HATCHINGS
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PLATYPUS
ASSET MANAGEMENT

Climate change: A Q&A for investors

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"Is my fund investing with climate change in mind? How will my portfolio be affected by climate change in the next few years?"

These are some of the questions we've heard from investors.

Climate change can be a complicated field to navigate, so we've answered a few of the most commonly asked questions on this subject.

How is climate change integrated in the Platypus Australian Equity Fund?

First and foremost, Platypus aims to deliver strong returns to investors. Our job is to understand the impact of climate change on earnings and share prices and invest accordingly.

Right now, it's the energy transition, rather than the physical impact of climate change, that presents the most material impact on the performance of companies in our universe. For example, the way a company is decarbonising its business, the ability to get new mining projects approved, the risk of stranded assets, and the price of carbon offsets. These are impacts that we factor into our decisions to buy or sell companies in our portfolio.

> The IPCC warns that we will only keep global temperatures at or below 1.5 degrees Celsius if carbon emissions are net zero by 2050.

We are also passionate about engaging with the companies we own and using our seat at the table to drive real change. For example, when drought and bushfires ravaged our country, our investment team asked resource companies how they were working towards the Paris Agreement and who is overseeing this work at the board level[1]. We take the knowledge we have about companies' transition plans and either hold them to account or encourage them to do more.

While we do not divest for ethical reasons, we do divest if we think the companies' approach to managing climate risk will destroy value for shareholders over our investment horizon.

What does net zero actually mean?

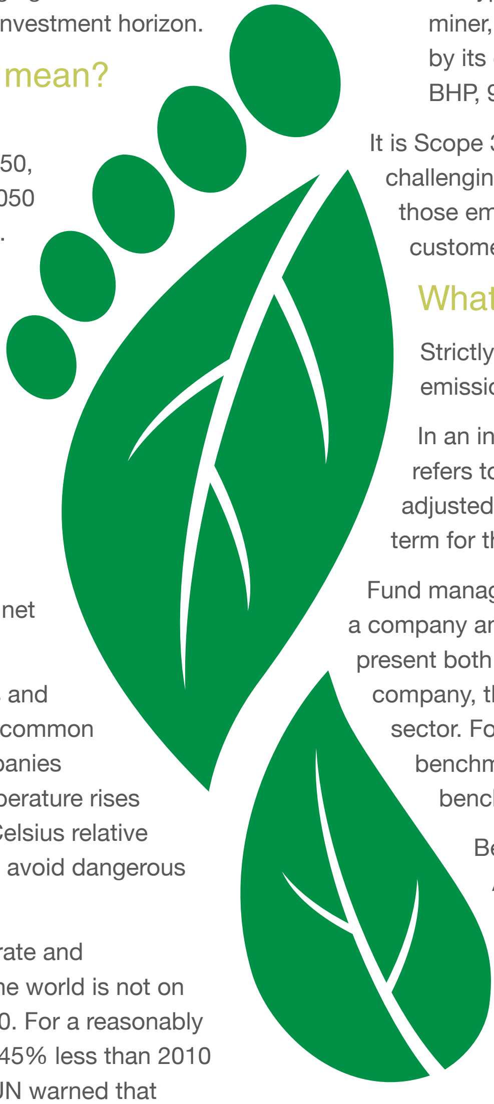
Net zero is a reference to the need to completely decarbonise our world by 2050, with any carbon that is still emitted by 2050 being offset (hence the "net" in net zero).

This comes from the United Nations Intergovernmental Panel on Climate Change, which states that if temperature rises are not kept to a maximum of 1.5 degrees Celsius later this Century, the world faces dangerous climate change.

The IPCC warns that we will only keep global temperatures at or below 1.5 degrees Celsius if carbon emissions are net zero by 2050.

This has flowed through to governments and companies and has become a relatively common global goal: if all governments and companies deliver net zero emissions by 2050, temperature rises should remain at or below 1.5 degrees Celsius relative to pre-industrial levels and the world will avoid dangerous climate change by the year 2100.

Unfortunately, even with all of the corporate and government commitments to net zero, the world is not on track to meet net zero emissions by 2050. For a reasonably orderly transition, emissions need to be 45% less than 2010 levels by 2030. In November 2021, the UN warned that emissions are actually expected to be 14% higher by 2030. In fact, our current global trajectory is likely to see temperature rises reach up to 4 degrees Celsius by 2100, the IPCC says. This would result in severe economic losses globally.[2]



What are scope 1, 2 and 3 emissions?

A company's carbon emissions are categorised in three buckets – Scope 1, Scope 2 and Scope 3. This has become the global standard for reporting emissions globally.

SCOPE 1 These are the greenhouse gas emissions that a company makes directly — for example while digging up coal (for a coal miner), making a t-shirt (apparel manufacturer), operating its planes (airline).

