Daintree
CAPITAL
A Perennial Partner

DAINTREE CAPITAL ESG AND SUSTAINABILITY REPORT 2023

Daintree Capital acknowledges the Traditional Owners of the Country in which we work, the Gadigal people of the Eora nation, and recognise their continuing connection to land, waters and culture. We pay our respects to their Elders past, present and emerging.

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Daintree Capital ESG and Sustainability Report 2023

Introduction

Daintree Capital (Daintree) invests in fixed income and credit securities with a benchmark unaware, capital preservation ethos. Daintree seeks to protect capital and maximise risk-adjusted returns through the cycle with a strong focus on income.

We work collaboratively with the other members of the Perennial Partners group to share ideas and implement practical initiatives for the benefit of clients and the community, and to progress our own journey to improve standards of corporate responsibility and sustainability.

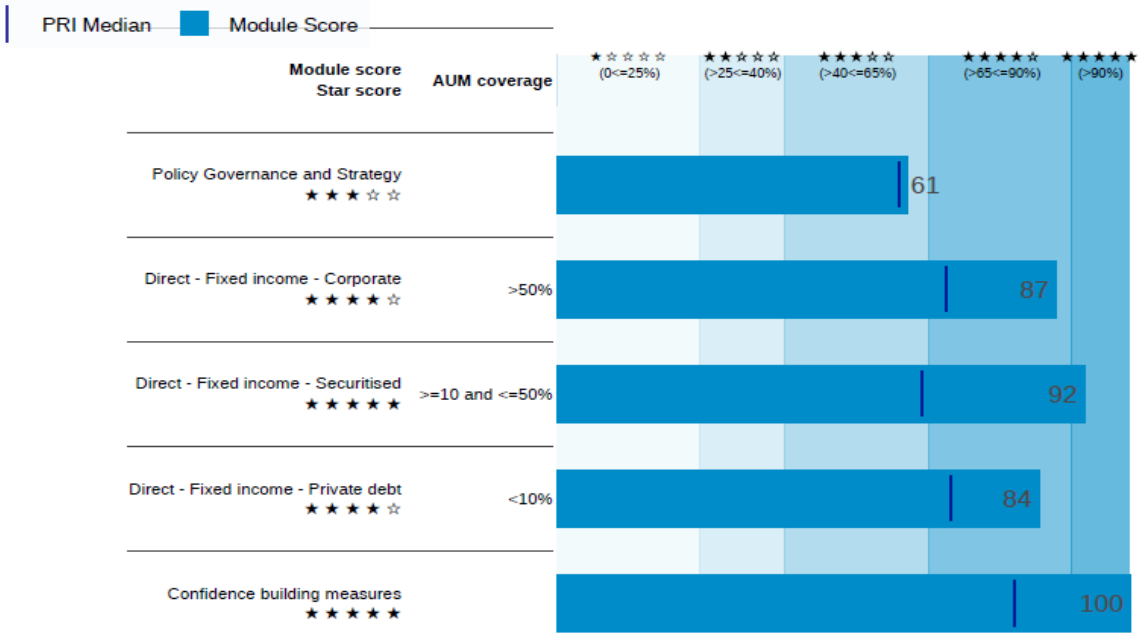
UN PRI Signatory

Daintree became a signatory of the UN Principles for Responsible Investment in 2019. The six principles provide a framework to guide signatories in the development and implementation of their responsible investment strategies.

Daintree's FY22 results are summarised below. A new reporting format makes comparison to prior years difficult, but the detailed results highlight our strengths and areas for improvement.

Highlights from the Investment and Stewardship Policy module include a thoroughness of investment policy integration and staff alignment, while noting that further work in the areas of stewardship policy development and implementation would see Daintree progress closer to best practice. Positively, our response to the results of the FY21 report has yielded material improvements, particularly in the confidence building measures.

Figure 1: Summary of FY22 UN PRI Results



Source: UN PRI

ESG Process

MAINTAIN RETURNS

An integrated ESG process supports our ability to achieve our investment objectives. Identifying companies with strong ESG characteristics[1] which may preserve, and possibly even improve, returns over time.

MANAGE RISKS

A thorough ESG assessment will allow us to identify risks that may not otherwise be identified with more traditional analysis. We can then appropriately manage or exclude these risks[2] to preserve or improve returns over time.

INVEST FOR GOOD

Through investment in "green" bonds, we can directly support environmental, social and community projects. We will consider these projects[3] in parallel with, and subject to, our other core principles.

