

# Paradice Sustainability Framework

## Version 1.0

To achieve globally agreed sustainability priorities, such as addressing climate change, current economic activity must undergo a significant transformation to become less impactful on the environment and society. This transition to a more sustainable global economy brings with it investment opportunities, as some companies stand to contribute to and benefit from these structural changes.

The Paradice Sustainable Transition Strategy (the “Strategy”) seeks to achieve superior risk-adjusted returns through investing in these companies – the ‘winners’ of this economic transition. The Strategy invests in companies assessed to be in alignment with our proprietary Sustainability Framework.

This document describes the Strategy’s investment philosophy, outlines the Sustainability Framework and how it is applied, as well as provides detail on other aspects of the investment process as they relate to sustainability and environmental, social and governance (ESG) issues.

This document should be read in conjunction with the relevant offer document for the Strategy. The Strategy is managed by Paradice Investment Management Pty Ltd (hereinafter “Paradice”).

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# Global sustainability priorities

World leaders acknowledge that significant changes need to happen across the global economy to preserve the longevity of humankind and the planet on which it depends. At the same time, economic inequalities and disparities in quality of life must be addressed in the interests of peace and justice.

Business as usual cannot continue. Current economic activity is depleting our planet's finite resources at a rapid rate, damaging nature and contributing to dangerous climate change. However, social needs – which include economic development, health and wellbeing – also need to be met for a growing population.

How does the world meet these complex and interrelated future needs in a more sustainable way?

The best current blueprint is the United Nations Sustainable Development Goals (SDGs), combined with Paris Agreement on climate change. Collectively this sustainability agenda set by nations around the world – serving as an articulation of social, environmental and economic needs – is shaping change across public policy, economic activity and societal expectations.

Meeting these needs will require a multi-decade transformation of the economy, with sustainability progressively embedded in all decision making, which can be understood as the 'sustainable transition'. The most urgent priority within this transition relates to our energy system, which must drastically reduce its reliance on emissions-intensive fossil fuels and instead transition to low-carbon energy sources.

The sustainable transition will require unprecedented collaboration between government, business and civil society. It will also require vast sums of capital. For these reasons, we believe addressing sustainability needs presents significant opportunities for investment.

## Investment philosophy

We believe structural trends relating to the transition towards a more sustainable global economy will benefit some companies more than others. In particular, those companies which offer products or services which are aligned to the sustainable transition will be well placed to create value over the long term.

We see value creation opportunities where a company's products or services directly contribute to a sustainability outcome. In particular, where these provide solutions to reduce negative impacts on the environment or to deliver positive social outcomes.

We also look for opportunities across the supply chains of relevant sustainable economic activities, acknowledging that the sustainable transition will not be delivered without the raw materials, key components or enabling technologies that underpin a finished product.

In many cases, we believe outperformance will be found among those companies that have products or services delivering the sustainable transition but are less recognised by the market for their alignment to these sustainability-related structural trends. For example, investors will readily recognise a renewable energy company as being aligned to the sustainable transition and often these types of companies will trade at a premium. However, key suppliers and components makers can be under-appreciated as being exposed to the same positive tailwinds.

### Our foundational belief:

Companies offering products or services which contribute to the achievement of sustainability outcomes are likely to benefit from structural tailwinds.

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# The Paradise Sustainability Framework

Given the vast number of companies in the investable universe, we need a structured way to validate a stock idea's alignment to our investment thesis. As such, we developed a proprietary Sustainability Framework informed by areas of sustainability need, combined with an understanding of economic activities that can address these needs.

## Starting point: global sustainability priorities

The global policy agenda to address the sustainable transition, such as the SDGs and the Paris Agreement, is typically set at the national level. As such, some areas of policy focus are not directly applicable for financial market participants such as listed companies and asset managers like Paradise.

To work out how best to think about these global sustainability priorities in an investment context, we started by distilling common sustainability objectives and combining these with an understanding of environmental science and sustainability principles. As per Figure 1 below, we identified eight objectives that the achievement of which would represent a sustainable global economy.

Once understanding the objectives, we could group the actions required in order to *transition* to a sustainable economy across three broad areas: efficiencies, emissions and enablers (see Figure 1). 'Efficiencies' and 'emissions' are largely actions to reduce environmental impact. 'Enablers' primarily relates to actions which either secure better outcomes for society or which enable innovative technologies across all three buckets (e.g. education).