SCOPE 2 These are the emissions a company makes indirectly by running its business, for example, the emissions in the electricity bought to run the business.

SCOPE 3 These are the emissions a company is responsible for, up and down its supply chain. These are typically significant in number. For an iron ore miner, Scope 3 emissions are the emissions produced by its customer making steel with the iron ore. For BHP, 94%[3] of all of its emissions are Scope 3.

It is Scope 3 emissions that are typically the most challenging to reduce because a company doesn't control those emissions. Having said that, it can work with customers to achieve emission reductions.

What is a carbon footprint?

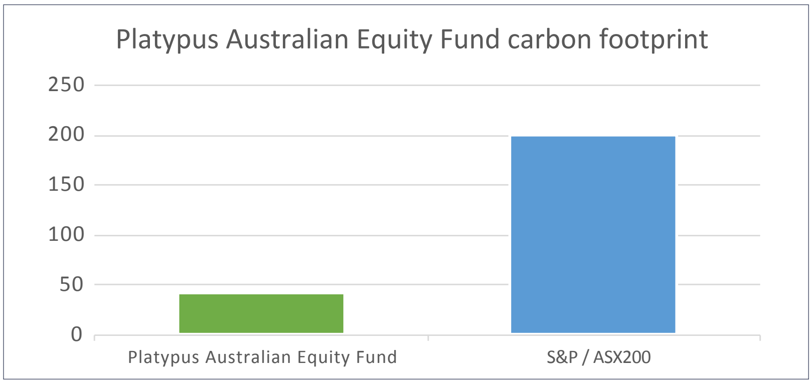
Strictly speaking, a carbon footprint is the total emissions brought about by a person or company.

In an investment context, a carbon footprint typically refers to a company's Scope 1 and 2 emissions, adjusted for revenue as a proxy for company size. The term for this type of carbon footprint is carbon intensity.

Fund managers typically calculate the carbon intensity of a company and their investment portfolio and they typically present both relative to an appropriate benchmark. For a company, that might be the average of the company's sector. For an investment portfolio, that might be the benchmark. For the Platypus Australian Equity Fund, the benchmark is the S&P/ASX 300.

Below is the carbon footprint of the Platypus Australian Equity Fund at 31 March 2022. At the end of the March quarter, the Platypus Australian Equity Fund had 15% of the absolute emissions of the S&P/ASX 300 and 21.5% of the S&P/ASX 300's carbon intensity.

	Absolute emissions (tCO2e)		Relative emissions (tCO2e/revenue)	
	Scope 1+2	Incl. Scope 3	Carbon intensity	Weighted avg carbon intensity
Portfolio	8,177	114,970	74.46	43
ASX300	54,042	569,574	202.72	200.05
Relative	**15.1%**	**20.2%**	**36.7%**	**21.5%**



Source: ISS, Platypus Asset Management at 31 March 2022

[1] Platypus Engagement Report, February 2021 www.platypusassetmanagement.com.au/~/media/platypus/documents/media/engagement-report-2020.ashx

[2] See www.ipcc.ch/sr15/ IPCC Special Report "Global Warming of 1.5C"

[3] ISS Climate Data Accessed 27/5/22

While carbon footprints are commonly reported by fund managers, a carbon footprint is not necessarily a measure of the fund's sustainability credentials. A concentrated manager may well have a footprint of 20% of the benchmark if they are underweight utilities, materials or industrials, or overweight low emitting sectors like healthcare or technology. This positioning may reflect a manager's view of the economic environment rather than a view of fossil fuels for climate change reasons.

How to assess whether a fund manager is actually integrating climate change?

It can be challenging to assess which fund managers are really thinking about climate change when they make investment decisions. It can be even harder to assess whether a fund manager is doing meaningful and impactful engagement work.

We've put together a few questions for investors that may help assess the quality of ESG across an Australian shares portfolio.

- What is the level of ESG integration within the investment process? What are the sources of ESG data?
- What is the size and experience of the ESG team?
- What is the ESG product's sophistication? (exclusion, ESG integration, impact etc)
- What's the fund's position on engagement vs divestment?
- Does the firm monitor the fund's position with respect to different temperature scenarios e.g. 1.5 degrees?
- What is the firm's ESG engagement capability and engagement history?
- Can the fund manager share an example of an engagement plan with detailed objectives and is progress against those objectives transparently tracked?
- Does the fund include transparent engagement and proxy reporting?
- Is the fund's full voting record available online? Are votes on climate related resolutions disclosed with rationale?
- Does the manager provide ESG/sustainable investment research and thought leadership?

The answers to these questions can help mitigate investment risk posed by climate change on your portfolio and why, we at Platypus, use our seat at the table with companies to drive change and hold companies to account.