1: Using a quantitative process and rating system drawing on data from MSCI.
2: Measures may include issuer engagement, reducing or limiting portfolio exposure or complete divestiture.
3: Assessment of financial and non-financial factors to ensure suitability for portfolio inclusion.

In implementing our responsible investment strategy, we are guided by three core principles.

Maintain Returns: As investment managers our primary goal is the achievement of superior returns for our clients over time. Daintree's ESG policy contributes to this goal in two ways: a) identifying and supporting companies that display strong fundamental and ESG (particularly governance) characteristics, and b) avoiding companies with weak financial prospects and/or poorly defined strategy. This latter category will likely see their cost of capital increase over time, ultimately becoming weaker investment propositions.

Manage Risks: By implementing several exclusionary screens our process seeks to avoid investment in sectors or industries that do not align with our ethical, financial, environmental or community outcomes. Furthermore, the policy allows for discretionary exclusions where issues are identified that are not captured by exclusionary screens.

Invest for Good: Fixed income investors have access to securities specifically designed to allocate capital toward social or environmental opportunities, towards thematic outcomes (such as the United Nations Sustainable Development Goals), or to incentivise an issuer to achieve or exceed a defined goal. Daintree's process acknowledges the positive role these securities play in contributing to ESG and sustainability outcomes and seeks to support them where possible.

Responsible Investment Working Group

Daintree is a founding member of the Perennial Partners Responsible Investments Working Group, with representatives from all parts of the business. The Group seeks to share ideas and progress corporate social responsibility initiatives for the benefit of clients, employees, and other stakeholders.

Building on the momentum from 2022, progress in 2023 included:

- Continued implementation of our Reconciliation Action Plan.
- A range of community volunteering opportunities offered to staff.
- Establishment of a blood donation group.
- Providing the option to salary sacrifice to a designated charity.
- Inclusion of guest speakers at meetings to hear fresh perspectives on sustainability topics of focus.

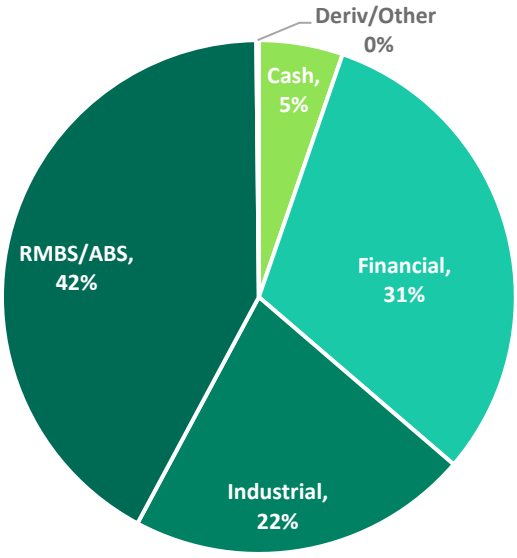
Portfolio Characteristics

Daintree is an active manager that constructs diverse fixed income and credit portfolios. This can include structured securities such as residential mortgage-backed securities (RMBS), derivatives used for hedging, and private companies not listed on a stock exchange.

Figure 2 shows an aggregated portfolio across all publicly available funds and investment mandates. It indicates that just over 50% of the underlying assets are available to be rated by our independent data provider. The RMBS/ABS category overwhelmingly represents funding for Australian residential mortgages but does not receive a formal ESG score or rating.

Despite this, Daintree considers several factors as part of its ESG approach for this sector, including adherence to prevailing regulatory settings, consumer credit protections, and the identification and avoidance of predatory lending practices.

Figure 2: Aggregated portfolio weights, 30 June 2023



Source: Daintree Capital

The Daintree Score

Daintree assesses each company's Environmental (E), Social (S) and Governance (G) credentials and monitors the evolution of these scores over time. While we believe all factors are important, we place particular emphasis on governance factors as research shows it to be a stronger predictor of issuer and bond performance over time. To reflect this in our portfolios, the Daintree proprietary scoring system was created (Daintree Score). The Daintree Score is a weighted score of the individual G, S and E components, which upweights governance on a 60/20/20 basis.

Following a broad-based review of factor weightings and scores late last fiscal year, FY23 was about consolidation. Environmental and governance scores registered improvements, while the social score held largely stable. Broadly speaking, Daintree notes clearer strategic direction and progress on the E and G factors among portfolio holdings, including in such areas as disclosure and policy implementation.

