

A large, vertical rectangular area on the left side of the page is filled with a photograph of a bright blue sky filled with soft, white, fluffy clouds. The sky transitions from a deeper blue at the top to a lighter, hazy blue near the bottom.

# ESG REPORT 2021

[WWW.SPHERIA.COM.AU](http://WWW.SPHERIA.COM.AU)

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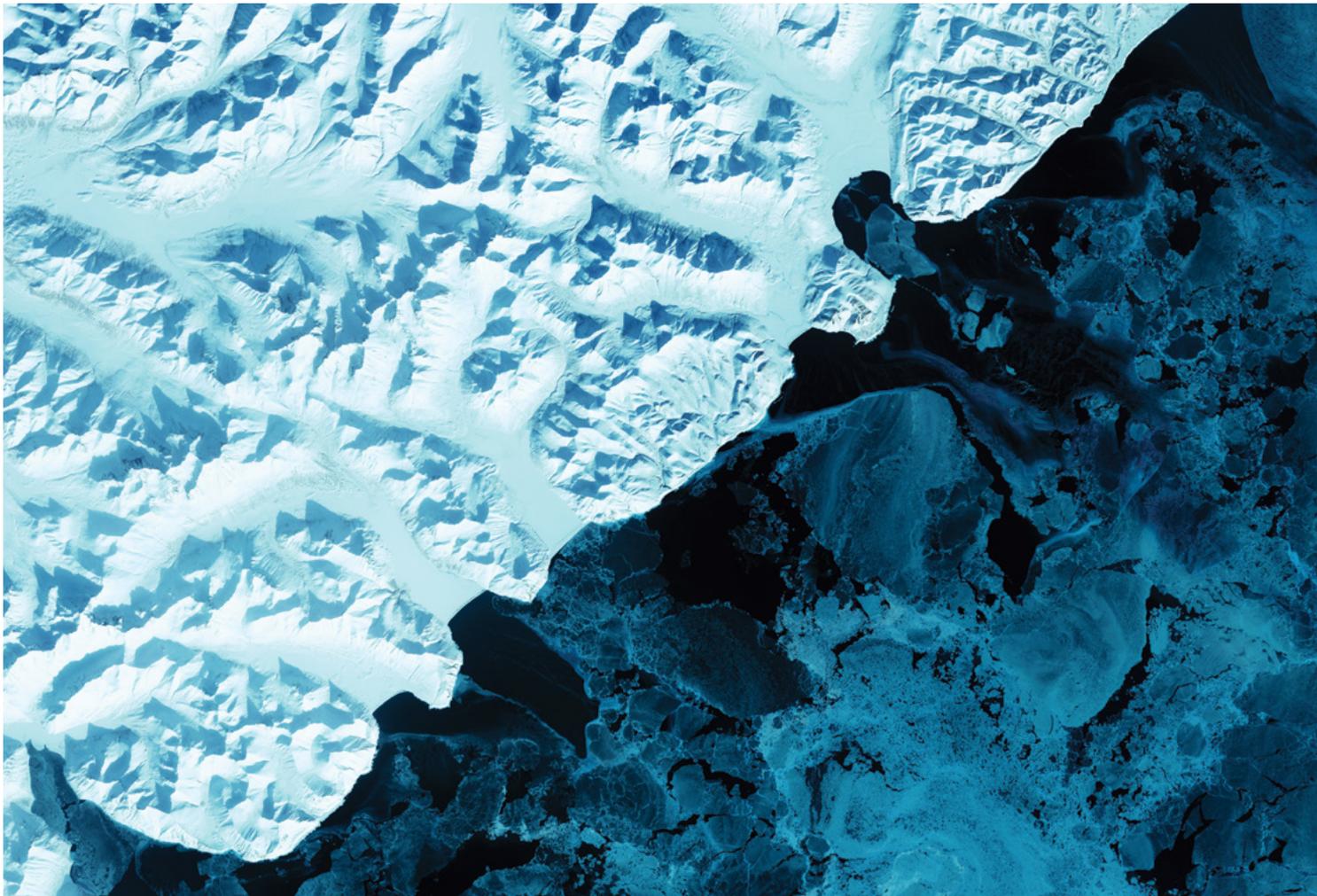
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# A message from Spheria's ESG team

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Spheria are very proud to present our first ESG and Sustainability Report for 2021. This report is representative of the effort we have made in responsible investing across all our Funds for the year 2021 and since our inception. This report highlights our overall ESG philosophy, our approach to ESG integration and key engagement outcomes from the past year.



