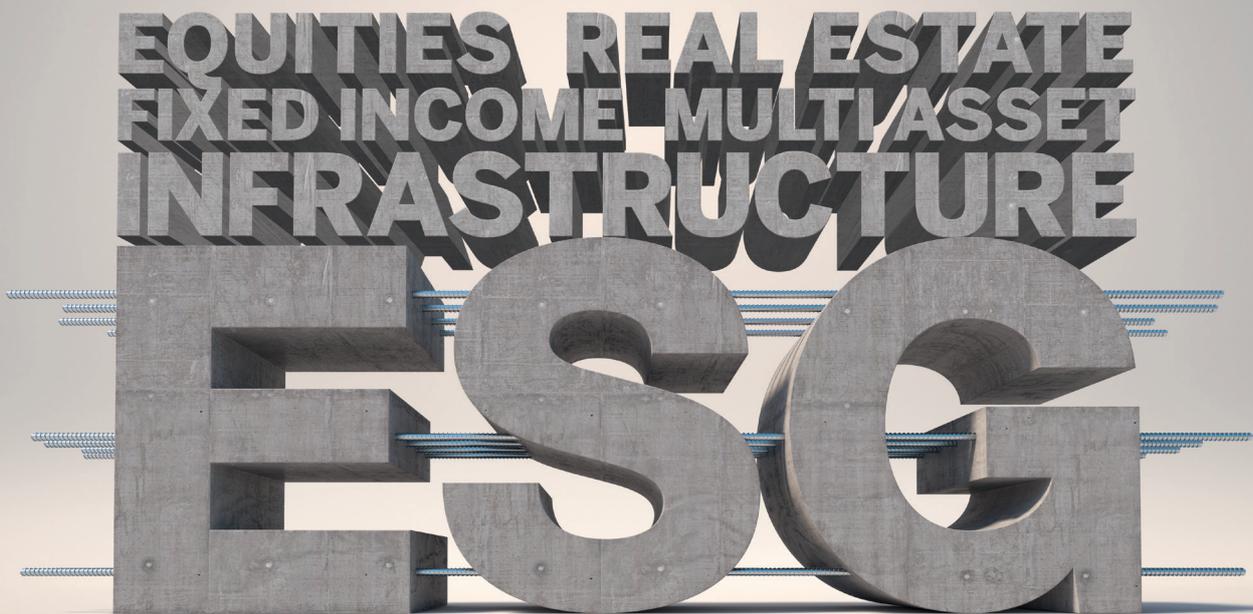


# Why understanding ESG factors makes for better investment decisions



At AMP Capital, we believe incorporating environmental, social and governance analysis into our investment processes makes for more informed investment decisions.

Here we explain why.

# Our approach to responsible investment

AMP Capital is Australia's largest responsible investment manager<sup>1</sup>, and has accumulated over a decade of experience integrating environmental, social and corporate governance (ESG) factors into our investment decision-making.

In early 2007 we became one of the first Australian signatories to the Principles for Responsible Investment (PRI), committing to extending responsible investment practices and ESG research across our entire investment universe.

Our main goal is to see material ESG risks considered in the same balanced way as any other investment risks. Our research shows that only around 26% of a company's true value lies in physical assets such as stock or buildings, with intangible assets making up the other 74%.

Understanding these non-financial drivers therefore provides deeper insights into how well a company or asset grows and protects company value. For example, within retail companies, management of supply chain and labour issues are key drivers. For an insurance company staff management practices are among the more important non-financial assets, so factors such as absenteeism, training, professional development and turnover rates are important indicators of overall company value and management quality.

While ESG issues can often be overlooked or mispriced by the market, AMP Capital believes engaging with companies and understanding these issues results in stronger conviction and better investment outcomes for our clients' portfolios.

“Understanding a company's non-financial drivers results in deeper investment insights and stronger investment outcomes for investors.”

## Supply chain risks in Asia

Increasingly, retailers are seeking cost efficiencies in their supply chains by, for instance, moving production around to areas with cheaper labour costs and switching to direct sourcing models. In June 2012, AMP Capital's ESG research analysts undertook a tour of Hong Kong and mainland China to obtain new investment insights about supply chain issues facing Australian-listed retailers, as well as general insights about the Chinese retail market and economy.

In our view, supply chain risk is about strategy risk and investors should engage with managers on supply chain issues for a number of reasons:

- > Retailers are exposed to high brand risk and sweatshop scandals can lead to brand damage and revenue loss.
- > Sustainability issues are more than 'ethics' – exploitation of workers can have a poor financial risk/ reward ratio.