Social scores represent a collection of diverse concepts related to the pivotal role that people play in corporate and economic life. Daintree seeks to review the material social issues for each portfolio holding, with commonalities which include modern slavery and employee relations. However, transparency and disclosures in this domain are less standardised, making comparison more difficult. Regular engagement provides opportunity to investigate relevant topics with management.

Figure 3: Daintree Score

Source: Daintree, MSCI. Rating is a portfolio weighted average with a range of 0 (poor) to 10 (excellent)

Carbon Dioxide Emissions Reporting

Daintree compiles issuer level emissions data for Scope 1 and 2 emissions. The sectors for which there are no exclusions applied that contribute most to these totals are the Materials, Electricity Distribution and Steel manufacturing sectors. On average, these sectors emit 6-8 times more carbon dioxide per unit of revenue compared to other sectors represented in Daintree portfolios, but these sectors have never exceeded five percent of Daintree assets under management since our founding in 2017.

Daintree's ESG policy requires regular review of emission trends where possible, and thus we draw on historical emissions data from our data provider going back to 2013.

More than 90% of corporate bond issuers in Daintree's portfolio have published and enacted emissions reduction policies.

Structured credit, which includes residential mortgage-backed securities (RMBS) and asset-backed securities (ABS), comprised more than 40% of assets under management as of 30 June 2023. To account for emissions from these securities, we have adapted the Partnership for Carbon Accounting Financials (PCAF) methodology for such assets to estimate the Scope 1 (direct) emissions.

To facilitate this analysis, some assumptions need to be made. For each RMBS, we have assumed that on average each security was secured by 1,000 residential properties, which in Australia emit about 20 tonnes of CO2 per year on average. For each ABS, we assume that they are secured by 2,000 car loans, with each car emitting an average of 4 tonnes of CO2 per year.

To calculate emissions attributable directly to Daintree holdings we use Exposure-to-EVIC, which takes the dollar value of Daintree holdings in the numerator and the combined value of equity, debt, and cash of the issuers as the denominator. The attributable emissions from Structured Credit is a higher percentage of gross emissions because these securities "factor down", or in other words are progressively repaid as per their design. Thus, Daintree's exposure increases the longer the security is held.

Table 1: Portfolio Emissions Summary

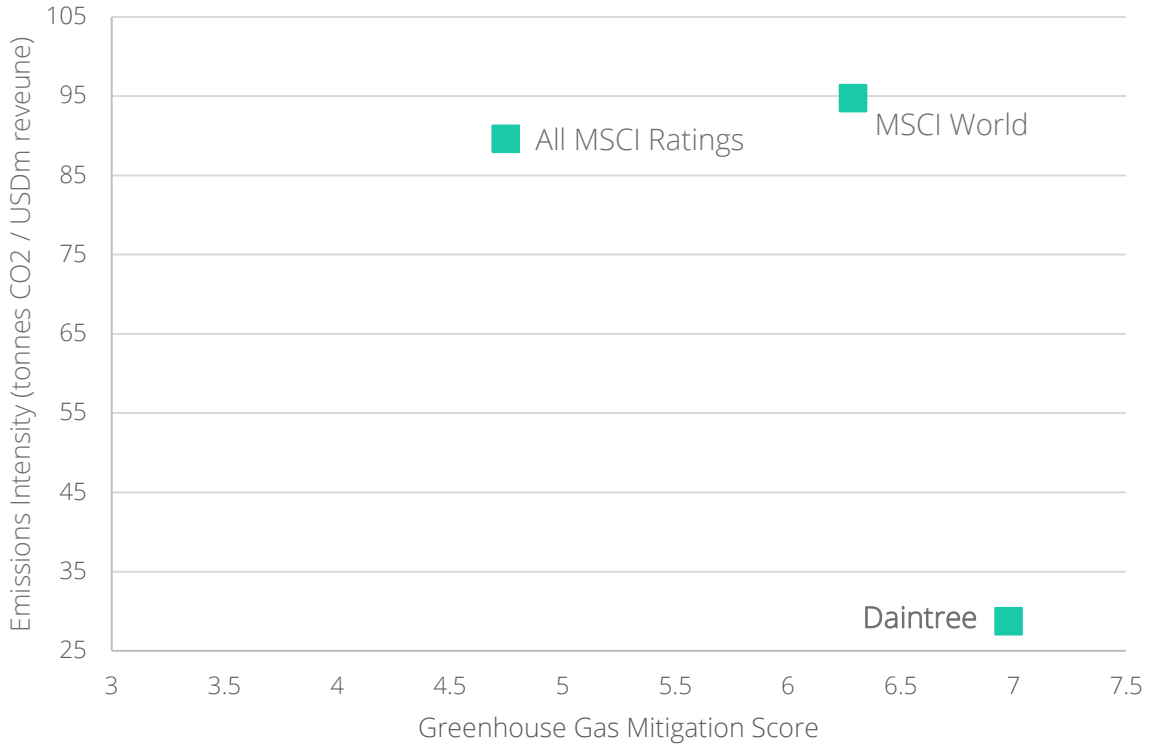
	Scope 1* (tonnes)	Scope 2* (tonnes)	Scope 1+2 Intensity (t/USDm rev)	Portfolio Coverage (% of AUM)	Comments
Bonds (Industrial, Financial)	47,253	39,868	28.7	53%	Scope 1 gross tonnes = 1,312,589 Scope 2 gross tonnes = 1,107,438
Structured Credit (RMBS/ABS)	175,656	N/A	N/A	42%	Scope 1 gross tonnes = 2,252,000