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# ESG at Spheria

Spheria's ESG process has been embedded within the investment process since day one and is continually evolving. In early 2020, we expanded our approach to ESG to incorporate the outcomes of a 31-point ESG questionnaire into our valuations to form a broader view of ESG risks and opportunities. While we don't exclude individual companies or sectors from our investment universe, a premium or discount is applied to the stocks based on proprietary ESG scoring. Our integrated approach to ESG involves formally engaging with companies on the themes highlighted in their ESG scoring system. Both our stock analysts and ESG specialists participate in the engagement meetings with the results of our discussions informing investment decisions.

We believe our ESG research and proactive corporate engagement strategy positions our portfolios for long-term success. Our close relationship with management teams thanks to long holding periods, coupled with an array of substantial holdings, gives us a competitive advantage when it comes to corporate engagement with our investee companies. Through corporate engagement, we strive to challenge management to achieve best practice and drive positive ESG outcomes, as well as superior performance.

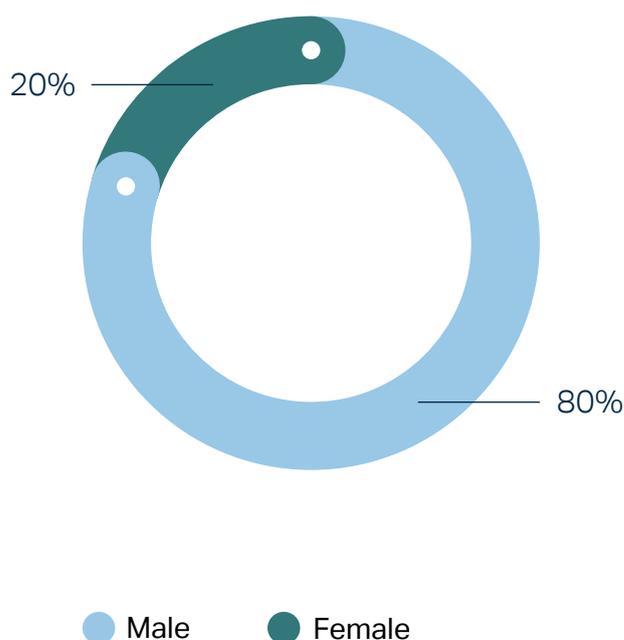
Investing responsibly is particularly important in the small and microcap sectors that we focus on, in which many companies do not

face the same level of scrutiny as their large cap peers. We believe that our research and engagement make positive contributions not only to our performance but to our investee companies and we are proud of it.

## Diversity

We celebrate that Spheria is culturally diverse with people from a range of backgrounds and nations. In the past year we have doubled our gender diversity across the organisation.

### All employees



# 4 key pillars of responsible investing

We are committed to investing responsibly as we believe environmental, social and governance risks are investment risks and that these ESG factors have material impact on returns.



## 1. ESG Risk Integration



## 2. Stewardship and Active Engagement



## 3. Advocacy



## 4. Transparency



### Environment

- Climate change
- Carbon emissions
- Scope 1, 2, 3 analysis
- Water use
- Packaging and recycling
- Energy use



### Social

- Social license to operate
- Supply chain transparency
- Diversity
- Human rights and labour standards
- Data protection and cyber security



### Governance

- Board structure and composition
- Remuneration
- Corruption and bribery
- Board skills
- Lobbying

# The United Nations Principles for Responsible Investment

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In accordance with our Responsible Investment (RI) beliefs, Spheria has been a signatory to the United Nations Principles for Responsible Investment since 2019. We adopt the six Principles for Responsible Investment (“Principles”) in our investment practice.

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing.

Our website sets out the details of our other RI memberships and the RI frameworks and initiatives we publicly support.



# ESG Process

## Our Approach

Our Responsible Investment and Stewardship approach centers around integrating ESG considerations into our investment process, to enhance long-term value and achieve sustainable risk adjusted returns. We do this through our internally developed proprietary ESG scoring system, independent research, and a corporate engagement program.

