO prospectus, and they are concluding their examination of the company's continuous disclosure practices.

Since engaging with the company, Nuix has since established a board sub-committee to ensure appropriate oversight was implemented, they expanded the diversity of the board and terminated their relationship with Dr Tony Castagna. Additionally, the accounting issues discussed in the media were already disclosed in pre-listing documents, including Nuix's shift to consumption-based licences outlined in the prospectus. ASIC has not found any issues with the initial prospectus and is currently concluding its investigation into Nuix's continuous disclosure practices.

A significant ongoing legal challenge involves a compensation claim by former CEO Eddie Sheehy, related to his option rights from a prior agreement, which is an existential threat that could impact shareholder value. Although direct engagement on this matter is limited at this stage, we have devoted substantial time and resources to understand the dispute and potential liabilities, including consultations with both our legal counsel and that retained by Nuix.

HUB24 (ASX: HUB)

To hold our portfolio company's accountable to our expectations for managing potential issues with respect to Cybersecurity, we engage directly with management teams to understand the internal policies and processes used to mitigate cyber-risk.

In this domain, ECP has developed a framework to understand the strength of our portfolio company's cyber security. We believe it is important for investors to understand critical elements such as the number of dedicated Board meetings on cyber risk; the dedicated internal engineering resourcing; as well as tools utilised for external penetration testing, and continuous, live vulnerability testing of a companies IP - to name a few examples.

In one such example, we recently met with the CIO at Hub24. Hub24 is a technology platform in the wealth management industry, used by advisers to administer client assets and execute investment strategies on their behalf. Its core technology is a gateway to sensitive client information, making cyber-security paramount.

We came away impressed by the layers of protection in place at Hub24. In particular, our research indicated an above average dedicated internal staffing resource working exclusively on cybersecurity and felt assured it had the full attention of the Board - reducing the risk of a data breach and associated reputational damage.

We learnt about how Hub24 follows frameworks laid out by the Australian Cyber Centre ('ACSC Essential 8 Strategies') and the US Department of Commerce ('NIST Framework'), and how it utilises multiple external vendors for IP penetration testing and various leading tools for continuous, live vulnerability testing, as well as deploying a modern zero-trust network architecture with end-point protection in place with access controls for users and devices regularly reviewed.

More recently, Hub24 acquired MyProsperity which we believe - when utilised - will enhance adviser cyber protection. MyProsperity is a secure portal for adviser-client engagement, allowing sensitive document sharing to be executed in a safer environment than traditional email chains, reducing wealth management practice exposure to data breaches.

Case Studies

Lovisa (ASX: LOV)

Lovisa Holdings Ltd, an ultra-niche, vertically integrated fast fashion jewellery retailer, is rapidly expanding internationally, with about 70% of its stores located overseas. The company is positioned to significantly grow its presence in the US and Europe, aiming to increase its store network to over 1300 stores by FY25. This growth is driven by replicating the successful Australian business model in new markets, utilising a corporate-owned store rollout strategy to leverage scale benefits and achieve rapid market entry at minimal cost.

In 2021, Lovisa announced a leadership transition with Victor Herrero succeeding founding CEO Shane Fallscheer. Herrero's extensive experience with the Inditex Group and his proficiency in five languages are seen as valuable assets in managing Lovisa's international expansion. Despite initial concerns about the CEO transition, our engagement with the company as to the structured approach to succession and Victor's leadership capabilities have reassured us as to the continuity of applying prior strategies.

Since Victor's appointment, a key focus for our engagement was the CEO's remuneration structure, which, though potentially sizable, is designed to align closely with shareholder interests. The long-term incentive (LTI) plan, which could see Herrero earn up to $24.0m, is contingent on performance metrics that include expanding the store network significantly. For Victor, the LTI rights are granted at no cost, and the degree of vesting will depend on his performance outcomes. Originally, market expectations were set around 700 stores by FY24, but for Herrero to meet the upper vesting targets of his LTI, he would need to accelerate store rollouts to reach approximately 1,000 stores by FY24.

We do not adopt a prescriptive approach to executive incentives. Based on the current outlook and the incentives already in place, we believe shareholders will be substantially rewarded should Victor and his team successfully execute their strategic plan. We continue to support the previously approved remuneration packages, initially accepted due to their ambitious targets and the potential for significant shareholder benefits.

Looking ahead, in the new year, we plan to engage further with the company to discuss how they have addressed concerns of ours (such as longer vesting periods, or the use of other performance metrics) and how they intend to evolve their remuneration structures moving forward. This dialogue will help ensure that executive compensation continues to align with shareholder interests and company performance, reflecting both market realities and the aspirations of our investment thesis.

IDP Education (ASX: IEL)

IDP Education is a major player in the international education market with two distinct businesses. It operates a student placement platform that places students from around the world into key education institutions in predominantly Australia, the UK, Canada and the USA. It is also the distributor of the IELTS test, which is the gold standard high-stakes English language test for students and immigrants around the world.

Our investment thesis is that IDP is building a global student placement platform that is the largest and best place for students to find a place to study internationally, benefiting from the rising wealth in Asia. IDP has a significant runway to reach ~15% market share in its most mature markets. IDP's IELTS business is a necessity for students and contributes to IDP being the most trusted brand name in education.

IDP Education is a business with a strengthening competitive advantage that we added during COVID-19 in 2020. In 2023, IDP hired Tennealle O'shannessy to replace outgoing CEO Andrew Barkla. Throughout the year we engaged with the board on a range of matters including, executive succession planning, Board evolution - post the sell down of Education Australia, the remuneration report and appropriate KPIs, and remuneration mix.

After last year's vote where we opposed the re-election of Colin Stirling as a university representative, the election of two female board members has been a source of encouragement for us. We remain steadfast in advocating for the inclusion of more global technology and education expertise on the board, recognizing the importance of these elements as the board continues to evolve. We are also pleased with the evolution of the remuneration package towards more at risk long term incentives as a percentage of total Remuneration.

Macquarie Group (ASX: MGQ)

Macquarie Group is a global financial services provider operating in 33 markets. Its operations span asset management, retail and business banking, wealth management, leasing and asset financing, market access, commodity trading, renewable development, specialist advice, and access to capital and principal investment.

Our investment thesis is the company is a Global leader in Infrastructure Asset Management and adjacent investment banking services. Its growth will be driven by increased weighting to renewables, technology and infrastructure. Its unique business model, based on staff empowerment and an ROE-based remuneration structure, is the foundation that will drive strong shareholder returns.

One of the largest themes underpinning our investment in Macquarie Group (ASX: MGQ) is the global energy transition towards renewable sources that will occur in the coming decades. Throughout the year, we have around ten engagements in the company, providing substantial support for the investment case around these long-term sustainable opportunities.

As the world's largest Infrastructure asset manager, Macquarie identified this long-term theme early and significantly leaned into it with the purchase of the Green Investment Bank in the UK in 2017, now called the Green Investment Group (GIG). MQG has recently shifted GIG from Macquarie Capital (MacCap) to Macquarie Asset Management (MAM) representing a turning point in the strategy that will allow MQG to bring in its fiduciary investors and scale the operation as the industry growth accelerates beyond the company's ability to self fund these projects.

MQG remains at the forefront of the decarbonisation effort with CEO Shemara Wikramanayake recently co-authoring an opinion piece with Mike Bloomberg, Natarajan Chandrasekaran titled "Financing India's decarbonisation ambition." The development of the renewable energy financing and infrastructure management industry is vital in supporting the transition to a renewable future. Currently, MAM is managing 111GW of capacity including 97GW of green energy assets in development or construction and 14GW of green energy assets in operation. This is up 141% on last year, managing a total of 46 GW of capacity, including 30GW in development or construction and 16GW under operation.

Case Studies

Domino's (ASX: DMP)

Domino's Pizza operates a mix of franchised and corporate-owned pizza restaurants and is the exclusive master franchisee in several countries including Australia, New Zealand, and various European and Asian markets. Our investment thesis is predicated on the continued expansion network stores, particularly driven by growth in the European and Japanese markets.

Our engagements with Domino's management have centred around addressing the challenges faced by franchisees, particularly in light of global food and labour inflation. This year, we have conducted six meetings directly with Domino's, including discussions with the board, as well as various stakeholders to evaluate the measures taken to support franchise profitability—a key driver of our investment strategy.

We came away impressed by Domino's proactive strategies to mitigate the adverse effects of inflation on their franchise network. The management team has been keenly focused on ensuring franchisee support, which is evident from several strategic initiatives:

- Regional Adaptations: Notable improvements have been seen in the ANZ and Asian segments, where adaptations in menus, costs, and pricing strategies have led to increased profitability compared to the previous year.
- Inflation Mitigation Strategies: Despite facing food inflation impacts of 4-5% and energy price increases of about 1-2%, Domino's has effectively adjusted prices, optimised delivery territories, and introduced new fee structures to help franchisees manage costs.
- Innovative Measures: The introduction of delivery fees in the ANZ region and the reduction of active delivery territories in Germany by approximately 10% are examples of Domino's commitment to operational efficiency and franchisee profitability.

Our discussions with Domino's board have reinforced the company's dedication to maintaining a healthy balance between profitability and growth. The board's ongoing review of franchisee performance metrics ensures that decisions are data-driven and aimed at fostering long-term sustainability.

Domino's focus on franchisee profitability is a primary concern for us, given a healthy franchise network drives their ability to grow their economic footprint. Going forward, we will continue our engagement with Domino's to ensure that these practices evolve in line with market demands and continue to support franchisee success. Of particular importance for us remains the short-term impacts on profitability and its impact on the network growth.

Rio Tinto (ASX: RIO)

Rio Tinto is a leading global mining group excelling in the discovery, extraction, and processing of Earth's mineral resources, and maintains a cost leadership in key commodities, positioning them as a key player to sustainably influence positive developments over time. The company boasts high-quality assets in iron ore, aluminium, and copper, consistently expanding its reach in these sectors. The company is focused on shifting global energy patterns, investing its capital and free cash flows in "green" minerals and metals, to drive sustainable change and benefit from the transition to new energy sources.

Over the last decade, Rio Tinto has been at the forefront of addressing ESG challenges within the inherently problematic mining sector, particularly concerning the use of raw materials and operational regions. Despite these challenges, Rio Tinto's experienced team leverages its extensive industry knowledge to make informed decisions regarding ESG issues, striving to mitigate the environmental impact while promoting sustainable practices. This approach not only positions Rio Tinto as a leader in responsible mining but also aligns its operations with the evolving global focus on sustainability.

At ECP, our investment exclusions enforce a strict zero-tolerance policy towards sectors such as thermal coal, petroleum, logging, palm oil, and pesticides, based on direct involvement in their production or delivery. Although these exclusions typically disqualify most mining companies from our investable universe due to potential degradation in business performance, Rio Tinto remains an exception.

Rio Tinto has proactively divested from assets negatively impacting the environment, focusing instead on more carbon-friendly resources like iron ore, copper, and aluminium. This strategic shift included selling off its coal assets and implementing plans to enhance the sustainability of its remaining businesses. While still evolving, Rio's efforts are concentrated on reducing emissions and achieving both industry and internal environmental targets.

While Rio has made strides in its environmental initiatives, it has struggled with its social responsibilities. Recent failures in internal controls and corporate culture have led to serious issues, including the destruction of the Juukan Gorge Aboriginal caves and allegations of staff mistreatment and sexual misconduct. These incidents prompted significant changes at the executive level, including the replacement of the Chairman and CEO.