Source: MSCI, Daintree. * Exposure-to-EVIC basis. EVIC = Enterprise Value including Cash.

Daintree portfolios compare favourably when benchmarked to the broad MSCI World index and against an even broader sample that includes all MSCI-rated companies, a cohort spanning more than 7,000 constituents.

This outperformance can be explained by the exclusion of emissions-intensive sectors and a relative overweight to Financials compared to the MSCI World index.

Figure 4: Emissions Benchmarking



Source: MSCI

Stewardship and Engagement

We utilise engagement as a tool to preserve and enhance the value of the assets we own on behalf of our clients, effectively bringing our stewardship responsibilities to life.

Daintree uses engagement to gain better insights into portfolio companies, and where applicable will, or may also, advocate for improvement or change for the benefit of our clients and other stakeholders.

As our engagement process matures, we are finding more opportunities to integrate specific ESG topics into our interactions.

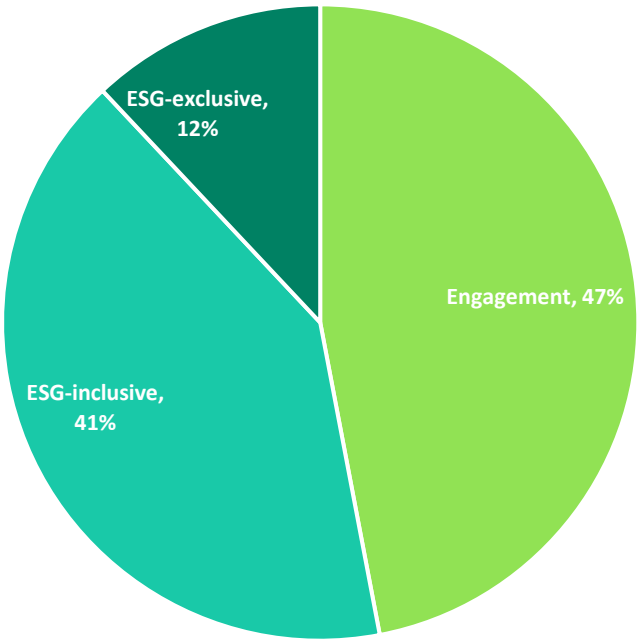
Over the last year these interactions have included:

- Discussions with general insurers regarding the outlook for premium increases in the context of cost-of-living concerns,
- Investigations into risk management practices of the banks in the wake of the failure of Silicon Valley Bank and Credit Suisse, and
- Building a knowledge base in the practical realities of modern slavery in the global supply chain by understanding how multinational corporations enforce their policies.

This work led to several positive outcomes, including:

- A better understanding of how each company implements and internalises their policies,
- An opportunity to compare, contrast, and identify best practice, and
- The chance to convey our findings to other companies, emphasising what we saw to be best practice and encouraging others to work toward continuous improvement.

Figure 5: Engagement Activity Summary



Source: Daintree

Purpose-Driven Investing

Fixed income investors can support tangible environmental, social and sustainability outcomes through participation in instruments collectively known as "green" bonds. These bonds can be further classified into sustainability and sustainability-linked categories. While the structures can vary, the intention is identical.