### Valuation Proprietary Scoring:

- Proprietary 31 question scoring system
- Premium/discounts prescribed to a stocks' valuation on underlying scores
- Consistent way to capture ESG into fundamental cash flow framework

### Risk Framework:

- Core/satellite approach – ESG risks feed into assessment for portfolio construction with high risk companies being unsuitable for core portfolio positions

## Spheria's Responsible Investment ecosystem

### Company Engagement:

- ESG framework allows intelligent and constructive engagement with company leadership
- Board and management readiness to address structural issues is evaluated and constructive feedback is provided during meetings. Follow up meetings on specific issues are arranged, when deemed necessary

### Business Operations:

- Adopting sustainability into our business operations

## Key themes

### Environment

- Climate change
- Carbon footprint (Emmi)
- Product lifecycle

### Social

- Modern slavery
- Supply chain
- Diversity and inclusion
- OH&S
- Culture

### Governance

- Board composition
- Executive pay
- Cyber security and data protection
- Board diversity

## Disclosures

# Engagement Focus Areas in 2021

Spheria's ESG focus areas for 2021 included disclosure in line with the Taskforce for Climate Related Financial Disclosures and Modern Slavery disclosure in line with The Commonwealth modern Slavery Act (2018) which came into force in 2020. In all ESG meetings with investee companies this year, we have routinely discussed both disclosures and encouraged improvements, when appropriate.

## Stewardship Activities

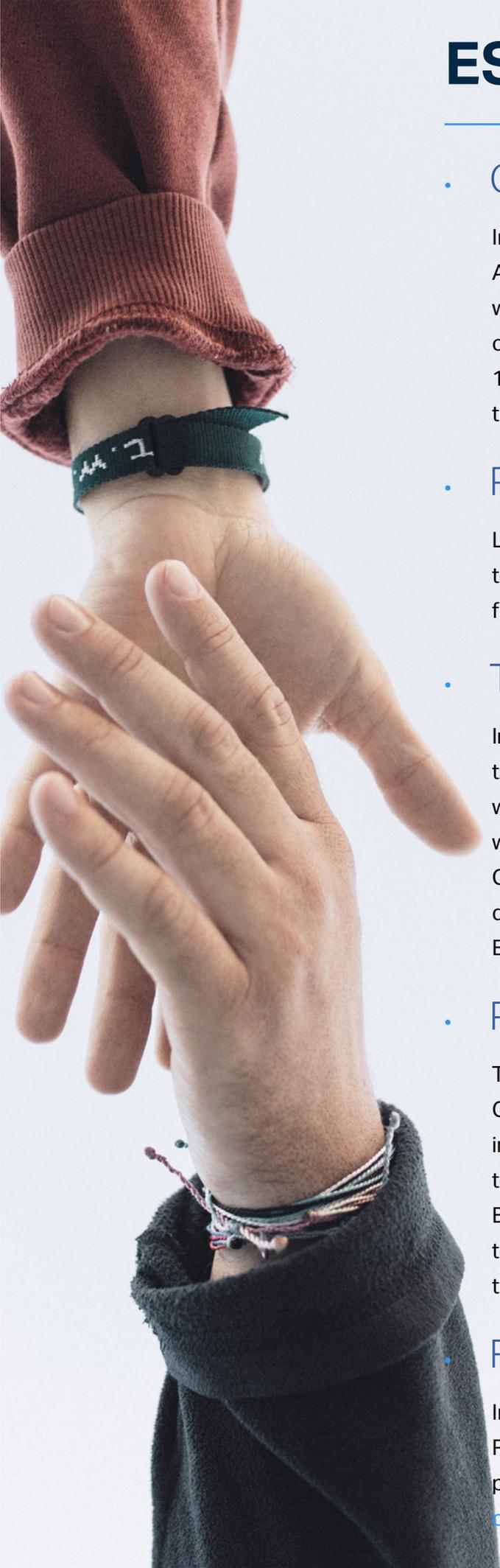
Engagement and monitoring are essential to our ESG strategy. Spheria will do the following for each portfolio company that we engage with:

- Outline to management Spheria's Responsible Investment beliefs and key concerns
- Formally engaging on the themes highlighted in our ESG scoring system and research
- Expose areas of ESG opportunity and risk in order to improve our understanding of companies' preparedness to deal with them
- Encourage corporations towards best practice

## Outcomes

- Both individual stock analysts and ESG specialists participate in the engagement meetings with the results of our discussions informing our investment decisions
- The leadership of our investee companies is alerted to the themes Spheria is keen to discuss, is encouraged to minimise ESG risks and maximise opportunities and work towards best practice
- As our work progresses and our sample grows, we plan to disclose our engagement findings in aggregate

# ESG Activity Highlights



- ## Cooperative Climate Action

In 2021, Spheria became a member of the Climate Action 100+ (CA 100+) and is now a member of their working group for Adbri's (ABC). We are cognisant that cooperative action is more effective than individual 1-on-1 engagements and we are interested in expanding this area of our work.