Engagements with the company and stakeholders have increased in response to these issues, leading to proactive measures in monitoring and addressing them through continuous dialogue with the Board and Senior Management. Under new leadership, Rio is committed to improving its social responsibilities in all operating jurisdictions. Although past events have been disappointing, the new management's acceptance of responsibility and implementation of stricter controls and processes are promising steps toward a better-managed company, benefiting both the environment and stakeholders.

Journeys of Discovery

10

Harnessing Dynamic Capabilities

Insights from Around the Globe

Throughout the year, several team members have travelled globally, engaging with new companies and those in our portfolio with international operations. We explored sectors like travel, housing, education, manufacturing, and retail, where we encountered diverse challenges such as shifting regulations, evolving competitive landscapes, and strong consumer resilience.

Amid mounting macroeconomic pressures like rising costs, high inflation, low employment, and decreasing consumer demand, investors should focus on business resilience, competitiveness, and strategic planning rather than short-lived economic trends.

As companies adapt to the new normal, they are trimming unnecessary expenses, discontinuing unprofitable ventures, targeting high-value customers, optimising operations, and refining their value propositions to strengthen their competitive edge.

Below, we summarise key insights from our travels, showcasing the characteristics of high-quality franchises worldwide and the ongoing transitions. We also present strategies that sustain business performance despite challenging environments.

Unearthing Resilience for Growth

Businesses previously benefiting from favourable macro-environmental conditions are now facing contraction phases, implementing strategies to reduce debt and sharpen their focus on profitability. The timing of these adjustments varies by sector: the travel industry began this transition two years ago, the housing sector is nearing the end of its cycle, and retail and consumer-related industries are currently undergoing transformation. Despite their current phase, companies are preparing for future success, focusing on resilience, customer engagement, and acceleration of growth.

Despite the ever-changing economic environment, various industries such as travel, housing, education, manufacturing, and retail are seeing an unexpected resilience in consumer health. Although industries move through similar business cycle trends, they do so with varying intensities. Companies that utilise Dynamic Capabilities demonstrate resilience that propels them towards future growth.

As we progress through a year of normalisation, businesses are taking proactive measures to cut unnecessary expenses, abandon unprofitable ventures, target high-value customers, refine operations, and clarify their value propositions to enhance competitive strength.

Companies that once flourished under favourable macro-environmental conditions are now entering contraction phases. These businesses are responding by minimising debt, fine-tuning their value propositions, and zeroing in on their most profitable customers. While some sectors, like travel, felt this shift earlier, others like the housing and retail sectors are currently undergoing significant transformations.

Regardless of where these companies stand in their business cycle, they are laying the groundwork for future success. This includes ensuring resilience, maintaining a strong customer focus, and fostering growth. Preparing for worst-case scenarios and concentrating on customers are key strategies for growth acceleration.

Building Resilience: Streamlining Operations and Reinforcing Value

Core to business resilience is adaptability and operational efficiency. Streamlining operations boosts productivity and cuts costs, allowing companies to remain agile and responsive to market shifts. These efficiencies prepare businesses for future market share gains and accelerated growth once economic conditions stabilise.

During the pandemic, Flight Center (ASX: FLT) significantly reduced its physical presence and workforce, enhancing its competitive edge and positioning itself for client growth and margin expansion. Companies are focusing on operational efficiency and effective resource utilisation to navigate economic uncertainties and prepare for potential downturns.

Strategic initiatives such as implementing Enterprise Resource Planning (ERP) systems and addressing procurement issues are critical. For example, Domino's UK (LSE: DOM) is improving supply chain efficiencies with ERP upgrades, while Domino's AU (ASX: DMP) has closed unprofitable stores to reduce costs. As supply chain challenges diminish, businesses are adapting to normalise operations and boost margins.

Moreover, businesses like FeverTree (LSE: FEVR) are resolving supply chain complications, with anticipated inventory adjustments and cost reductions expected to enhance margins in the near future. Despite decreasing freight rates and stabilising raw material costs, labour challenges like availability and wage inflation persist. Companies are gradually benefiting from these shifts, adjusting inventory levels and operations to release capital and alleviate financial strains.

Harnessing Dynamic Capabilities

Customer-Centricity: Nurturing Loyalty and Targeted Marketing

Companies are sharpening their focus on customer-centric strategies to ensure long-term competitive success. By targeting their most valuable customers and key demographics, they aim to enhance the customer experience and generate robust free cash flows. As an example, St James Place (LSE: SJP) streamlined its technology, introducing a new CRM to boost engagement and streamline operations for better service delivery.

Across various sectors, we noticed a significant shift towards enhancing product value and service quality, moving away from growth solely for its own sake towards more targeted and strategic expansion. For instance, Zalando (FSE: ZAL) is emphasising profitable growth and carefully selecting customer segments for rational expansion. Take Two (private) is catering to long-haul travel customers with significant service needs, focusing on quality to add value.

Companies are employing diverse tools and tactics to improve customer experiences and build loyalty, such as innovative product development, loyalty programs, targeted rebates, and value-oriented offerings. Loyalty programs are especially effective, reducing advertising costs while maintaining high gross margins and low SG&A expenses. Firms with a deep understanding of their customers are better equipped to manage reduced market demand efficiently.

William Sonoma (NYSE: WSM) generates 3-4x more profit from loyalty members. In contrast, Ulta Beauty (NASDAQ: ULTA) with 41m loyalty members are 2-3x more profitable, and Dominos US (NYSE: DPZ) 30m active loyalty members deliver improved engagement and order frequency.

Moreover, innovation plays a crucial role in this process. While ensuring greater value is provided to a more specific set of customers, companies seek to drive sustained growth and double down on their competitive advantage in the market. Again, identifying customers' pain points is driving renewed product innovation, and these benefits will be enjoyed in the coming years. Rightmove (LSE: RMV) was one notable example where a product development was used to boost value for agents and improve customer experiences, while Apple (NYSE: AAPL) is set to release a VR headset, aiming to drive growth in developed markets and diversify beyond the iPhone.

Strategic Positioning: A Matter of Luxury or Value

In today's market, a clear and compelling value proposition is essential. Businesses that effectively communicate their unique selling points can differentiate from competitors, enhance brand recognition, and attract and retain customers, thereby driving growth.

Strategic positioning is increasingly vital as affluent consumers continue purchasing, though less frequently, while those with limited budgets gravitate towards value-oriented offerings. The variation in consumer behaviour is also influenced by country-specific economic factors. For instance, U.S. consumers are cushioned by 30-year mortgages against rising interest rates, whereas the UK market is more resilient compared to Australia. This makes a well-defined value proposition crucial.

Companies that fail to clearly identify their market segment, including those in mid-tier, risk losing ground to changing consumer preferences. Meanwhile, premium and mid-market firms are now adopting value strategies to preserve customer relationships and operational efficiencies.

James Hardie (ASX: JHX) and Louisiana Pacific (NYSE: LP) have reintroduced lower-priced product lines, targeting major home builders with significant price reductions, as part of their value strategy. While Ralph Lauren (NYSE: RL) has moved away from discounting to maintain alignment with its luxury brand value, focusing on affluent consumers and investing in brand storytelling to enhance its relevance.

On the flip side, Domino's AU (ASX: DMP), known for its value offerings, faced setbacks in Europe due to pricing errors and not adequately understanding consumer perceptions of value, particularly in delivery versus carryout. This miscalculation, coupled with the company's reliance on high purchase volumes, significantly impacted its market position.

The delicate balance between luxury and value is crucial for companies aiming to navigate consumer trends effectively and achieve sustainable success. Implementing value-oriented strategies may help capture volume amidst lower purchase frequencies, but requires careful management to avoid alienating both existing and potential customers.

Power Dynamics: A Changing Landscape

The evolving landscape has sparked a power struggle among stakeholders in the value chain, such as consumers, employees, suppliers, and distributors, all centred on delivering value. This tug-of-war is reshaping business models, driving industry consolidation, and prompting competitive strategies to protect margins and foster growth.

The focus is on the economics of consumer value, assessing who has acted responsibly and who has maxed out their pricing power. ARB Corp (ASX: ARB) and Restoration Hardware (NYSE: RH) have recognized their pricing limits; ARB maintains a robust customer order book while RH experiences backlash from aggressive pricing. There's a noticeable shift as more profitable brands adopt direct-to-consumer (DTC) models, moving into retail and bypassing traditional distributors.

An observable shift is seen with more profitable brands moving towards direct-to-consumer models and entering the retail sector. While distributors grapple with challenges, retailers are thriving, and increasingly these consumer-facing brands are moving vertically. American Airlines (NASDAQ: AAL) and Constellation Brands (NYSE: STZ) are leveraging DTC strategies to respond to changes in their industries, such as evolving booking platforms and decreasing demand.

Additionally, the economic pie is being redistributed among stakeholders in some industries, leading to large consolidations. Gamma Communications (LSE: Gamma) and Rightmove (LSE: RMV) have observed consolidation among channel partners and agents, respectively, enhancing supplier power.

In fragmented industries, a lack of consolidation presents opportunities for entities that adopt alternative market strategies. ARB Corp is beginning to implement a DTC strategy in the US, building on its Australian success. In contrast, William Sonoma (NYSE: WSM) utilises a B2B approach that integrates design, manufacturing, and distribution.

Employment dynamics also vary by sector. Technology sectors face challenges of over-hiring, travel industries strive to re-attract employees, and manufacturing grapples with a shortage of skilled labour. CWT (private) has struggled with staff attrition, while PWR Cooling (ASX: PWH) is developing grassroots initiatives to cultivate talent.

Moreover, a shift towards employer power is becoming apparent, potentially impacting remote working policies. Once prioritised, remote work is now taking a backseat as companies increasingly require office attendance, often exceeding expectations.

Turning the Tide: Securing Competitive Excellence

In the year of normalisation, it's crucial to remember that the temporary (pandemic) surges in business performance are the outlier, and comparing performance to 2019 levels provides a better understanding of a company's health.

While this year might see flat or declining growth for most, preparing for potential downturns will differentiate quality businesses from the rest. Strategic decisions made this year will lay the foundation for rapid growth in 2024 and beyond.

The insights from the US and UK underscore the importance of a company-specific perspective. Identifying companies with clean balance sheets, a loyal customer base, and a management team that understands their value proposition and the resources underpinning their competitive advantage will secure long-term above-average returns.

> "Companies are sharpening their focus on customer-centric strategies to ensure long-term competitive success."

ECP Insights

11

How to Barricade Against Black Swans

Resilience Defends Investors from Unknown Risks

Wealth compounds over the long term. When investing, we do so under considerable uncertainty, and sound risk management strategies are necessary to ensure we generate above-average returns. However, the longer the investment horizon, the greater the probability of experiencing unforeseen events and the more pronounced the exposure to idiosyncratic risks. Identifying resilient, high-quality franchises is an investor's optimal risk management tool to manage future uncertainties. Here, we illustrate how antifragile companies protect portfolios from the unknown.

The past few decades have been a golden era for most traditional assets as interest rates steadily declined and economies expanded, relishing globalisation and technological innovation. Investors tend to extrapolate history into the future, assuming regularity of fundamental drivers; however, in times of stress, these become less reliable.

Equity investors seek to identify businesses that will increase in value over time. The goal of any investor is to forecast future expected returns based on the best estimate of what we expect the future will be.

When forecasting, rare (black swan) events present a material risk for investors; we know with certainty that rare events will occur. History is littered with systemic stressors that appear more regularly than they should, statistically; the GFC, Covid-19, and the recent war in Ukraine are examples of these events that have affected businesses worldwide.

However, many invest as if black swans do not exist. Solely focusing on the opportunity ahead while failing to account for this level of uncertainty means investors fail to account for ambiguous, unforeseen risks.

The ability of anyone to fully account for all future outcomes is impossible. Moreover, investors that attempt to predict black swans may make them more vulnerable to the ones they failed to predict.