Any cost 'savings' from underpaid labour must be balanced against additional risks in terms of quality, productivity, lead times and other issues.

- > A company's management of suppliers and supply chain could be indicative of how it deals with other stakeholders, including shareholders.

The meetings with factories, manufacturers, logistics companies and quality control auditors provided AMP Capital's Investment teams with detailed investment insights about sustainability issues and how these are managed by various retailers. Our analysis paid special attention to potential risks with direct sourcing, particularly from Bangladesh.

## Climate change and infrastructure

AMP Capital has been investing in the infrastructure asset class since the late 1980s and is recognised for its approach to integrating ESG considerations within mainstream infrastructure investments.

Climate change risks are considered throughout the entire lifecycle of the investment process, from identification of new investment opportunities to the active management of assets. When originating new investment opportunities in cleantech, renewable energy and other thematic investments, some of the themes we consider include government policy, regional directives, regulatory environments and legislative trends.

In the 2012 financial year we completed a range of transactions including a high voltage transmission link to an offshore wind farm in the United Kingdom, 10 wind farms in Ireland and power generation assets in India across the agri-waste, hydro and wind sectors.

Furthermore, climate change related risks and opportunities are monitored throughout the asset management phase via:

- > ESG audits and asset management plans, which include consideration of mitigation and adaptation strategies, and the availability of government subsidies and incentives to accelerate implementation
- > Influence through board positions on underlying investee companies, which allows for climate change to be considered in the context of both daily operations and the longer term strategic direction of the investment
- > Bi-annual valuation reports, incorporating likely impacts of climate change related legislation on long term cashflow and investment profitability
- > Insurance provisions and contract renewal, in which the boundary and scope of service provision relating to climate change, where possible, is explicitly addressed.

## Active ownership and engagement

AMP Capital is at the forefront of corporate governance initiatives. Our knowledge and dedicated resources seek to add value to the assets and portfolios clients have entrusted to us to manage.

Recognising that we can influence company policy on matters of corporate governance by virtue of the shareholdings under our management, we lodge considered proxy votes on all resolutions and engage with companies on issues such as executive remuneration, board composition and risk management. All this is done in the interest of driving better long term investment outcomes for our clients.

For us flashing lights appear when companies lack transparency, when boards are not representative of

their public shareholders, or when pay structures reward management for actions contrary to shareholder interests. Diligent analysis of these issues can help identify which companies to invest in and which to avoid.

For many years AMP Capital has voted against poorly structured remuneration schemes. Interestingly, it has only been since the recent introduction of the 'two-strikes' rule that some companies have really begun to take notice of shareholder concerns.

Integral to our work on governance is engagement with companies on their approach to managing ESG risks and contributing to public policy and industry debates on relevant ESG topics.

“Our ESG research integration techniques are appropriate to each asset class and can also be tailored to meet individual client requirements.”

## Proprietary ESG research

AMP Capital's dedicated ESG resources and research capabilities are embedded in our investment teams. Our ESG research integration techniques are appropriate to each asset class and can also be tailored to meet individual client requirements.

Rather than being wholly reliant on external data and broker research, which is widely available in the market, we have also built relationships with key charities, non-government organisations and unions to help uncover information on hidden ESG risks and opportunities.

This approach means we do not seek to exclude particular companies, asset types or industry sectors from our investable universe wholly on moral or ethical grounds. We do believe, however, that responsible investing requires consideration of future market trends and societal expectations of corporate responsibility which may affect a company's long term sustainable performance.

### Important note

While every care has been taken in the preparation of this document, AMP Capital Investors Limited (ABN 59 001 777 591) (AFSL 232497) makes no representation or warranty as to the accuracy or completeness of any statement in it including, without limitation, any forecasts. Past performance is not a reliable indicator of future performance. This document has been prepared for the purpose of providing general information, without taking account of any particular investor's objectives, financial situation or needs. An investor should, before making any investment decisions, consider the appropriateness of the information in this document, and seek professional advice, having regard to the investor's objectives, financial situation and needs. This document is solely for the use of the party to whom it is provided.

## Contact us

For more information about how  
AMP Capital is integrating ESG issues  
into our investment approach, visit  
[ampcapital.com.au/esg](http://ampcapital.com.au/esg) or call us on

**1800 658 404**