- ## PRI Submission

Like many of our peers, this year Spheria submitted to the PRI under their new and extensive reporting framework and we look forward to receiving their rating.

- ## Training

In July 2021, the Spheria team participated in a session of training focused on emerging ESG themes. Areas of focus were climate adaptation, hydrogen and nuclear energy within the net-zero transition debate, expectations on COP26 in Glasgow, circular economy developments, ESG disclosure regulatory trends, asset owners' approaches to ESG, cyber risk, and impact investing.

- ## Process Fine-tuning

The Spheria team expressed concerns about Greenwashing and the risk that our process may inadvertently reward companies that pay only lip service to ESG. As a result of that discussion, we fine-tuned our ESG ranking system: we no longer award positive scores to companies with good disclosure, we only penalise those with poor ones.

- ## Responsible Investment Policy

In 2021, Spheria's Board discussed and approved our Responsible Investment Policy, which we subsequently published on our website (<https://spheria.com.au/corporate-responsibility/>).



# Engagement Highlights

- **Climate change**

Climate change represents a sizeable portion of our ESG scoring framework and corporate engagement work. During our conversations with investee companies the following areas emerged as of particular interest:

- a. **Severe Weather Events and Adaptation**

Cognisant of the risks that a slow pace of carbon emission reductions poses to physical assets through the increased severity and frequency of weather events, we have often discussed mitigation strategies with several investee companies. With Blackmores (BKL) we focused on key ingredients' availability; with Bega (BGA) we assessed their supply chain matrix and redundancy built into their

system; with Auckland Airport (AIA) we discussed CAPEX forecasts and weather expectations; with Genworth Mortgage Insurance (GMA), we discussed their climate stress testing and geographic distribution of their insurance portfolios.

We are keen observers of insurance companies and how they approach, mitigate and price climate risks. We believe that what insurers do may provide useful adaptation pointers for the broader market.

- b. **Disclosure**

We recognised early on that climate change disclosure and market cap were inversely correlated and - small and micro-caps being our particular area of expertise – we decided to focus our work on promoting investee companies' improved disclosure and the adoption of TCFD framework.

While good disclosure in this area requires thoughtful analysis and resources, we believe that even at the smaller end of market capitalisation companies should engage in this work as it can inform an important aspect of their long-term strategy.

We have encountered a wide range of disclosure quality by the companies we have engaged with and we have consistently raised the importance of this issue and argued for improved disclosure with most.

We encouraged Auckland Airport (AIA) to join other peers in disclosing scope 3, for example and Inogen (INGN) to publish their TCFD disclosure; we encouraged Alumina (AWC) to bring their JV partner Alcoa on this journey; and the list goes on. We believe that many companies are hearing investors' calls for better disclosure and are increasing their efforts in this area. Several companies promised to start disclosing their carbon footprint using the TCFD framework from next year.

#### c. R&D

One of the (many) difficult aspects of climate change is that some of our industrial processes require innovation to transition the technologies we use to net zero emissions. We discussed at length with Orora (ORA) the improvement they are making to their glass furnaces, what R&D they are investing in and the fuel sources they are trialling. We encouraged Adbri (ABC) to focus more closely on R&D; the company is tentative with regards to a net zero pledge because of the need of technological advances to get there. In absence of a clear path, Adbri's leadership is stopping short of a formal net zero commitment for now.

While we understand leadership teams' desire to make formal net zero commitments only when meaningful technological paths have been identified, we believe that - if innovation is key - companies need to invest in the research and development that their long-term viability depends on.

#### d. Emmi

In July 2021 Spheria started utilising third party carbon emissions provider Emmi. Spheria are able to utilise Emmi to get a clear snapshot of the carbon emissions on a standalone company basis as well as on a portfolio basis. The Emmi Global Carbon Efficiency Rating (GCER) aggregates corporate carbon emissions and financial data to derive carbon-adjusted financial metrics for companies.

## • Modern Slavery: a wide range of disclosure practices

COVID challenges and geopolitical tensions this year have brought in sharp focus the importance of reliable supply chains.