Black swan events are low in predictability and high in impact. By this, we are not talking about share price performance but rather the performance of the underlying businesses. In anticipation of these events, preventative measures are necessary to protect portfolios from unpredictable risks.

So how do we prepare for black swan events if we do not know what they are or when they will strike?

Proceed with Caution

The intrinsic uncertainty of the world, the numerous stakeholders in place and the systemic nature of rare events make it incredibly unlikely that companies that are not resilient can prevent all these risks over the long term.

Investors are loss-averse, not risk-averse. When investing over long-term horizons, risk management strategies need to account for the unforeseen risks that may lead to capital loss.

Identifying asset resiliency is the optimal preventative measure to mitigate uncertainty and change. By aligning with sustainable business economics, portfolios will possess the idiosyncratic essentials to compound economic returns.

When investing, we are (generally) exposed to three primary issues:

1) The risk that performance falls below a target threshold;
2) The risk related to the reliability of an investment's underlying performance; and
3) Failure to manage uncertain risks that lead to fluctuation according to the non-predictable future state of the world.

Investors tend to manage risk and uncertainty through a probability-based lens, using variance as a proxy for risk. Here, investors assume the normality of returns distribution when the probability of black swan events occurring is higher than suggested.

Nissim Taleb, author of 'Antifragile: Things That Gain From Disorder' introduced the concept of antifragility. Here, randomness, uncertainty and chaos are welcomed, as when these systems are under stress, they are resilient and then improve—they gain from this disorder.

Unlike fragile items, which break when stressed, the antifragile benefits from volatility and shock. Antifragility is beyond resilience—the resilient manages, adapts, and resists shocks, whereas the antifragile gets better. Antifragility is the antithesis of fragility.

There's a saying in finance that during times of crisis, the return correlations of all risky assets go to 1. Asset prices move similarly—down and fast. Resilient investments recover much faster, while antifragile assets will improve.

Much like the human body, we need stressors to ensure that we are in good shape and that we improve and grow. Resilience is the blueprint for living in a black swan world. Antifragility is the key to sustained, above-average investment performance.

It is difficult to predict when something will cause something fragile to break. However, incorporating resilience into risk management frameworks means using these heuristics to guide non-predictive decision-making under uncertainty. Resilience is the antidote to genuine uncertainty.

How to Barricade Against Black Swans

Let's Illuminate

There is no risk in steady-state environments, yet it is not so simple when we find ourselves in situations of change. For investors, change increases risk because we do not know its effects, leaving open the possibility of unexpected consequences.

As investors, we are essentially business owners. Finding resilient companies means investing in those that can grow their economic footprint while strengthening their competitive advantage despite rare, unforeseen events.

Since a company's free cash flows (FCF) are the key determinant for future valuations, it is sensible to identify which businesses can continue to execute their business strategy without being negatively impacted by black swan events—the highest quality franchises.

Businesses that generate predictable, above-average returns deliver superior value creation over time. These high-quality franchises have strong FCFs, a sustainable competitive advantage, high returns on invested capital, and a solid financial position. Importantly, they hold a Dynamic Capability which provides the ability to manage and adapt to change.

"Businesses that generate predictable, above-average returns deliver superior value creation over time. "

The Antifragile Academic

IDP Education (ASX: IEL) is a major player in the international education market. The business operates a global student placement platform and distributes IELTS, the gold standard high-stakes English language test for students and immigrants worldwide.

The education sector was one of the hardest hit by the pandemic as it relies on the movement of students and immigrants across borders. As the world shut down, IDP had to rapidly transition from in-person events and counselling to a virtual platform and shift the IELTS tests online.

IDPs size, scale and existing digital expertise allowed it to execute its business strategy seamlessly. At the same time, its dynamic capabilities proved to be the key attribute in further extending its competitive advantage.

Indicators of their adaptive capacity during the pandemic:

— The IDP had almost no debt heading into the pandemic. At the time of global shutdowns, IDP raised ~$190m in equity (<10% of issued capital), deferred its dividend, increased its debt facilities and cut operating costs, mitigating any balance sheet risk for the foreseeable future.

— The company's multi-destination strategy meant that it serviced students travelling to predominantly Australia, UK and Canada. While Australia suffered the largest drop in student numbers, the UK remained relatively open, making IDP far more resilient to the pandemic than its peers who serviced single destinations.

— Rare events can catalyse competitive behaviour, favouring the more resilient. IDP's acquisition of the British Council's (BC) Indian IELTS business, which has long been recognised to hold significant synergies, saw the IDP leverage the capital raised to drive strong EPS accretion. Arguably, this might never have occurred without Covid-19 (the pandemic placed financial strain on BC, driving the need for capital).

IDP's digital strategy has been a strengthening competitive advantage, with the company continuously taking market share. The pandemic was a black swan event impacting the business; however, it proved beneficial given the antifragility of IDP—accelerating market share gains leading to an increasingly stronger business had the black swan event never occurred.

Investors could never have predicted these events or incorporated them into an investment thesis. However, the company's resilience could have been identified by acknowledging 1) a highly experienced and competent management team, 2) a strong balance sheet providing it with optionality, and 3) a digital strategy that was not reliant on any one revenue stream.

The Resilient Rollout

Domino's Pizza Enterprises (ASX: DMP) owns and operates the exclusive master franchise in several global territories. Through time, the company has been exposed to several externalities, including underpayment of wage accusations, the pandemic, and the recent inflationary environment.

Domino's resilience has been pervasive through time. The company is highly entrepreneurial, focusing on innovation and knowledge retention while demonstrating a clear ability to manage and adapt to change. All of which continually renew and extend their competitive advantage.

Domino's continually redeployed and reconfigured its resources to meet evolving customer demands. Whether innovative menu offerings, in-store efficiencies, or optimising their route to customers, Domino's demonstrate an adaptive capacity that ensures they constantly improve their operations to deliver hotter, fresher pizza while rolling out new stores.

Indicators of their adaptive capacity during the pandemic:

— The pandemic drove heightened risks to the business, given their exposure to carry out sales—half of their business was entirely wiped out overnight. In turn, the company pivoted toward their delivery service, leveraging cheap national TV advertising while providing new routes to its customers (car park delivery).

— Inflationary pressures continue to impact the business, with franchisees suffering the effects of food and labour inflation globally. Here, Domino's are pulling on several levers to combat these pressures, such as using their coupon and loyalty programs to drive consumer behaviour toward higher margin products.

— The European energy crisis is presenting another large impact on their operations. In Germany, they reduced 'active territories' by ~10% (with a further 8% expected) to help drive efficiencies and support franchisee margins due to the lower cost per delivery.

The unfolding chaos of the industry will see poorer restaurant operators go out of business in the coming years. While we cannot provide evidence of their antifragility (yet), the benefits of the strength and resilience of their business model will come to fruition in the medium-long term—its competitive position is only strengthening.

In the face of externalities, Domino's has demonstrated an ability to reconfigure its resource base to mitigate the threat—its resilience stems from systems and processes that create and retain resources driving future competitiveness. Domino's relentless focus on franchisees, nurturing human capital, and continued operational efficiencies will ensure their store-rollout objectives will continue over the long term.

Resilience: The Antidote to Black Swans

The future is uncertain. Rare events are unavoidable. The longer our investment horizon, the greater the uncertainty and the higher the probability of black swan events. Taking a precautionary approach reduces the likelihood and severity of these events.

The pandemic, devastating weather events, and the invasion of Ukraine are examples of macro-environmental shocks impacting companies worldwide. Portfolios that comprise resilient, sustainable investments provide a degree of comfort amidst market uncertainty and maximise the likelihood of resilient performance over the long term.

Investors that fail to mitigate uncertain risks will almost certainly lead to underperformance, however, accepting uncertainty and applying resilience-based risk management principles can mitigate these risks in situations of major systemic disruptions.

When selecting investments, companies that are resilient in the face of these challenges are vital, while finding antifragile companies is the key to long-term investing. Resilient businesses will manage and adapt when the uncertain materialises.

The market's tendency to overreact to short-term events presents a unique investment opportunity. The best antidote to the (current) lower-growth, uncertain world is to invest in high-quality resilient companies. Seek out the antifragile and concentrate your portfolio on these, they are the best protection against unknown risks.

Dealing With the Unknown

Interest Rates and Investing Under Uncertainty

Decisions made by central banks around the world have drastically impacted equity markets. Globally, many asset owners would never have predicted the extent of the rise in interest rates, with many grumbling at the lack of foresight provided by key decision-makers. When dealing with change events that were not foreseen, investors have few tools to prepare and manage these associated risks. Probabilistic modelling cannot fully encapsulate these black swan events, and for equity investors, taking a resilience-based approach may better protect their wealth against unknown uncertainties and risks.

The Reserve Bank of Australia (RBA) had fallen foul of prior statements that they would not raise the cash rate until 2024. Phillip Lowe, Governor of the RBA, apologised for people listening to what was said and acting on that rather than paying attention to the caveats of what was said. This apology was clearly in response to gripes similar to the one made by a dear friend who said, "the people who should know better have totally misled us all, and now I have lost a small fortune."

Phillip Lowe insisted that his guidance was never "calendar-based" but "state-based", meaning the path of future rate hikes was always tied to the state of the economy, not some predetermined date in a diary. However, would our client have borrowed as much money if he had thought rates might rise sooner than 2024? I think not.

Policy Frameworks

The Governor was not alone in his view on future interest rate movements, with similar opinions espoused by other central banks. In 2015, the Executive Office of the US President published insights into the premise on which interest policy is based, highlighting how interest rates are determined.

Through the lens of Economic Theory, the paper explores the Ramsey model, which generates a fundamental link between per capita consumption growth, the real interest rate, and the economy's growth rate.

The paper starts with the simplest version of the model and then, in a later discussion, considers uncertainty but still utilises the standard Euler condition and standard functional forms for household preferences to arrive at the formula

$$r_{t+1} = \rho + \sigma g_{t+1}.$$

with the real interest rate defined as a function of the growth rate of consumption per capita.

The discount rate r measures how much people value current consumption relative to future consumption. The intertemporal elasticity of substitution, $1/\sigma$, measures the extent to which households are willing to give up consumption today for consumption tomorrow. If growth is expected to be high, people will try to borrow against their future higher income to consume more now, which will drive up the interest rate.

At some point, the higher interest rate will discourage borrowing and restore equilibrium between the return on capital investment (which reflects the ability to produce income in the future) and the household's desire to consume now. The interest-rate response depends on the interaction between σ, and the growth rate of per capita consumption and is developed from modelling historical data.

The report concludes:

In a world with financially integrated national capital markets, the general level of world interest rates is determined by the equality of the global supply of savings and global investment demand.

- Capital markets of advanced economies are now tightly integrated, while emerging market economies are becoming increasingly integrated into the global financial system. Low-income economies remain partially segmented from the global capital market.
- As a consequence of increasing international market integration, long-term real and nominal interest rates are increasingly moving in tandem and have declined along with U.S. rates. Nominal interest rates also tend to be correlated across countries though differences in inflation expectations can produce differences in nominal rates.
- In a world with uncertainty, global long-term real and nominal interest rates will include risk premiums that can reflect country-specific risk factors. Strong economic linkages, however, reinforce substantial correlation in countries' long-term bond risk premiums.

Here, the final point highlights one key issue for investors: uncertainty. Risk frameworks have long acknowledged the role of uncertainty, with many theoretical models highlighting the distinct roles of risk and uncertainty. Importantly, uncertainty represents more about economic activity than risk.

Uncertainty is Unpredictable

Uncertainty relates to unpredictable events that result in adverse outcomes. For many investors, applying probabilistic-based modelling to portfolios can adequately manage the trade-off between risk and return. While risk can be determined by probabilities, uncertainties cannot.