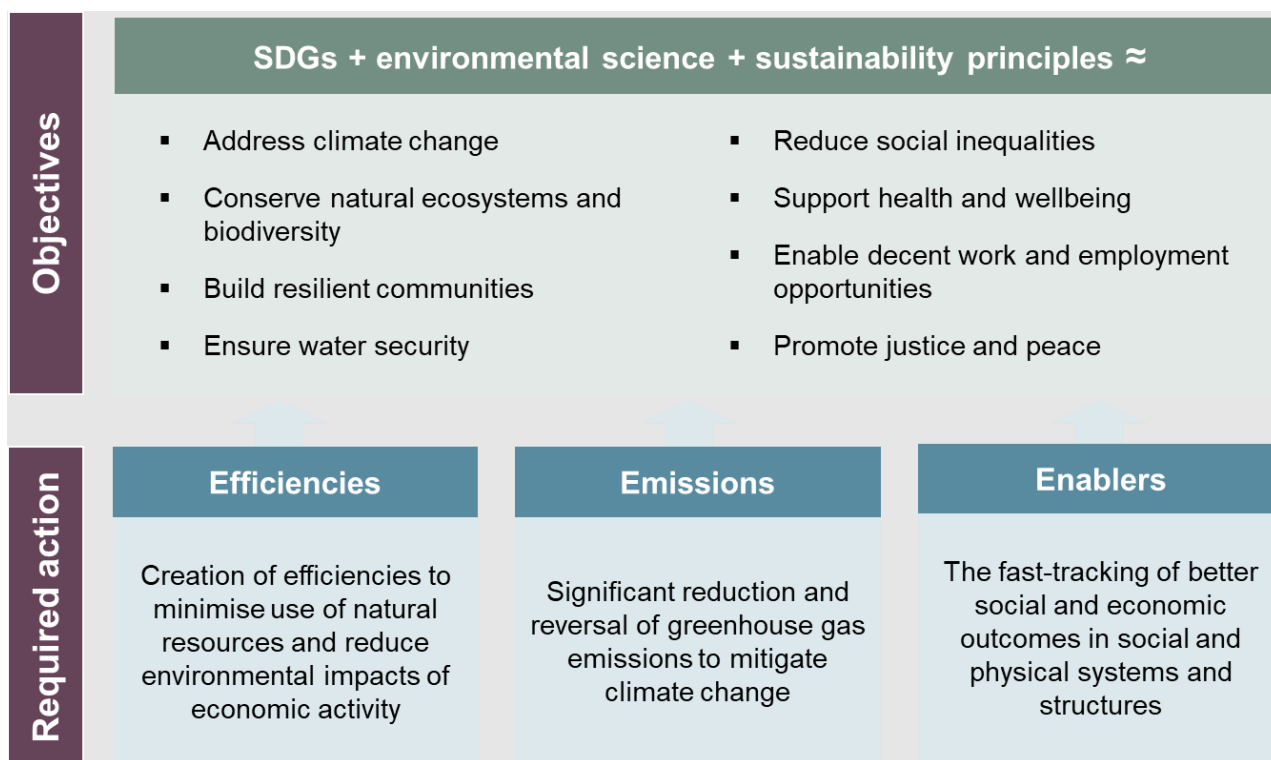


Figure 1 | Global Sustainability Priorities

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## The Paradise Sustainability Framework

The Paradise Sustainability Framework identifies 12 sustainable investment themes that we will target within the portfolio. It is informed by our overarching foundational belief and our understanding of what economic activities will support the required actions across the three areas of ‘efficiencies’, ‘emissions’ and ‘enablers’. See detail in Figure 2 below.

Companies must offer products or services which meaningfully align to one of the 12 themes for it to be included in the portfolio. Products or services may be directly contributing to a sustainability outcome, or be within the relevant supply chain which ultimately delivers a sustainability outcome (e.g. a key component or raw material).