We encountered a wide range of disclosure practices with regards to supply chain transparency. We learnt from leading companies in this area, like City Chic (CCX) and Blackmores (BKL) some of the intricacies that supply chain analysis entails. We encouraged others to do more in this area. Companies based in the US appear not as advanced in their analysis and disclosure as companies based in the UK, Europe and Australia. US legislation appears to steer corporates there to focus more on anti-bribery measures

than unearthing issues of modern slavery. Some companies, like Breville (BRG) have poor disclosure but good practices and we encouraged them to share more of their work with external stakeholders.

We are quite surprised by the absence of reported incidents of modern slavery. If the practice is endemic and our companies are investigating this issue and reporting publicly on it, how is it that nobody is finding any problem?

We hope for more meaningful disclosure in the future. Only when companies start disclosing issues and discussing remediation strategies, we can be confident that supply chain transparency is being taken seriously: that proper audits are made and that supply chains are well understood and well managed.

## • Cybersecurity

In a year when cyber-attacks skyrocketed in number and severity, assessing cyber risk has become particularly important. We often found limited corporate disclosure on this subject. Our engagement work shows that sometimes this is a warning bell but sometimes this is an area where companies have invested considerable resources but have failed to inform external stakeholders about it. One learns who falls in the first and who in the second category only by asking probing questions. The insurability of companies' cyber risk is an interesting proxy for cyber preparedness as premiums skyrocket (and insurance is sometimes refused), when insurers' due diligence reveals inadequate processes.

## • Company specific engagements

We prepare for our engagements with extensive due diligence, and we address different topics with different companies depending on what our analysis highlights as areas of concern / opportunity. As examples, we discussed tailing disposal plans, community relations and gender diversity with Geopacific Resources (GPR); community relations was also discussed extensively with Perseus Mining (PRU), following an unflattering Oxfam publication; corporate culture and Board availability to meet with investors were key concerns in our engagement with Crown (CWN); Governance issues and appropriate use of funds with Seven West Media (SWM), anti-bribery measures with Horizon Oil (HZN); Board renewal plans with Monadelphous (MND); etcetera.

Together with climate and modern slavery disclosure, Governance always features in our engagement meetings. The length of time we spend discussing Governance varies from company to company, depending on their individual circumstances: sometimes it is just a nudge towards greater Board diversity and renewal, like in Monadelphous (MND)'s case, sometimes it is a lengthy discussion on companies' practices and underlying culture, like with Crown (CWN).

# Spheria ESG Alliances

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## **PRI Signatory**

Spheria has been a signatory of the United Nations Principles for Responsible Investment (UNPRI) since 2019. The principles promote the inclusion of ESG issues into investment analysis and decision-making processes and is used by Spheria as a blueprint in their ESG investment processes.



## **TCFD Supporter**

In November 2020, Spheria became an official supporter of the Task Force on Climate-Related Financial Disclosures (TCFD).



## **CA 100+**

In September 2021, Spheria joined Climate Action 100+ and their working group in Adbri.



# Voting

## Proxy Voting Summary

### Micro-cap Portfolio

			Management Proposals		Shareholder Proposals	
	Total	Percent	Total	Percent	Total	Percent
<b>Votable Proposals</b>	236		236		0	
<b>Proposals Voted</b>	236	100.00%	236	100.00%	0	0.00%
<b>FOR Votes</b>	219	92.80%	219	92.80%	0	0.00%
<b>AGAINST Votes</b>	17	7.20%	17	7.20%	0	0.00%
<b>ABSTAIN Votes</b>	0	0.00%	0	0.00%	0	0.00%
<b>WITHHOLD Votes</b>	0	0.00%	0	0.00%	0	0.00%
<b>Votes WITH Management</b>	222	94.07%	222	94.07%	0	0.00%
<b>Votes AGAINST Management</b>	14	5.93%	14	5.93%	0	0.00%

### Smaller Companies Portfolio

			Management Proposals		Shareholder Proposals	
	Total	Percent	Total	Percent	Total	Percent
<b>Votable Proposals</b>	266		265		1	
<b>Proposals Voted</b>	263	98.87%	262	98.87%	1	100.00%
<b>FOR Votes</b>	242	90.98%	242	91.32%	0	0.00%
<b>AGAINST Votes</b>	20	7.52%	19	7.17%	1	100.00%
<b>ABSTAIN Votes</b>	1	0.38	1	0.38%	0	0.00%
<b>WITHHOLD Votes</b>	0	0.00%	0	0.00%	0	0.00%
<b>Votes WITH Management</b>	246	92.48%	245	92.45%	1	100.00%
<b>Votes AGAINST Management</b>	17	6.39%	17	6.42%	0	0.00%