When determining our expectations of the future world, we do so based on the current information at hand. The difference between objective and subjective probabilities is that the former relates to risk (known outcomes), while the latter relates to uncertainty (unknown outcomes).

Investors have to make subjective assessments of the future states of the world — we do not have objective probabilities. Here, the difficulties lie in which subjective assumptions are made and how they are applied.

Since uncertainty relates to our knowledge of what is to come, the effects of this uncertainty cannot be precisely detailed. As Donald Rumsfeld noted, these are the 'unknown unknowns', which are the uncertainties of where "we do not know what we do not know".

After the Global Financial Crisis and following the Lehman Bros collapse, Alan Schwartz, the CEO of Bear Stearns (which ran into trouble before the bailout of Lehman Bros), said, "we all !@#$% up… banks, regulators, everybody… and fifty years from now, there'll be another crisis, and it'll be about some instrument that we've never heard of." Well, as it turns out it wasn't fifty years, it was ten years, and it wasn't an instrument, it was COVID-19.

In 1952, Milton Friedman and Leonard Savage presented their expected-utility paper, commenting that even when you do not have enough information for objective probabilities, you should better adopt some probabilities and make decisions under them. This seems similar to what resulted in the announcements regarding interest rate movements.

When assigning subjective probabilities, one does not know with certainty the outcome in advance as there is no such evidence.

In uncertain situations, the errors may be so significant that attempting to predict these outcomes is unhelpful.

Dealing With the Unknown

The Resilience Defence

There is no risk in steady-state environments, yet when we find ourselves in situations of change, risks will emerge. For investors, change increases risk because we do not know its effects, leaving open the possibility of unexpected consequences or outcomes.

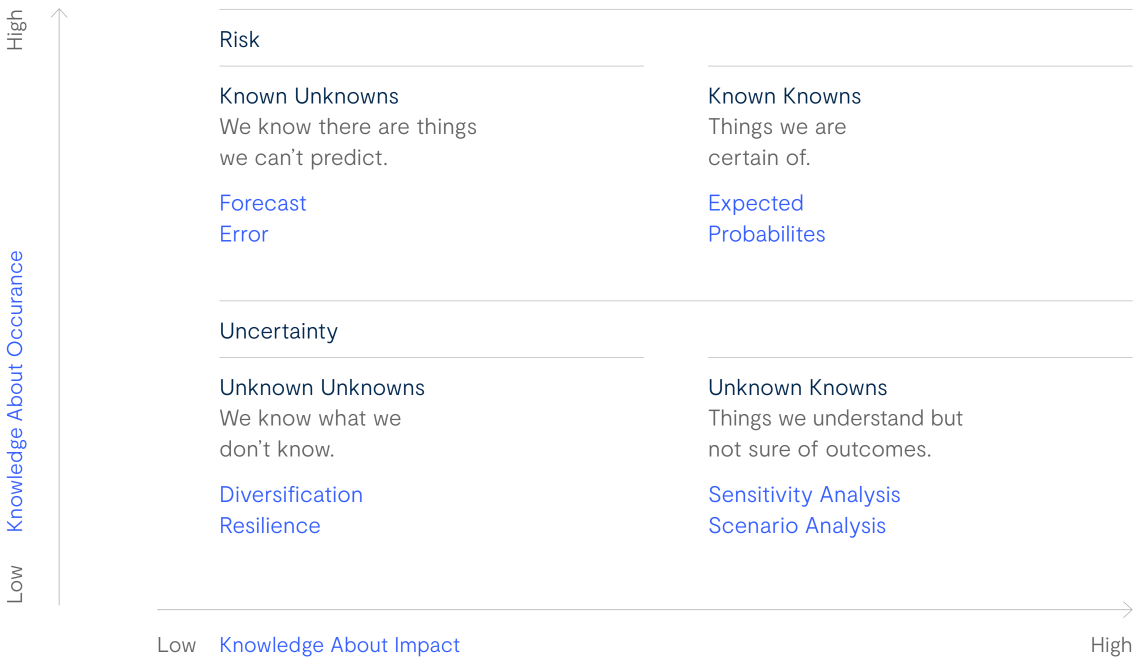
Traditional risk management practices lie in the domain of probabilities, while non-probabilistic assessments rarely feature in risk mitigation methods.

Black swan events occur at unpredictable intervals. Nissim Taleb, the author of 'The Black Swan: The Impact of the Highly Improbable', highlighted the concept of black swan events, commenting that these events are low in predictability and high in impact.

The spread of COVID-19 and the Ukraine war profoundly affected global equity markets. Stock markets fell due to the increased uncertainty, and the immediate impact these events had on economic activity saw reduced trade, lower investment and household spending, and rising employment — all of which contributed to the first recession in over 30 years.

Over the long term, unexpected situations arise that may not be incorporated into probabilistic modelling. These situations may (negatively) impact investment portfolios and, when left unmanaged, may seriously affect long-term wealth. By accounting for these 'unknown unknowns', investors will better protect and grow their wealth through time.

Below outlines the concepts of risk and uncertainty, highlighting the known-unknown continuum, which highlights two fundamental criteria: knowledge of the occurrence and knowledge of impact.



Source: Jason Pohl

Academic theory suggests several approaches when faced with the 'unknown unknowns', including diversification which has been relied upon by many investors worldwide. However, diversification too often is but an excuse for poor due diligence.

As investors, we are essentially business owners. Finding resilient companies means investing in those that can grow their economic footprint while strengthening their competitive advantage despite rare, unforeseen events.

Resilient companies are well-resourced (financially and organisationally) to withstand 'unknown unknowns'. A key component of determining resilience is the concept of Dynamic Capabilities (DC). At ECP, we use the DC framework to gauge and assess a firm's ability to manage, react and grow in times of uncertainty.

DC's are essentially change-oriented capabilities that help firms redeploy and reconfigure their resource base to meet evolving customer demands and competitor strategies. Not all firms have this ability, and the best businesses have this dynamic capability.

When a firm has a Sustainable Competitive Advantage (SCA), its strategic approach has found a recipe that creates value that only belongs to the firm, where imitation is impossible. However, an SCA is not sustainable forever, as the resources driving its competitive advantage may change due to externalities.

Prepare for 2023

Investors are loss-averse, not risk-averse. When investing over long-term horizons, risk management strategies need to account for the unforeseen risks that may lead to capital loss. Resilience is the preferred approach to diversification.

Investing over the long-term means investing in a careful, considered and committed way. Being conservative in one's optimism means being squarely focused on mitigating the risks of the inevitable black swan.

We know with certainty that rare events will occur and that the intensity of these is unknown. Investors applying probabilistic-based approaches to risk management frameworks will only partially account for these looming disasters. Applying resilience-based principles will mitigate the dormant risks lurking behind these major disruptions.

Even a one-in-two-hundred-year storm has been known to have occurred two years in a row, and it is our job, as portfolio managers, to ensure that the companies in our portfolio can withstand our ignorance of future outcomes, especially as the frequency of its occurrence is unknown.

Cultivating Culture

The Importance of a Good Corporate Culture

Culture is how an organisation thinks, acts, and interacts. A good corporate culture drives superior business performance - it motivates and retains the most talented employees who ensure sustained strategy execution. It also promotes equality in the workplace and supports both social and industrial changes as they occur. When searching for high-quality companies, assessing a firm's corporate culture is critical to evaluating the success of an organisation and its long-term potential.

A strong corporate culture cannot be built overnight, it will evolve and permeate over time and requires strong leadership and employee buy-in. While it's difficult to define, it has an outweighed influence on a firm's long-term success.

Good culture provides both employer and employee with an environment that encourages and fosters communication, collaboration, innovation and social harmony. This helps to ensure high productivity levels while maintaining focus and motivation.

A good culture does not replace a corporate strategy, but it should help to facilitate its execution and encourage a strategy that is continually evolving and improving.

Companies that can cultivate such an environment may benefit from a high degree of buy-in from their employees as they put the collective greater good of the company ahead of their own individual aspirations.

A high degree of alignment allows these organisations to thrive, driving positive financial outcomes, ultimately leading to their people being better rewarded.

What Drives a Good Corporate Culture?

A good corporate culture begins at the top. It needs to be a key priority for senior leadership, who need to understand and be aware of the benefits that a good corporate culture delivers.

Culture is central to long-term performance - the executive is essentially the culture guardian. Culture is the most critical enabler of successful strategy implementation and should be protected at all costs.

When senior management is focused on ensuring a good corporate culture, it trickles down to middle management and other employees to become firmly embedded within the organisation.

The tenure of management is an important consideration when assessing the presence or absence of a healthy corporate culture, as it provides us with confidence that the management team holds the skills, resources and experience required to continue to nurture their culture through all business cycles.

Not all companies are filled with seasoned leaders, so in these cases, it is important that any new leader recognises the importance of corporate culture and the influence it can have on the long-term performance of the company.

Companies with a poor corporate culture are less effective in executing their strategic goals. In some instances, painful and disruptive decisions may be made to remove employees for the greater good of the organisation. See our previous article on James Hardie (ASX: JHX) and the steps taken to protect their culture.

What Does a Good Corporate Culture Lead To?

A positive corporate culture leads to higher productivity levels and better financial outcomes. An organisation with a strong and positive corporate culture can more readily increase its overall productivity, reducing labour force churn rates while delivering better, more sustainable outcomes.

For any business, improved productivity creates a virtuous cycle, boosting morale and creating a culture of excellence - a competitive advantage in itself.

Conversely, when workers waste time on tasks unrelated to driving revenues or profits, they (negatively) impact the organisation and eventually, they leave the organisation, are dismissed, or worse, they stay and disrupt others while dragging down the firm's culture.

For many businesses, people are one of their most significant capital outlays, and are one of the most important areas of investment.

Normally it is easy to measure the ROI of an asset; however, it is more challenging when assessing the ROI of the workforce. Staff costs are generally a high percentage of overall variable costs in a firm, so the importance of extracting solid returns is critical.

Moreover, when a company has a positive corporate culture, employees become chief promoters of the firm. For many stakeholders (customers, suppliers, and the broader community), this level of support from their working base emphasises the quality nature of the business.

This is readily observable by those outside of the firm and can result in reputational value being added, driving people, customers, partners, suppliers, and potential employees, amongst others, to the company, further driving revenue, reducing operational friction, or both.

How to Assess Corporate Culture?

Measuring or assessing organisation culture can be difficult as the benefits of a strong corporate culture are often intangible. Some cultural indicators are online staff satisfaction surveys, company churn rates, net promoter scores, or, quite simply, the financial performance of a firm.

One internal mechanism for measuring the corporate culture is staff engagement levels and net promoter scores. These are indicators of how interested the workforce is in not only talking about the positive attributes of a firm but also highlighting where things can improve.

In our experience, culture is also an attribute that is proudly displayed by those who possess its positive manifestation, and conveniently brushed over when it is lacking or poor. Companies tend to highlight when a culture is good, making senior managers available for meetings, or highlighting positive workplace stories.

On the contrary, when a culture is bad or toxic, management tends to restrict access and try to hide evidence of the fact that people dislike working in the organisation. Often the information presented (or lack thereof) provides us with insight and causes us to look deeper under the hood.

Not all companies that perform well have strong or positive corporate cultures. However, if the corporate culture is bad, it often leads to issues and missteps within the organisation, which can impair the enterprise value of the firm.

"A strong corporate culture cannot be built overnight, it will evolve and permeate over time and requires strong leadership and employee buy-in. "

Cultivating Culture

Cultural Case Studies

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RioTinto

Road to Recovery

Rio Tinto (ASX: RIO) offers an example of where the company performed well (financially), but a terrible corporate culture under the previous CEO and management team led to serious operational breaches.