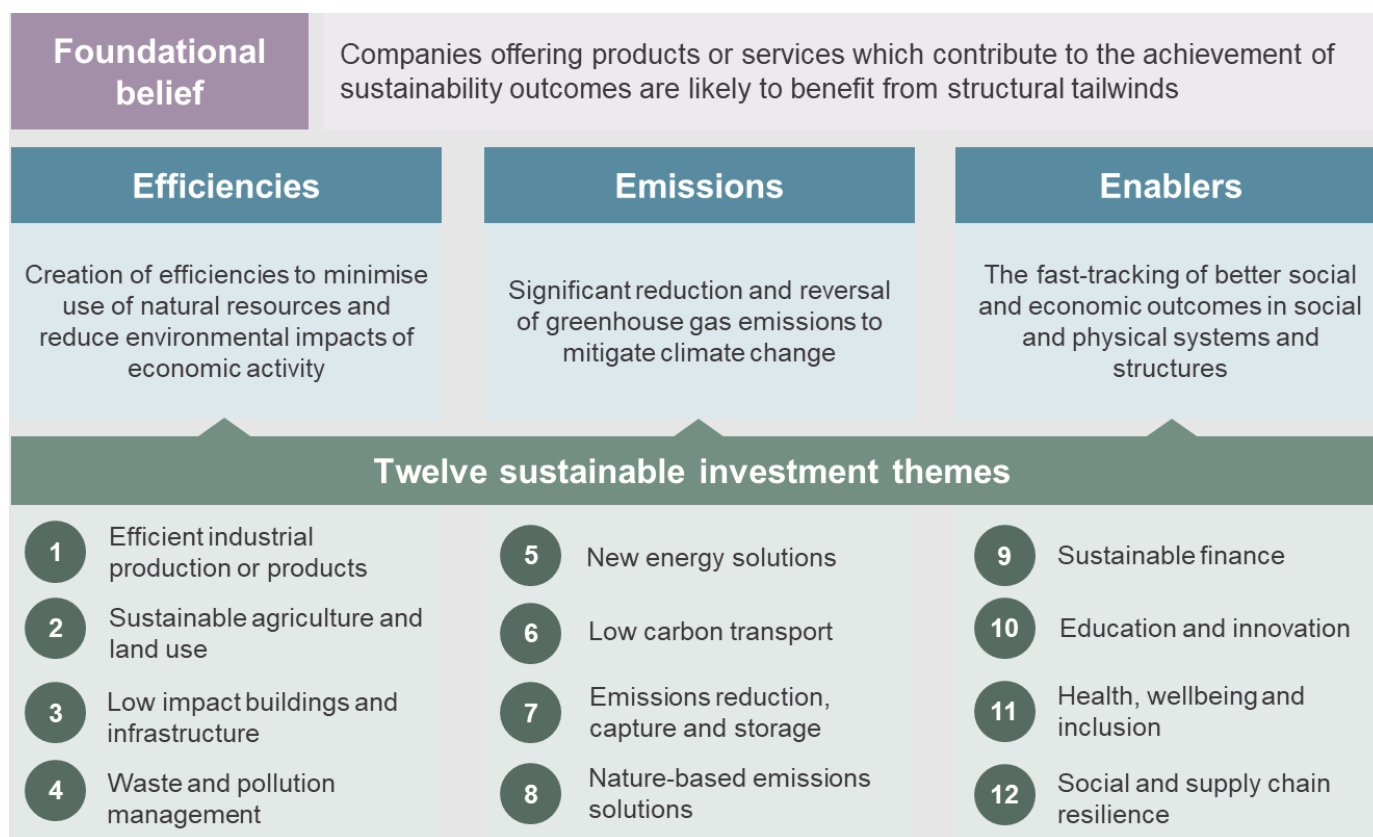


Figure 2 | The Paradise Sustainability Framework

## The twelve sustainable investment themes: examples

The twelve sustainable investment themes serve to focus the search for potential investment opportunities by identifying the kinds of product and services which contribute to the achievement of sustainability outcomes. Below we provide some illustrative examples of what types of economic activity or specific products and services fit under each theme.

### Efficiencies

- **Efficient industrial production or products**
  - Production processes which improve efficiency – of electricity consumption (scope 2 emissions), raw material inputs, water use etc; automation; robotics; semiconductors; products which are more energy or water efficient in use phase (e.g. heat pumps, efficient appliances)

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- **Sustainable agriculture and land use**
  - Agricultural technologies with lower environmental impact; food security; lower impact pesticides; sustainable forestry products
- **Low impact buildings and infrastructure**
  - Energy and water efficient buildings; green infrastructure; lower carbon construction materials; increased recycling in demolition and redevelopment phase
- **Waste and pollution management**
  - Circular economy; recycling (including recyclable packaging); waste management and treatment; pollutant filtration; water purification; wastewater treatment

#### *Emissions*

- **New energy solutions**
  - Products and services relating to moving away from fossil fuel-based energy sources; renewable energy; green hydrogen; alternative fuels; energy grid solutions; critical minerals for new energy solutions such as energy storage
- **Low carbon transport**
  - Electrification of transport; key components and raw materials for electric vehicles (EVs); lower carbon alternative transport for heavy vehicles; alternative fuels for transport applications (e.g. aviation)
- **Emissions reduction, capture and storage**
  - Technologies or methods that result in direct (scope 1) greenhouse gas emissions reduction in heavy industrial processes (e.g. steel manufacture and aluminium smelting); carbon capture and storage; carbon utilisation; direct air capture
- **Nature-based emissions solutions**
  - Nature-based carbon storage; plant-based alternatives; solutions addressing livestock emissions (e.g. feed reducing methane)