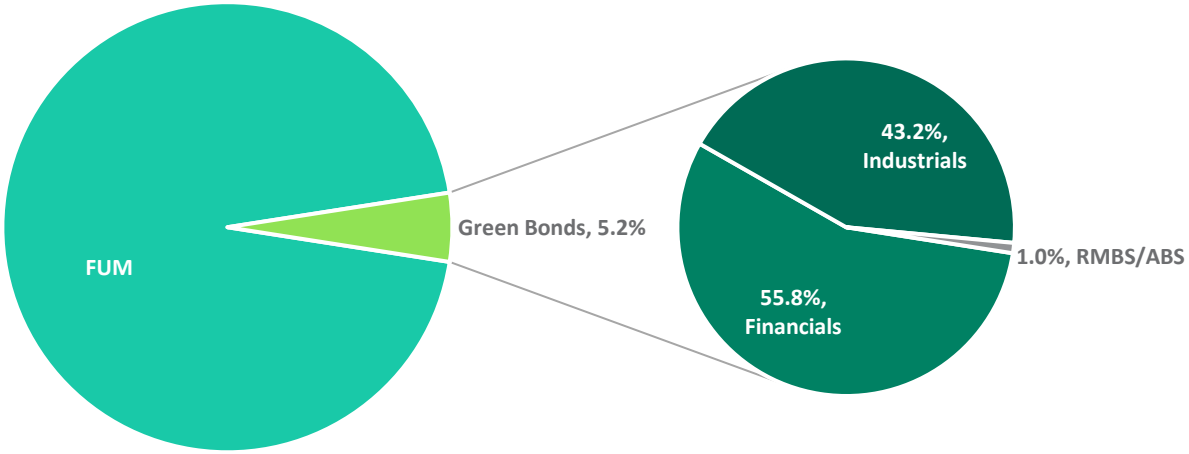
Examples of active investments as at 30 June 2023 include:

- A bond issued by an Australian bank that directs proceeds toward projects that address the United Nations Sustainable Development Goals,
- Two sustainability-linked bonds issued by Australian supermarket retailers that incentivise the issuer to achieve specified goals by imposing financial penalties should they be unsuccessful.
- A structured credit security that funds loans for residential rooftop solar installations

While green bonds became a larger part of overall assets under management, increasing from 3.9% as at 30 June 2022, they still represent a relatively modest allocation compared to total assets under management.

We aspire to increase exposure to green bonds over time. In doing so, our ESG policy requires a balanced approach that acknowledges the benefits of these securities while simultaneously ensuring that they deliver appropriate financial returns for the risks incurred.

Figure 6: Green Bond Summary



Source: Daintree

Corporate Social Responsibility

Daintree is committed to leading by example by creating a corporate culture that embodies the values we espouse as investment managers. Client portfolios are guided by a comprehensive **ESG investment policy**, but we also strive to reflect these values operationally to the greatest extent possible.

For example, our firmwide operations have been certified as operationally carbon neutral since FY21, in partnership with Pathzero. An overview of Pathzero's approach can be found **here**. Additionally, we achieved Climate Active Certification in FY22 and FY23 – an Australian government-backed program to certify carbon-neutral claims.

As UN PRI signatories we are committed to the highest standards of ESG integration across the entire investment process. We recognise that by partnering with the UN PRI we can magnify our voice on issues of importance. One such effort was a global movement to protect the Amazon wilderness from excessive and destructive farming practices that reduce biodiversity, impinge on the territory of native tribes, and increase wildfire risks. Another involved joining a global coalition of asset managers, credit rating agencies and other stakeholders to advocate for better integration of ESG considerations within credit rating opinions.

As mentioned above, Daintree is an active member of the Perennial Partners Responsible Investment Working Group, a forum where several Perennial boutiques and support functions discuss and implement initiatives designed to further the sustainability credentials of Daintree and Perennial Partners.

Closer to home, Daintree continues to support a simple scheme that partners with One Tree Planted to plant one tree for each new client to the firm, which many other Perennial Partners boutiques have adopted. Being planted in bushfire-affected regions, this initiative plays a small part in supporting environmental resilience and recovery.

Daintree employees are afforded time to pursue individual community engagement, including a longstanding association with Raise youth mentoring. Each year, a mentor is matched with mentee of early high school age, working through a structured programme over two school terms.

Disclaimer