For Rio, the breaches resulted in the Juukan Gorge destruction, and they were also responsible for a toxic workplace culture. While the company continued to perform well, generating record earnings, these events took away from its financial performance resulting in a share price that underperformed.

Rio's detailed study of its own workplace revealed a very toxic workplace culture that had evolved over many years. The report was disappointing for the Board and senior management team but it helped to drive drastic changes with all management and employees embracing a new cultural outlook.

For us, Rio's transparency and willingness to change is one positive element of its culture (albeit a recent one). Rio's courage to investigate the situation and publicly reveal the findings demonstrates strong governance practices and should be applauded.

Rio's current Board and Executive team are highly motivated and genuinely focused on making positive changes to ensure its employees operate in a sustainable way while operating responsibly within environmental and social mandates.

Rio's 'Report into Workplace Culture' followed multiple ESG breaches, underscoring how a toxic culture can influence decision-making, resulting in suboptimal outcomes. While the financial performance of Rio was excellent during the same period, the report revealed that many employees were dissatisfied and disengaged.

The result of this poor culture was productivity issues, poor decision making and generally unhappy people both at and outside of the workplace. The indirect costs of this poor corporate culture were significant, demonstrating why swift action is necessary.

When a toxic culture exists, and this manifests in situations such as the Juukan Gorge heritage site destruction or workplace harassment issues, leaders may find themselves in a position that can drive substantial (positive) changes for the betterment of the organisation.

The appointment of the new CEO, Jakob Staushol and then Kellie Parker as the Head of Australia were significant decisions and demonstrated the company's intention to build a better culture.

Rio was squarely focused on rebuilding its corporate culture to ensure better future decision-making. We expect that this cultural change will drive better financial outcomes, and ensure lower staff turnover rates and lower incidents at the workplace.

Cochlear®

Quality Sounds

Cochlear Limited (ASX: COH) is a company that was founded in the early 1980s. It has a rich history in R&D and has long been an employer of choice for those wishing to access engineering resources and support in the hearing space.

Many of the senior management team have been at the company for decades, including the CEO, CTO, Head of North America and the Head of EMEA. Several other leaders have significant tenures, as well as many employees, who have been with the firm for a very long time.

Cochlear's culture centres around research and innovation. The company's significant spending on technological advancements has resulted in continuous innovation that has driven positive change within the industry. The result of this has meant that it has attracted many high-quality people while fostering an innovation-based culture.

By ensuring a positive cultural workplace, centred around research and innovation, the company has successfully produced leading-edge technology in the hearing implant-related field. It has dominated the market with a leading market share of nearly 70% (in implants), a position that competitors can only dream about.

Moreover, the effect of this has led to superior financial results and share price performance over a very long period of time. It can be largely attributed to the long tenure of management and the culture they have created within the organisation.

People Power

At ECP, we seek to identify companies with predictable earnings streams that are growing their economic footprint. For all companies striving to grow their economic footprint, it is important to focus on corporate culture and the benefits that a positive culture can bring to an organisation.

The true test of a positive corporate culture is not only in the upcycle but, more importantly, in the downcycle, a time when a positive corporate culture truly makes a difference in motivating and retaining employees.

Company culture is a critical enabler of successful strategy implementation. Ensuring a respectful and healthy working environment is essential for long-term performance. Finding companies that excel in this area will ensure greater conviction in an investor's belief surrounding other fundamental areas of the investment case.

The Carbon Transition

Decarbonisation

Background

The long-term investment horizons of superannuation funds make them acutely vulnerable to the systemic disruptions associated with climate change. Our industry is in the early stages of its transition. Conscious of the commercial implications of climate risks and regulatory, legislative and policy requirements for action, institutional investors are acting to address the likely impacts of global warming.

Achieving net zero emissions before 2050 is a key element of the Paris Climate Agreement (UNFCCC 2015) to limit global temperature rise to well below 2 degrees Celsius above pre-industrial levels and to strive for 1.5 degrees.

Several Australian superannuation organisations have committed to addressing the emissions of their investments. Their commitments are to evaluate their alignment with the goal of net zero emissions by 2050, a key element of the Paris Agreement.

Under pressure from regulators and customers, many are emphasising engagement activities, such as asking the companies in which they invest to disclose – and, in some cases, address – their climate risks. Superannuation funds are committing to reduce emissions funded through their investment portfolios, a further sign of gathering momentum for change.

Race to Zero

Part of understanding this transition is the importance of engagement in transitioning portfolios towards net zero. At present, the strategies adopted by most funds are centred on investee engagement rather than the setting of net-zero targets.

In addition to encouraging greater disclosure from the companies in which they invest, some funds now engage with the biggest emitters in their portfolios to align their strategies with the goals of the Paris Agreement through initiatives such as Climate Action 100+.

More funds are increasing their investments in clean energy; more are divesting from fossil fuels. In 2020, for instance, both HESTA and Aware Super started divesting from thermal coal companies as part of their longer-term targets to reduce emissions within their portfolios.

With some of the super funds committing to net zero carbon emissions (UniSuper, Active Super, HESTA, and Aware Super, to name a few), we expect many more to follow. There are always leaders and laggards, and at ECP, we have taken the view to be part of this industry change.

At ECP, we know that Sustainable Business is Good Business. Our process of identifying high-quality franchises results in companies that are carbon-light and have strong ESG credentials. These businesses are highly innovative and are key to solving our societal challenges.

Sustainable Development Goals

United Nations Sustainable Development Goals

Our Commitment

ECP supports the UN Sustainable Development Goals (SDGs), and we believe that the business community should be aware and understand the key societal challenges we face and to implement responsible practices where appropriate.

From an investment perspective, we do not invest in companies to meet the SGDs. However, we do use this blueprint from an analysis perspective which informs our engagement in ensuring we are invested in the highest quality franchises.

United Global Compact Compliance

The United Nations Global Compact, which is a non-binding pact to encourage businesses to adopt sustainable and socially responsible policies and to report their implementation, has issued ten principles to be assessed.

According to the analysis, ECP's portfolio is 100% compliant with international norms since there are no Global Compact Violations. At the same time, none of the companies in the portfolio is on the Global Compact Compliance Violation Watchlist.

> "ECP's portfolio is 100% compliant with international norms since there are no Global Compact Violations."

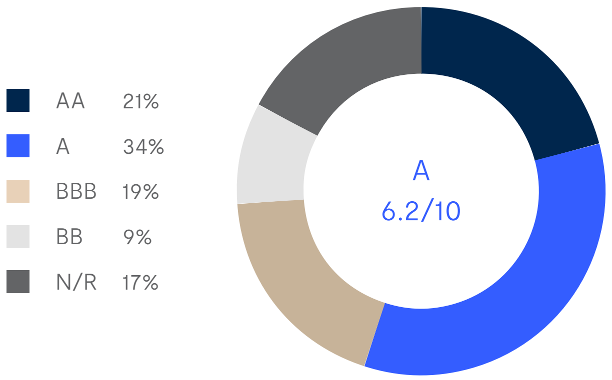
SDGs & Our Portfolio

Impact Assessment

This year, we commissioned an independent ESG analysis and SDG impact assessment of our ECP Emerging Growth companies portfolio. Our portfolio is rated A, noting that we do not have any controversial business involvement exposure, and our portfolio fully complies with the United Global Compact.

About 25% of companies in the portfolio are classed as leaders with AAA or AA ratings. While we caution against making assessments of the sustainability of investments through external rating agencies, it is a positive sign that a relatively high proportion of our portfolio has been awarded this rating, particularly given our large exposure to emerging companies with limited disclosures that inform these ratings.

Portfolio ESG Rating Distribution



Portfolio Score		6.2
Portfolio Rating		A
United Global Compact Compliance	✓ Compliant	0%
Business Involvement Exposure	✓ Pass	0%

Interestingly, About 4.6% of the portfolio revenue is exposed to products and services that help to solve the world's major Social, environmental challenges.

Our sustainable impact solutions score is an industry average of 2 out of 4. Importantly, we are not an impact fund. However, we would expect the portfolio's exposure to sustainable impact-related themes to increase over time as technological advances will increasingly seek to solve the challenges the world faces. Notably, the top contributor to Social impact is Costa Group.

While we do not use ESG ratings in our research, the analysis indicates that, on average 38% of companies in the portfolio have stable ESG rating momentum. i.e. ESG rating has not been upgraded or downgraded recently. Additionally, 33% of portfolio companies have positive ratings momentum; and ~25% of companies in the portfolio are classed as leaders with AAA or AA ratings.

Based on the assessment of ESG scores, our portfolio has higher ESG scores across themes captured under the Governance pillar. This is followed by themes in the Social and Environmental pillars. From a sector perspective, our portfolio has a strong relative position in Information Technology (IT) and Health Care compared to the benchmark. All companies in the IT and Health Care sectors are AA or A rated. In Financials, the Companies are either A or BB rated.

Out of the 5 companies that contribute to the largest portfolio weights, Domino's falls within the ESG rating of BBB and Carsales.com falls within the ESG rating of A. Interestingly, all the highest ESG-rated companies in the portfolio are Consumer-based, and we note that the portfolio's largest position GQG Holdings is not covered for ESG ratings.

Sustainable Development Goals

Lowest ESG Rated Positions in Portfolio

Holding Name	Portfolio Weight	Rating
Netwealth Group Ltd	6.35%	BB
ARB Corporation Ltd	3.04%	BB
Lovisa Holdings Ltd	4.66%	BBB
Audinate Group Ltd	1.01%	BBB
Pwr Holdings Ltd	4.82%	BBB

Highest ESG Rated Positions in Portfolio

Holding Name	Portfolio Weight	Rating
Altium Ltd	4.42%	AA
Serko Ltd	0.99%	AA
REA Group Ltd	4.93%	AA
Corporate Travel Management Ltd	6.37%	AA
Nanosonics Ltd	1.05%	AA

Largest Positions in Portfolio

Holding Name	Portfolio Weight	Rating
Domino's Pizza Enterprises Ltd	8.22%	BBB
Carsales.com Limited	7.59%	A
Hub24 Ltd	7.22%	A
IDP Education Limited	6.66%	A
Judo Capital Holdings Ltd	6.45%	A

Exposures

Revenue Exposure to Sustainable Impact Solutions

	Portfolio	Benchmark	Active Exposure
Social Impact	4.5%	2.0%	+2.4%
Nutrition	0%	1.2%	-1.2%
Affordable Real Estate	0%	0%	0%
Major Disease Treatment	0.1%	0.3%	-0.2%
Sanitation	0%	0.5%	-0.5%
SME Finance	0%	0%	0%
Education	4.4%	0.7%	+4.3%
Environmental Impact	0.2%	1.7%	-1.5%
Alternative Energy	0%	0.7%	-0.1%
Energy Efficiency	0.2%	0.3%	-0.1%
Green Building	0%	0%	0%
Sustainable Water	0%	0.7%	-0.1%
Pollution Prevention	0%	1.1%	-1.1%
Total Revenue Exposure	4.6%	4.7%	+1.1%

Sustainable Development Goals

Exposures

Exposure to Potential Negative Impact from Company Operations

Environmental

Natural Capital	Portfolio	Benchmark	Active
Exposure to severe biodiversity controversies	0%	15.7%	-15.7
Exposure to companies facing water stress	69.6%	37.4%	+32.1%

Social

Basic Needs	Portfolio	Benchmark	Active
Exposure to severe product safety controversies	0%	1.3%	-1.3%
Exposure to severe marketing controversies	0%	1.3%	-1.3%

Empowerment	Portfolio	Benchmark	Active
Exposure to severe employee relations controversies	0%	3.4%	-3.4%
Exposure to companies facing major layoffs	6.4%	9.1%	-2.8%
Exposure to predatory lending	0%	1.3%	-1.3%

Around 69.6% of portfolio company operations are exposed to water stress, which is slightly worse than the benchmark. While 1.6% are exposed to severe biodiversity controversies. However, exposure to major layoffs and severe biodiversity controversies is better than the benchmark.