#### *Enablers*

- **Sustainable finance**
  - Financing of decarbonisation activities, affordable housing and other activities directly contributing to sustainable outcomes
- **Education and innovation**
  - Education provision; improvement of access to education; products or services which foster innovation (e.g. technology solutions)
- **Health, wellbeing and inclusion**
  - Healthcare; wellbeing and lifestyle solutions; nutrition; social inclusion (individuals); financial literacy and inclusion
- **Social and supply chain resilience**
  - Social resilience (community) such as telecommunications, connectivity, digitisation, environmental and safety testing/diagnostics (all non-health related testing)
  - Climate adaptation – products or services relating to making society and the built environment more adaptable/resilient to physical climate impacts (e.g. storm or fire-resistant building materials)
  - Supply chain logistics/distribution solutions which support resilience

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# Implementation

The Portfolio Management team determines which one of the twelve sustainable investment themes that the company aligns to. If there is no material alignment, the company will not be considered for investment. In some cases, especially where a company has a diverse business, it is possible that more than one sustainable investment theme could apply. In such instances, the Portfolio Management team will categorise the company in the most relevant sustainable investment theme.

The alignment of a company to one of the sustainable investment themes must be meaningful. It is not easy to define a specific threshold which makes the alignment meaningful. This will be determined by the Portfolio Manager. Decisions will typically be guided by two key considerations – whether the sustainability-aligned products or services are significant to the company itself, or whether they have meaningful positive impact on real world outcomes. Specifically:

1. We will consider whether the company's exposure to the sustainable investment theme is a significant part of its current or future business. For example, a majority of its business lines are linked to the sustainable transition, or pursuing opportunities in certain products or services is a core part of the company's strategy.
2. We will consider whether a company offers certain products or commercial activities which may be a minority part of its business, but these have a significant impact on real world outcomes. For example, should the size of company mean the scale of such activities are meaningful or the activities themselves enable real world outcomes (such as Sustainable Finance).

It is also worth noting that part of the Strategy's investment philosophy is to invest broadly across the value chains of investment themes to pursue attractive returns. Take theme 6 'low carbon transport': companies within the electric vehicle value chain are going to be highly relevant to this theme. We may invest directly in an electric vehicle manufacturer, but we will also be looking to invest in the company which, for example, makes the vehicle's battery components or produces the lithium which goes into the batteries.

Given the application of the Sustainability Framework includes decisions of a subjective nature, Paradise has in place governance structures to oversee its application. Documented investment rationale demonstrating alignment with the Sustainability Framework will be prepared by the Portfolio Management team on an ongoing basis. The governance structure will include internal peer review and compliance oversight. Where there are concerns in relation to the application of the Sustainability Framework, matters will be escalated through Paradise's standard risk and controls processes.

## Meeting minimum standards

It is not enough for portfolio companies to have their products or services align to our Sustainability Framework and meet financial criteria, they must also meet other minimum standards related to ESG, sustainability and ethical considerations. Specifically, we expect that a company:

1. Avoids significant harms
2. Meets minimum ESG-related operational standards

## Avoiding significant harms

In managing the investment strategy, we apply several exclusionary screens to avoid investments in companies involved in certain business activities which we consider cause significant environmental or social harm. This view

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is informed by sustainability and ethical considerations. The exclusionary screen criteria is laid out in the table below.

## Exclusionary screens

The Strategy takes all reasonable care to not invest in companies which derive <sup>1</sup> :	
<i>Controversial and nuclear weapons</i>	Any revenue from the production of controversial weapons (such as cluster munitions, landmines, chemical weapons or biological weapons);
	Any revenue from direct involvement in the development, production and maintenance of nuclear weapons;
<i>Tobacco</i>	Any revenue from the production of tobacco products (including e-cigarettes and nicotine alternatives);
<i>Pornography</i>	Any revenue from the production of pornography;
<i>Gambling</i>	More than 5% of revenue from the direct manufacture, ownership or operation of gambling facilities, gaming services or other forms of wagering;
<i>Conventional weapons</i>	More than 5% of revenue from the production of conventional weapons, civilian firearms or military equipment used for combat;
<i>Fossil fuels</i>	More than 5% of revenue from directly undertaking thermal coal mining; or
	More than 5% of revenue from directly undertaking unconventional oil or gas exploration or extraction (defined as oil sands, hydraulic fracturing and arctic drilling).