## Opportunities Portfolio

			Management Proposals		Shareholder Proposals	
	Total	Percent	Total	Percent	Total	Percent
<b>Votable Proposals</b>	266		265		1	
<b>Proposals Voted</b>	263	98.87%	262	98.87%	1	100.00%
<b>FOR Votes</b>	242	90.98%	242	91.32%	0	0.00%
<b>AGAINST Votes</b>	20	7.52%	19	7.17%	1	100.00%
<b>ABSTAIN Votes</b>	1	0.38	1	0.38%	0	0.00%
<b>WITHHOLD Votes</b>	0	0.00%	0	0.00%	0	0.00%
<b>Votes WITH Management</b>	246	92.48%	245	92.45%	1	100.00%
<b>Votes AGAINST Management</b>	17	6.39%	17	6.42%	0	0.00%

## Global Micro-cap Portfolio

			Management Proposals		Shareholder Proposals	
	Total	Percent	Total	Percent	Total	Percent
<b>Votable Proposals</b>	561		555		6	
<b>Proposals Voted</b>	459	81.82%	453	81.62%	6	100.00%
<b>FOR Votes</b>	399	71.12%	394	70.99%	5	83.33%
<b>AGAINST Votes</b>	53	9.45%	52	9.37%	1	16.67%
<b>ABSTAIN Votes</b>	1	0.18%	1	0.18%	0	0.00%
<b>WITHHOLD Votes</b>	6	1.07%	6	1.08%	0	0.00%
<b>Votes WITH Management</b>	403	71.84%	397	71.53%	6	100.00%
<b>Votes AGAINST Management</b>	56	9.98%	56	10.09%	0	0.00%

# Community Contribution

Through our support of the Australian Alzheimer's Research Foundation (AARF), Lighthouse Foundation and volunteering initiatives, we seek to be active contributors to our community.

## Workplace Giving

We offer a Workplace Giving program to our employees, facilitating donations to charities of choice via pre-tax salary deductions. Monthly donations (up to predetermined capped amounts) are matched in full by employers, who also cover associated administration and due diligence costs.

## Employee Volunteering

We actively encourage employee fundraising and volunteering. Current volunteering partners include the Rockpool Dining Group's Hope

Delivering program. The Spheria team has assisted in the preparation and distribution of meals from the program's Sydney hub (pictured).

Since March 2020, Hope Delivery has been preparing meals for international hospitality visa workers, the homeless and disadvantaged severely affected by the COVID-19 pandemic in Sydney and Melbourne. It is also providing meals to OzHarvest who work with the homeless and underprivileged people in our community.

## Strategic Sponsorships

Spheria sponsors events where there is a strategic relevance to our business operations. We also collaborate with the Pinnacle Charitable Foundation to donate directly to partners in support of initiatives which resonate closely with our employees and core values.



## Australian Alzheimer's Research Foundation (AARF)

Spheria has renewed funding to underpin our partnership with the Perth based Australian Alzheimer's Research Foundation (AARF). Funding is helping researchers study the very early onset of Alzheimer's disease, which is debilitating, strikes at random and is incurable. Currently there is no effective treatment for Alzheimer's, and with 1,800 Australians diagnosed with dementia every week, the disease remains the second leading cause of death in Australia.

Analysis into early stage cell changes at the onset of Alzheimer's – to better understand its origins – has been identified as essential to both develop the most effective treatment of the disease, and in the search for a cure. Results of the studies being funded will contribute new knowledge about the underlying causes of the disease, how it develops and its progression.

The AARF has a vision of a world in which Alzheimer's no longer exists, and a mission to support leading edge research that makes it both treatable and preventable.

## Lighthouse Foundation

As a further way of supporting acutely disadvantaged young people, Spheria have established a new Victorian based partnership with the Lighthouse Foundation. Lighthouse helps young vulnerable people in Victoria who are homeless and who typically come from backgrounds of long-term neglect and abuse. More than 1,000 kids have secured the assistance they require to achieve a lifelong sense of belonging, the opportunity to heal and the capacity to thrive.

Within a safe home and a community to belong to, these young people are nurtured by the Lighthouse Model of Care – a holistic therapeutic treatment program drawing on over 60 years of empirical research into human development. One of the main anchors for their experience – during and for as long as they wish following their time at Lighthouse – is the dedicated Resource Centre which was forced to close during 2020. Funding will enable this critically important hub to be expanded with more offerings and services.