The SDGs represent the coverage of the United Nations' 17 principles issued for companies that follow the path towards a sustainable future. According to the data analysis, ECP's mid-cap portfolio contributes towards 7 of the 17 principles. The biggest contributions are towards SDG 16 (Peace Justice and Strong Institutions), SDG 17 (Partnerships for the Goals), SDG 11 and 7.

01. No Poverty
End poverty in all its forms, everywhere.

02. Zero Hunger
End hunger, achieve food security and improved nutrition, and promote sustainable agriculture.

03. Good Health and Well-being
Ensure healthy lives and promote well-being for all, at all ages.

04. Quality Education
Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all.

05. Gender Equality
Achieve gender equality and empower all women and girls.

06. Clean Water and Sanitation
Ensure availability and sustainable management of water and sanitation for all.

07. Affordable Clean Energy
Ensure access to affordable, reliable, sustainable, and modern energy for all.

08. Decent Work and Economic Growth
Promote sustained, inclusive, and sustainable economic growth, full and productive employment, and decent work for all.

09. Industry, Innovation and Infrastructure
Build resilient infrastructure, promote inclusive and sustainable industrialization, and foster innovation.

10. Reduced Inequalities
Reduce inequality within and among countries.

11. Sustainable Cities and Communities
Make cities and human settlements inclusive, safe, resilient, and sustainable.

12. Responsible Consumption and Production
Ensure sustainable consumption and production patterns.

13. Climate Action
Take urgent action to combat climate change and its impacts.

14. Life Below Water
Conserve and sustainably use the oceans, seas, and marine resources for sustainable development.

15. Life On Land
Protect, restore, and promote sustainable use of terrestrial ecosystems, manage forests, combat desertification and biodiversity loss, and halt and reverse land degradation.

16. Peace, Justice and Strong Institutions
Promote peaceful and inclusive societies for sustainable development, provide access to justice for all, and build effective, accountable, and inclusive institutions.

17. Partnerships
Strengthen the means of implementation and revitalize the global partnership for sustainable development.

Our Planet

Our Climate Change Position Statement

This year ECP has initiated a number of steps toward fulfiling our long-term strategy toward our approach to sustainability and our own (internal) ESG practices and corporate social responsibility. Part of this is to introduce our own climate change position statement.

The Paris Agreement was originally designed as a framework for government, however, its philosophy and underlying goals are highly relevant to the corporate world. For any business, exposure to government action presents a core consideration for any business strategy or investment. With increasing climate-related regulation, companies with plans to reduce their GHG emissions will be well-positioned over the long term to deliver above-average returns.

Companies and investors are essential to a pathway toward a net-zero economy. As with any major paradigm shift, the early adopters of these seismic changes within an operating environment will see increased innovation and higher free cash flows and returns on invested capital through time. Moreover, these actors will find early adoption leads to greater credibility amongst their stakeholders, leading to a greater brand reputation.

As a fund manager, ECP's investment philosophy is centred around identifying high-quality investments (Quality Franchises) that can generate predictable, above-average economic returns. Quality Franchises are sustainable business models that have responsible and trustworthy management. These companies understand that reducing their GHG emissions means improving their business, providing value to their stakeholders, and respecting our community and environment.

Within superannuation, decision-makers (asset owners and asset managers) play a vital role in the road toward achieving decarbonisation. When investing, allocating capital toward companies who are aware of all risks, including climate-related risks, means we are embracing our mandate of responsible investment.

At ECP, we see ourselves as part of the fight against climate change. Engaging with companies to assess the resilience of their business models to externalities ensures not only are we investing in the highest quality businesses we can find, but moreover we are investing in companies that will continue to build a sustainable future for our people and the planet.

We believe that the Paris Agreement and the scientific-based targets present investors with a viable process for slowing down the rising global temperatures. Without such mitigation, the planet's trajectory toward rising temperatures of between 2°C and 4°C by 2100 presents unacceptable and devastating impacts on ecosystems and our health and survival.

For long-term investors, we cannot disregard these signals and cannot ignore the tail risks that may play a detrimental role in our client's long-term wealth creation. What is good for our community is good for our portfolios. Quite simply, sustainable business is good business.

"The planet's trajectory toward rising temperatures of between 2°C and 4°C by 2100 presents unacceptable and devastating impacts on ecosystems and our health and survival."

Our Planet

Roadmap to Net Zero

Since our submission earlier in the year, we have introduced a Roadmap to Net Zero to our Climate Change Position statement (see below or go to www.ecpam.com/sustainability). Within our roadmap, we have taken the approach of focusing on our emissions relative to the index in setting our goals and aspirations.

2014

Signatory to Principles of Responsible Investment (PRI)

2019

Broadened our qualitative research process to specifically consider a Sustainability Pillar – with 40% of our overall assessment being related to Sustainability & Stewardship.

Climate change considerations increasingly becoming a formal part of our analysis.

2021

Supporter of the Task Force for Climate-related Financial Disclosures (TCFD).

Updated Responsible Investment Policy and developed a specific ESG & Sustainability Policy.

Environmental Negative Screens updated to include Thermal Coal, Petroleum, Old-forest logging, Palm Oil, Pesticides – sectors identified as issued relating to climate change are reviewed annually.

2022

Member of the Responsible Investment Association of Australasia (RIAA).

Publish Roadmap to Net Zero.

Portfolio-wide engagement on Net Zero and climate change considerations for all investments.

2023

Climate Active certification for our business operations.

Formalise the framework to ensure our portfolios target carbon intensity* less than the relevant index for our portfolios.

Deepen climate-related engagement and establish measurable objectives for companies related to ESG/climate change initiatives and begin to monitor them.

2024

Work with clients on their decarbonisation targets and how we can assist – establish measurable portfolio objectives to meet decarbonisation targets.

Introduce portfolio offerings for clients that may assist in limiting carbon exposure.

Partnerships & Collaboration – Net Zero Asset Management Initiative and the Institutional Investor Group on Climate Change.

2025

Achieve Net Zero for our business operations.

Target carbon intensity* 25% less than the index across all portfolios.

Conduct external assurance / independent assessment on ESG and climate related statements.

2030

Target carbon intensity* 50% less than the index across all portfolios.

Achieve Net Zero for our business operations – since inception.

2040

Target carbon intensity* 75% less than the index across all portfolios.

2050

Achieve Net Zero for our firm operations and across all portfolios.

* Total Carbon Emissions (tCO2e) per A$1 million invested.

A portfolio's total carbon emission in tons of CO2e measures the portfolio's tons of CO2e, taking scope 1-2 and scope 3 emissions into account. Each equity investment's carbon emissions are apportioned based on equity ownership. As defined in the Greenhouse Gas Protocol, Scope 1 emissions are those directly occurring "from sources that are owned or controlled by the institution". Scope 2 emissions are "indirect emissions generated in the production of electricity consumed by the institution". Scope 3 emissions are all the other indirect emissions that are "a consequence of the activities of the institution but occur from sources not owned or controlled by the institution".

Our Planet

Task Force for Climate-Related Financial Disclosures

The Task Force on Climate-Related Financial Disclosures (TCFD) was created in 2015 by the Financial Stability Board (FSB) to develop consistent climate-related financial risk disclosures for use by companies, banks, and investors in providing information to stakeholders.

As a long-term investor and through our commitment to upholding responsible investment practices, it is prudent that we carefully consider any long-term risks to our investments. Increasingly, climate change and environmental risks pose serious threats to some business models, whether they be physical or transitional risks, as we transition to a net-zero economy.

ECP believes that the increasing focus of investors on ESG-related issues and climate change impacts each and every company. In line with the TCFD, we believe that the transition and physical risks presented by climate change provide material risks for some businesses, while others may find it presents some compelling opportunities and financial benefits.

This year was our second year of being a supporter of the TCFD, and we published our annual TCFD Report, which is available on our website.

Why is the Climate Relevant?

Where companies are exposed to climate change or negatively impact the environment or our community, they will inevitably be exposed to increasing regulation, consumer backlash, generally higher costs to operate, and lower returns on investment capital. These are exactly the types of businesses that we avoid.

For us, protecting our client's capital is paramount. Every investment is assessed concerning the potential risks associated with ESG and, further, where there may be an opportunity for the business over the long term.

ECP and its investment team periodically discuss and assess climate-related risks and opportunities with respect to potential investment opportunities. For us, understanding these significant changes within our society means a holistic understanding of a business today, and into the future.

The result of applying our rigorous process means our portfolio companies are highly resilient against most economic cycles, they are less sensitive to changes in economic rates, they are less impacted by major market disruptions and they are able to manage carbon pricing and other government intervention policies combating climate change.

While we do not take a top-down approach when investing, we are relentless in our search to ensure we are aware of climate-related opportunities and their potential impacts on our investment companies. Below highlights several key areas where climate change may present opportunities for the quality companies we seek to invest in.

Risks

As a fund manager, the following information about our investments provide some colour around the two key areas of risk associated with climate change.

Physical Risks

Physical risks are those related to the physical impact of climate change. These types of risks may be (acute) physical risks, including extreme weather events, chronic heat waves, sea-level rise, erosion, and biodiversity loss. Moreover, these risks may include longer-term shifts in climate patterns (chronic risks), affecting anything from the organisations' supply chain to their employees' safety.

Acute physical risks, such as decreased production capabilities, may reduce revenue streams. Additionally, the financial impacts of these risks are compounded by increased insurance premiums and the necessity for capital investments to replace damaged assets. Disruptions to staff commutes during severe weather events further exacerbate operational challenges, potentially leading to productivity and service delivery losses.

Chronic physical risks pose significant financial threats, particularly through increased electricity costs, which may inflate operational expenses over time. Frequent asset replacements due to ongoing damage and the financial repercussions of asset write-offs and impairments may escalate capital costs. These chronic issues underscore the urgent need for strategic investment in resilient infrastructure and adaptive operational practices to mitigate long-term financial risks associated with climate change.

Transition Risks

Transition risks relate to the transition to a lower-carbon economy, which could entail policy, legal, and technology developments, market changes, or reputation issues. Organisations are already seeing this impact with climate-related litigation and policy changes rising. Costs of operation, raw materials, and products are vulnerable to shifts in policy, technology, and markets. Changes in consumer preferences and customer behaviour must also be considered.

The potential financial impacts stemming from transition risks include the potential for reduced demand for products or services, which directly threatens to decrease revenue streams. Furthermore, as financial markets adjust to the new climate realities, capital availability could be reduced. This contraction could hinder the ability to finance expansions and innovations or even maintain operations at current levels.

Additionally, increased public relations and marketing expenditures may arise to mitigate potential reputational damage associated with perceived inadequacies in environmental commitments or responses. These heightened expenses are essential for maintaining a brand's position and customer trust in a competitive market increasingly focused on sustainability.

Opportunities

Resource Efficiency

By using more efficient modes of transport or more efficient production and distribution processes, high-quality companies will see reduced operating costs and efficiency gains while also potentially seeing greater production capacity. Moreover, by clearly focusing on more efficient buildings and lower water usage or recycling, companies can extract increased value from their fixed assets.