## Implementation

We take all reasonable care in applying the exclusionary screens and have in place robust processes to identify and monitor the portfolio holdings against the screen criteria, based off information we believe to be accurate. Paradise primarily draws upon information from our service provider, MSCI ESG Research, to implement the screens. We note that our provider relies upon direct company reporting to ascertain revenue streams and business involvement, which may not always be explicitly disclosed. For these reasons, we do not guarantee that the Strategy will meet all of these criteria at all times. However, where a holding no longer meets the criteria, we will divest the holding as soon as practicable and in investors' best interests.

## Minimum ESG-related operational standards

Although a core focus of the investment strategy is a company's products or services, we also expect companies to meet minimum ESG-related operational standards. In other words, even if *what* they do is aligned to sustainable outcomes, *how* they run their business must also be considered.

We consider ESG-related operational standards on a case-by-case basis, looking specifically at the company in question. In particular, we adjust for country-appropriate standards as we acknowledge that it would not be appropriate to apply developed world operational standards to a company operating in a developing country.

Operational practices we may consider when determining a company's adherence to minimum standards includes but is not limited to:

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<sup>1</sup> In determining revenue, our third party research provider MSCI ESG Research assesses a company's gross revenue or, in instances where this figure is not reported by the company, it applies a revenue estimation methodology.



- Workplace health and safety
- Adherence to human rights principles
- Labour rights and standards
- Diversity and inclusion
- Environmental management
- Reduction of greenhouse gas emissions
- Ethical business conduct
- Corporate governance structures

## Implementation

Company-specific assessments for minimum ESG-related operational standards are undertaken by the Portfolio Management team prior to taking an investment position. The team will consider insights gained through corporate disclosures and direct engagement, as well as third party inputs such as external research, controversy monitoring services and specialist ESG data (including but not limited to MSCI ESG Research). Assessments will be informed by norms in the operating country and whether the company in question is lagging local corporate peers.

Given the application of minimum ESG-related operational standards is largely subjective in nature, Paradise has in place governance structures to periodically review the Portfolio Management team's assessments. For example, the Portfolio Management team provides a rationale as to why it considers a holding to meet minimum ESG operational standards in instances where the company has an MSCI ESG Rating of B or lower, is unrated by MSCI ESG Research, or if it is determined to have a 'very severe' or 'severe' controversy case as defined by MSCI.<sup>2</sup>

# Paradice's firm-wide commitment to responsible investment

While the Strategy uniquely applies the Paradise Sustainability Framework and other minimum standards, it also adheres to standard responsible investment practices in line with the wider Paradise business. Paradise is a signatory to the Principles for Responsible Investment (PRI) and has in place a suite of policies and procedures to guide its responsible investment practices. The two key practices that are common for all Paradise investment strategies are ESG integration and stewardship.

Please also refer to the Paradise Responsible Investment Policy.

## ESG integration

ESG integration specifically refers to the integration with investment decision making of ESG factors which have the potential to be *financially material*. This applies a risk or opportunity lens, with the objective being better risk-adjusted returns over the long term.

The Strategy integrates financially material ESG factors throughout the investment process, such as in fundamental analysis and portfolio construction. The manner in which ESG matters are considered within these parts of the

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<sup>2</sup> Please see more information on our third party provider MSCI ESG Research's relevant methodologies on its website at <https://www.msci.com/our-solutions/esg-investing/esg-ratings> and <http://www.msci.com/notice-and-disclaimer>.



investment process is strictly financial and distinct from the other ways ESG or sustainability information is evaluated such as when applying the exclusionary screens or minimum operational standards.

## Stewardship

Stewardship is also commonly referred to as 'active ownership' and describes the use of the influence afforded to institutional investors in a responsible manner and in the interests of long term value creation. As an investor in listed equities, Paradice is entitled to voting rights at shareholder meetings and is offered access to representatives from investee companies. As such, proxy voting and corporate engagement are tools through which Paradice can exert influence and seek to drive outcomes in the long term interests of our clients.

Like all Paradice investment strategies, the Strategy seeks to take an active approach to engagement and voting. Given the nature of a global equities strategy, there can at times be limitations to active stewardship due to position size, language or geographical barriers to engaging more regularly. Nevertheless, when seeking to drive change at investee companies and access is available, the investment team will typically engage to encourage greater contribution to sustainability outcomes from products or services or address operational ESG-related concerns.

The Portfolio Manager will actively exercise all voting rights in line with Paradice's Proxy Voting Policy.

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The Sustainability Framework may change from time to time, in line with evolving global sustainability priorities.

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