Energy Source

By using more efficient modes of transport or more efficient production and distribution processes, high-quality companies will see reduced operating costs and efficiency gains while potentially seeing greater production capacity. Moreover, companies can extract increased value from their fixed assets by clearly focusing on more efficient buildings and lower water usage or recycling.

Product and Services

Developing or expanding low-emission goods and services through innovation and shifts in business models or consumer preferences may provide opportunities for businesses to drive increased revenues through new income streams or greater consumer value. Here, companies may find themselves in a far superior competitive position that better reflects the shifting consumer preferences.

Markets

For some companies, climate-related opportunities may arise through access to new markets, public sector incentives, or greater reach in their ability to access new assets and locations. Having nimble, quality franchises that can leverage these opportunities can provide material investment outperformance over the long term.

Resilience

At ECP, a key characteristic of our portfolio investments is their resiliency against externalities and economic cycles. By participating in renewable energy programs and adopting energy-efficient measures, companies may increase their market valuation by demonstrating greater resilience and reliability in their supply chains and operating through several conditions. Moreover, these companies may benefit from increased revenue through new products and services that ensure greater reliance.

Quality is Sustainable

As mentioned above, there are several risks and opportunities that lie ahead for our portfolio companies regarding climate change and their business models. For each company, different risks and opportunities may occur due to varying reasons. Despite the changing landscape, Quality Franchises provide the best solutions to managing these risks or pursuing these opportunities. Some examples of risks and opportunities of our portfolio companies include:

Rio Tinto Plc (ASX: RIO)

Physical Risk

Rio Tinto's assets, infrastructure, communities, and broader value chains are exposed to chronic and acute climate change risks, such as the impacts of extreme weather events. Their operating sites may be vulnerable to natural disasters or extreme weather events. Climate change may increase the frequency and severity of these events, including rising sea levels, floods, droughts, bushfires, and extreme temperature impacts on operating environments.

RIO has noted that their Scope 1 and 2 emissions targets are to reduce emissions by 15% by 2025 and 50% by 2030, relative to 2018 levels. These targets are ambitious and aligned with 1.5°C, the goal of the Paris Agreement. They are particularly ambitious as ~ 80% of their emissions come from processing activities, which are typically hard to abate. While this presents a challenge for Rio, we believe that the highest quality miner that maintains leading governance practices will better manage physical climate risks. This includes incorporating climate changes into how they design, operate, and close assets through an increased understanding of exposure to each asset.

Energy Opportunity

Rio Tinto has set its sights on delivering a lower carbon future, with its mobile diesel being a key strategic decision. Mobile diesel is Rio's third largest GHG emission source (16% of emissions), and the company is looking to develop low-emission alternatives for mobile fuel use in haul, load, and rail. Diesel for trucks and electricity are the main sources of emissions in Rio's copper business, and here also, the company is advancing alternative fuel truck trials. Between 2022 and 2024, Rio plans to conduct a range of modifications to owned shipping vessels, which are collectively expected to deliver more than 10% of carbon emission reduction. These include applying high-performance paints to reduce friction, modifying the propellers, and installing swirl ducts, enhancing energy efficiency.

James Hardie Industries (ASX: JHX)

Physical Risk

James Hardie has highlighted that severe weather, natural disasters and climate change could have an adverse effect on their business. Adverse climate changes that directly impact plants or other facilities could materially adversely affect manufacturing or other operations and, thereby, harm their overall financial position, liquidity, results of operations and cash flows.

Notably, this year, James Hardie has provided a dedicated Chief Sustainability Officer (CSO) to the Executive Leadership Team (ELT), directly reporting to the CEO. As part of their framework, James Hardie has committed to reduce absolute Scope 1+2 greenhouse gas (GHG) emissions by 42% by 2030 and to end zero manufacturing waste to landfills by 2035. As part of this, they plan to reduce the climate impact of fibre cement products by 50% by 2030.

Resilience Opportunity

James Hardie's approach of distributing products locally provides substantial efficiency and competitive advantage. 63% of deliveries in FY21 were within 500 miles of manufacturing facilities, which drives efficiencies - the strategic placement of plants optimises product movement. In addition to distributing locally, 83% of materials are sourced within 100 miles. This is a unique characteristic of their network of plants, which reduces inbound and outbound shipping. Less shipping enables lower costs and a lower carbon footprint than competing producers who may ship materials and products across the country to deliver products to market.

Additionally, their LEAN initiative prioritises conserving the use of natural resources, reducing consumption, reusing, and recycling where possible, which is focused on managing their environmental impact related to waste, energy, emissions, water, and effluent. By participating in these programs, James Hardie has proven to be more resilient through COVID-19, battling these pressures better than their competitors, resulting in market share gains, improved pricing power, and material revenue growth.

PWR Holdings Limited (ASX: PWH)

Transition Risk

As industries worldwide respond to increasing environmental regulations and a growing demand for sustainable practices, companies face significant transition risks related to the shift towards a low-carbon economy. These risks are particularly pronounced for businesses reliant on high-energy consuming materials and processes. Understanding these challenges is crucial for developing strategies that mitigate negative impacts on operations and capitalise on emerging opportunities in green innovation.

PWR's approach includes managing energy in the manufacturing process, improving energy efficiency and intensity, optimising the energy mix, and reducing grid reliance. Additionally, the company focuses on the emissions intensity of its production process, including upstream and downstream elements of the supply chain. Of particular importance is aluminum, PWR's primary raw material used in its products, is almost exclusively employed to produce our high-performance cooling solutions. Its production is both energy-intensive and generates significant greenhouse gases (GHG).

Opportunity

By using more efficient modes of transport or more efficient production and distribution processes, PWR aims to reduce operating costs and drive efficiency gains, posting greater production capacity. As part of this, automation plays a critical role in PWR's strategy. In 2023, the company purchased an automatic stacking machine that assembles cores from a component level to a 'ready to braze state' in approximately 5 minutes, a task that traditionally took 35 to 40 minutes. This efficiency gain boosts output and reduces the need for full-time equivalent staff, as the operator can simultaneously manage the plating and stacking processes.

Moreover, PWR now operates three manufacturing hubs capable of servicing global customers. The three manufacturing sites facilitate product manufacturing closer to our customers, reducing the distance products travel via air, sea or road to customers. Moreover, standardised equipment and specifications across all locations enable effective global capacity planning. This strategic approach helps PWR better serve its sustainability and efficiency initiatives by streamlining the global operating footprint through careful capacity planning.

Macquarie Group (ASX: MQG)

Transition Risk

Macquarie has recognised the impact of both physical and transition risks associated with climate change on its operations. In response, they have deepened their understanding of climate scenario analysis and are continuously refining their approach to integrate these insights into their existing stress testing activities. This proactive strategy enhances their ability to anticipate and mitigate potential impacts on their financial services.

Recently, Macquarie has undertaken a detailed analysis of the physical and transition risks within its Australian business lending and residential real estate lending portfolios. This included the creation of climate risk vulnerability heat maps, which provide a visual representation of areas most at risk. Additionally, Macquarie has integrated climate-related risks into its environmental, social risk, and credit analyses, particularly for carbon-intensive sectors. They have also developed specific methodologies for transition risk analysis in critical areas such as oil, gas, coal, and power generation sectors within their lending and equity portfolios.

Market Opportunity

Macquarie is the largest global infrastructure manager, with $560b in AUM, exemplifying how businesses can leverage climate-related opportunities for substantial market gains. As an early adopter of green investment strategies, Macquarie has capitalised on new markets through its substantial investments in renewable energy projects worldwide. It now has one of the largest renewable principal investment books and green advisory businesses through its acquisition of Green Investment Bank.

Macquarie is a key player in enabling the transition of global energy infrastructure to a decarbonised world, with Macquarie's Green Investment Group being pivotal in fostering its global presence in the green energy sector, allowing the bank to access new assets and locations while leading the shift towards sustainable finance. Currently, 10% of Macquarie's AUM is in renewables, with expectations of strong growth as the projects it manages transition from development to operational phases, allowing for the deployment of significantly greater capital amounts.

Our Planet

Our Targets & Goals

ECP acknowledges the risks associated with companies with a high carbon footprint. Generally, these companies are capital intensive, exposed to cyclical fluctuations, and increasingly exposed to higher amounts of government regulatory action. For us, having clear targets and goals for our strategy in different capacities ensures we continue to deliver value for our stakeholders outside of superior long-term investment returns.

As part of our commitment to being a responsible fund management company, our board has set the goal of achieving significantly lower carbon emissions for our investment portfolios (per million dollars invested) than the respective benchmarks. To date, we have achieved this, and we continue to regularly reassess our goals in this respect to minimise our portfolio's carbon footprint while not sacrificing returns to our clients.

This year ECP continued to build upon our Climate Change Position Statement by publishing our Roadmap to Net Zero. Within our roadmap, we have taken the approach of focusing on our emissions relative to the index in setting our goals and aspirations.

Since our mandate is to deliver investment returns above the respective performance benchmark, and many of the steps required to achieve net zero are still developing, we believe it would be inappropriate to set absolute carbon-reduction targets. For now, our focus is on engagement with our investments to be best practices and engaging with our clients where appropriate to assist them in achieving their climate-related ambitions and targets.

Our Roadmap to Net Zero key milestones:

— 2025 - target carbon intensity 25% less than the bench across all portfolios.

— 2030 - target carbon intensity 50% less than the bench across all portfolios.

— 2040 - target carbon intensity 75% less than the bench across all portfolios.

— 2050 - achieve net zero across our firm operations and investment portfolios.

While we believe many of the initiatives to deliver net zero are still developing, we have begun setting key milestones for our portfolio companies which we believe will support the above:

— 2025 - 50% of our investment companies with publicly available net-zero targets.

— 2028 - 75% of our investment companies with publicly available net-zero targets.

— 2030 - 100% of our investment companies with publicly available net-zero targets.

In addition, ECP has begun its journey toward achieving carbon neutrality for our operations. We expect this to be completed by 2025, and we expect to begin to assess and engage our channel partners and key suppliers concerning their operations.

Climate Action Plan

At ECP, we appreciate that no matter how big or small a company is, everyone is part of our community and as such, we all have a responsibility to act or improve where we can. While our steps may be small compared to some, we have started our journey and expect each year to add incremental steps toward our common goal.

Below outlines the action ECP is taking over three years to improve our climate outcomes, drive cultural change and engage our people and customers, enhance our climate change governance and risk management framework, and report on our climate change performance.

Goal	FY23	Beyond FY23	Actions
Reduce our footprint	✗	✓	— Understand the carbon footprint of our operations — Engage with staff on reducing our carbon footprint — Work towards achieving net zero carbon emissions for our business by 2025
Support our clients	✗	✓	— Understand our clients own climate-related objectives — Work with clients on how our products can work towards their climate-related objectives — Provide information on our engagement activities
Understand and manage the risks	✓	✓	— Assign oversight of climate change strategy to the Board — Integrate climate change risk into our own business strategy — Consider climate change within our research process
Be transparent	✓	✓	— Express support for the TCFD disclosures — Align disclosures with TCFD recommendations — Publicly communicate our plan, reporting, and carbon emission data

Our Team & Community

Our Team

Long Service Recognition

This year we celebrated the heart of our organisation — our dedicated employees — at our Recognition Gala. This special event honoured team members whose commitment has been instrumental in shaping the culture and success of our companies.

Highlighting the evening were heartfelt acknowledgments to those who have stood alongside us through significant milestones. Gabrielle Short was celebrated for her incredible 25-year journey working closely with Dr. Manny Pohl AM. Keiko Iwano marked two decades of dedicated service, while Jared Pohl and Jason Pohl were recognized for their 15 and 10 years of commitment, respectively.

At ECP Asset Management and EC Pohl & Co, we firmly believe that our people are the cornerstone of our success. The longevity of our team members underscores a shared culture driven by common values. As a family-based business, we understand that fostering a workplace where similar attitudes and values resonate leads to a meaningful and cohesive environment. Last night's gala was not just a celebration of individual achievements but a testament to the collective spirit that propels our company forward.

We extend our deepest gratitude to all our employees for their relentless dedication and for embodying the values that make us who we are. Here's to many more years of success and shared growth!

Our Team

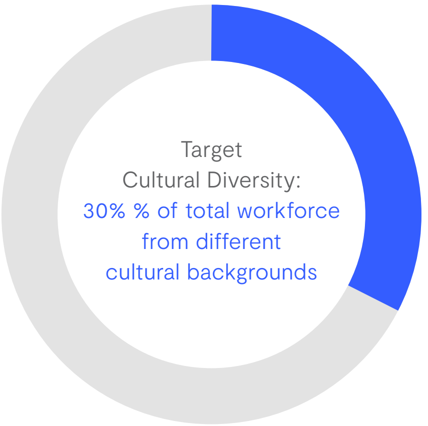
Inclusion & Diversity

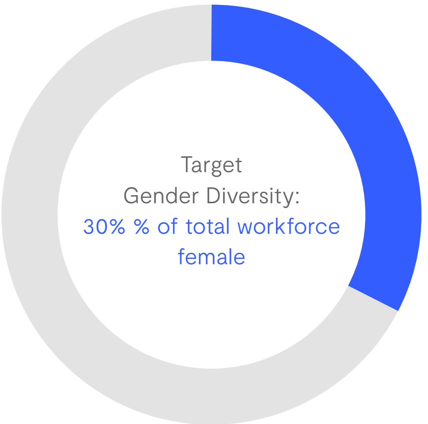
ECP recognises and respects the value of diversity. As an organisation, we aim to create an environment where the diversity of our people in experiences, perspectives and backgrounds are valued and utilised. We recognise that each employee brings their unique capabilities, experiences and characteristics to their work.

We strive to create and foster a supportive and understanding environment in which all individuals realise their maximum potential within the Company, regardless of their differences. We are committed to hiring the best people to do the best job possible irrespective of age, gender, cultural background etc.

At the 2020 financial year-end, the board ratified our Inclusion and Diversity Policy. ECP believes that it is a necessary step for any business to ensure an inclusive work environment that fiercely protects people's right to bring their whole self to work. Creating a collaborative and innovative environment for all our employees means having a diversity of thought and the ability to incorporate different points of view, driving maximum engagement.

ECP is continuously evolving and working towards greater diversity and inclusion. The objective of our policy will be to ensure that our working environment ensures appropriate gender representation, and celebrates cultural backgrounds and social diversity. The ECP Board has adopted the following diversity targets.





Gender

Over the year, ECP introduced several initiatives aimed at ensuring our female employees are provided equal opportunity within our working environment.

These include:

- A market-leading gender-neutral commencement salary, which guarantees no unconscious gender bias when offering a salary to prospective employees and avoids the embedding of a gender pay gap.
- Under this policy, staff will have access to a period of fully paid parental leave for up to six (6) months if they are the primary carer or up to one (1) month if they are the secondary carer.
- An apprenticeship program, regardless of gender, allows all employees the same access to achieving partnership status within the firm based on a defined tenure program that provides equal equity-sharing opportunities amongst the investment team.

Cultural Diversity

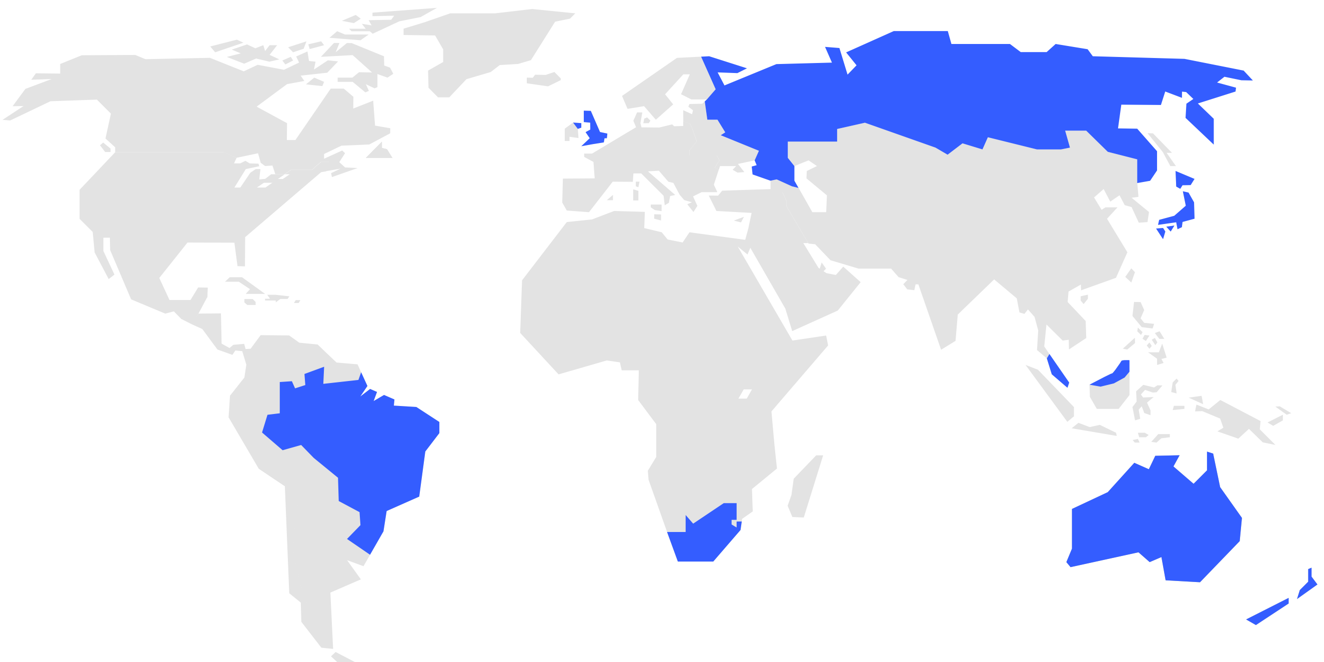
ECP recognises that diversity of thought is key to providing optimal outcomes for our clients.

Achieving above-average investment returns requires that we are open to all points of view, and to achieve that requires our firm to be representative of the global, connected world we live in.

Increasingly, businesses and investment companies have a global operating footprint. To fully understand and appreciate investment opportunities requires all our staff and resources to cover a broad range of opinions and ideas that fully capture the potential over the long term.

Where our staff are from:

- South Africa
- Australia
- Brazil
- New Zealand
- Russia
- UK
- Malaysia



Our Team

Investments & Distribution

Dr Manny Pohl
BSc(Eng), DBA, FAICD, FFin

Jared Pohl
MBA

Andrew Dale
CA

Amy Teh
CFA

Annabelle Miller
BCOM

Damon Callaghan
CFA

Jason Pohl
BCOM, LLB, MBA, GAICD

Justin Warton

Sam Byrnes
CFA

Lauren Rigby

Lachlan Hodgkinson
BBUS

Back-Office & Support

Scott Barrett

Gabrielle Short

Keiko Iwano

Julia Czaus

Larissa Tedesco

Our Community

This year ECP and associated entities, including the Pohl Foundation, have made a number of charitable contributions within our community. Over the years, we have made contributions toward the Taronga Conservation Society, Art Gallery of New South Wales, Lifeline Australia, Currumbin Wildlife Hospital, Bond University and A Sound Life.

Art Gallery of NSW

We have an ongoing relationship with the Art Gallery NSW, whereby over the years, we have funded the restoration of several artworks. The Gallery is one of Australia's premier art museums. Prior restored works include The Foil by Hugh Ramsay and The Prospector by Julian Ashton. The Portrait of a Protestant minister of religion by William Key is currently under restoration, which we expect to be completed in the coming year. This year we have supported the restoration of The Lady in Blue by Hugh Ramsay.

The Lady in Blue, Hugh Ramsay

"Hugh Ramsay (1877-1906) was born in Scotland and relocated to Australia in 1878. He enrolled at Melbourne's National Gallery School age 16 and was recognised as a prodigious talent, moving to Paris in 1900 to further his studies and establish a professional practice.

Ramsay's A lady in blue 1902 is a defining work for the painter who reached great artistic heights in his short lifetime - it is the most enigmatic of Ramsay's paintings.

Ramsay employs the striking colour distinction of evocative blue for the female figure's dress as she emerges from the darkness. She is physically close, but psychologically distanced from the male behind her. The softened tones of flesh and hair against the dramatic lighting instil a sense of human drama."

The Art Gallery of NSW

ECP Annual Ambrose

Our annual charity golf day, The Annual Ambrose, is held annually at the Lakes Golf Club. This year we had over 140 attendees and raised $50,435 to support the Taronga Conservation Society in their pursuit of helping move this iconic Australian species off the path to extinction. The funds allow Taronga to support the build and ongoing work in their state-of-the-art new Platypus Centre. This centre will care for Platypi displaced by drought and other disasters, be a leading centre for Platypus research and be the first-ever facility to breed Platypi for release into the wild.

Our Community

ECP Friendly Feast

Each year, we host our friends in business for the night to say thank you for their service and support throughout the year. This event is our way of expressing heartfelt thanks for their unwavering support and dedication throughout the year. It is through their contributions that we are able to fulfil our commitments to our clients and enhance our professional experiences. Their collaboration makes our journey in this dynamic industry not only successful but also deeply enjoyable. We look forward to continuing to work together, fostering strong partnerships and achieving shared success in the years to come.

ECP UNSW Immersion Program

In 2023, we launched the inaugural ECP Industry Immersion Program in partnership with the UNSW Finance Career Showcase. Developed in conjunction with UNSW, the Program provides students with a deep dive into the funds management industry with a particular focus on investment management and equity analysis, with the goal of providing students with practical and differentiated insights as they look to commence their careers in the industry.

Over the course of several weeks, students applied their knowledge and explored topics such as forensic accounting, portfolio construction and equity research. The program culminated in a networking function providing students with the opportunity to network with industry professionals and broaden their professional network.

We were pleased to contribute to the development of the next generation of investment professionals and were glad to learn that over 75% of surveyed participants had gained internship, work experience, or part-time or full-time positions within the industry; 90% found the program has been beneficial to their career prospects; 80% are considering pursuing CFA, CA, CAIA, or other relevant professional qualifications, with the remainder considering postgraduate tertiary studies; and that all students found the program beneficial from a networking perspective.

Our Community

JP Morgan Corporate Challenge

This year our team participated in the J.P. Morgan Corporate Challenge, the world's largest corporate running event. This unique event combines fitness, friendly competition, and fun, offering a 5.6-kilometer race that brings together company teams of all speeds and abilities. Participating in the challenge provided our team members with a fantastic opportunity to bond and engage in some healthy competition outside the workplace. We are proud of everyone who took part and represented our company with great enthusiasm and energy.

F3 - Future Females in Finance Project

This year, ECP Asset Management partnered with F3 in a six-week structured online work experience placement for university students. F3's mission is to better the number of females entering the financial services industry across the generations through education, access to work experience and good role models. ECP was proud to be involved in a program specifically designed to encourage young women to embark upon a career in financial services.

CFA Societies Australia 2024 International Women's Day Event

International Women's Day is a global day celebrating the social, economic, cultural and political achievements of women. In March 2024, the CFA Societies Australia hosted a gala networking event series with keynote speaker, Turia Pitt. ECP Asset Management was proud to participate in this event alongside clients to support this day which was all about unity, celebration, reflection, advocacy and action.

ECP

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