ESG REPORT FY20

Released July 2020

PERENNIAL

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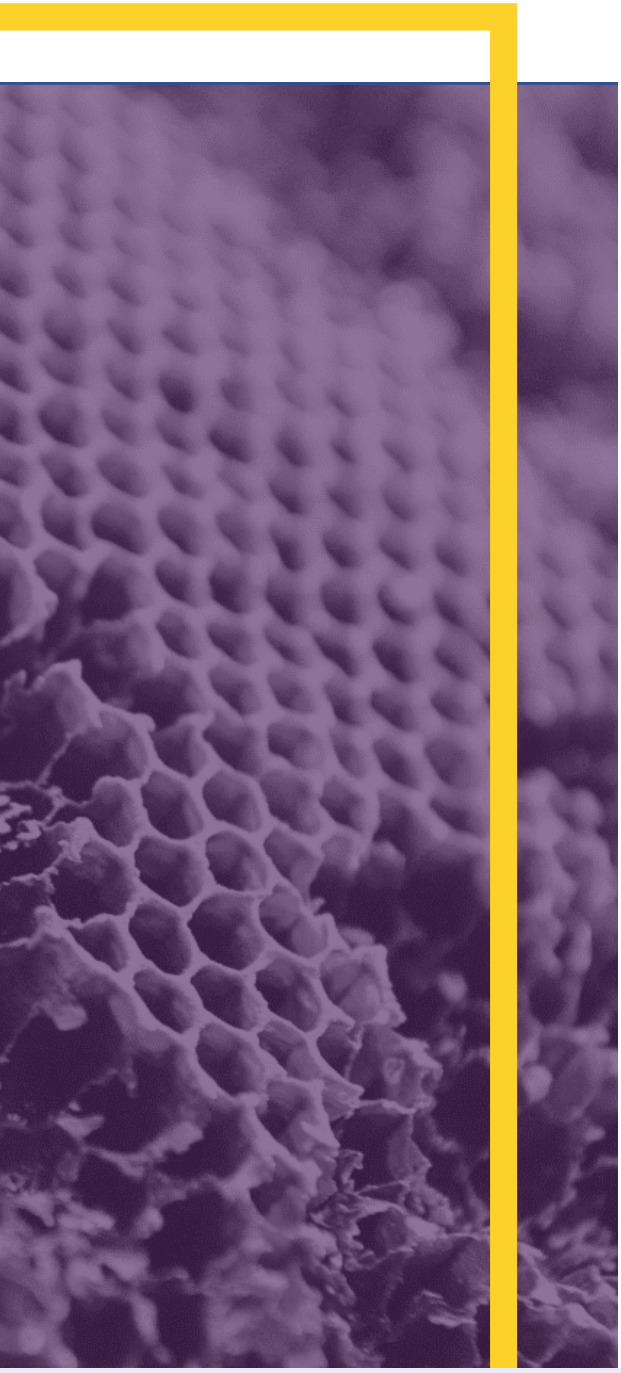
SUSTAINABLE. OPPORTUNITY.



WELCOME

This year, we are excited to release Perennial's first annual ESG report. This report showcases our increased focus on ESG and sustainability across the Perennial group over the last five years. It provides tangible evidence of effort across the organisation. In February 2018, we developed our first dedicated sustainability product with the Perennial Smaller Companies Sustainable Future Trust. In May 2019, a quoted version of the Sustainable Future Trust was created through Perennial partner eInvest (ASX: IMPQ). We are moving rapidly and seeking to use ESG and sustainability to provide great outcomes for our investors and society more broadly.

ESG AT PERENNIAL

At Perennial, we believe that an holistic view of a company, including the consideration of ESG factors, promotes a well-rounded approach to investing. We believe that this provides better risk adjusted returns and superior outcomes for our clients. When making investment decisions, we consider ESG through a multi-lensed approach including our proprietary ESG&E scoring system, external sustainability data and engagement with companies to assist with decision-making.

UN PRI SIGNATORY

Perennial has been a signatory to the United Nations Principles of Responsible Investment (UN PRI) since 2009. As a signatory, we agree to the six principles for Responsible Investment.

In our 2019 PRI results, Perennial achieved the top band for all three assessment areas: Strategy & Governance, Listed Equity – Incorporation and Listed Equity – Active Ownership.

AUM	Module Name	Your Score	Your Score / Median Score
	01.Strategy & Governance	A	A
Direct & Active Ownership Modules			
>50%	10. Listed Equity - Incorporation	A	B
>50%	11. Listed Equity - Active Ownership	A	B

Source: 2019 Assessment Report for Perennial Value Management

ESG PROCESS

PERENNIAL'S 4 PILLARS OF ESG INTEGRATION

Our approach to integrating ESG in the investment process is based on the following 4 pillars:

1. Our in-house proprietary ESG&E scoring system
2. Engagement with management and boards on material ESG risks and opportunities
3. Proxy voting responsibilities
4. Portfolio management

ESG&E Score

The ESG&E Score is a proprietary scoring system established and run in-house by the Perennial sustainability team with input and insight from the sector analysts. Each company is given a score for Environment, Social and Governance performance as well as a score for company engagement.

Engagement

Engagement with companies to discuss material ESG issues, risks and opportunities.

Proxy Voting

Perennial should vote on all company resolutions considered at general meetings where it has the voting authority and responsibility to do so, regardless of the materiality of the resolution.

Portfolio Management

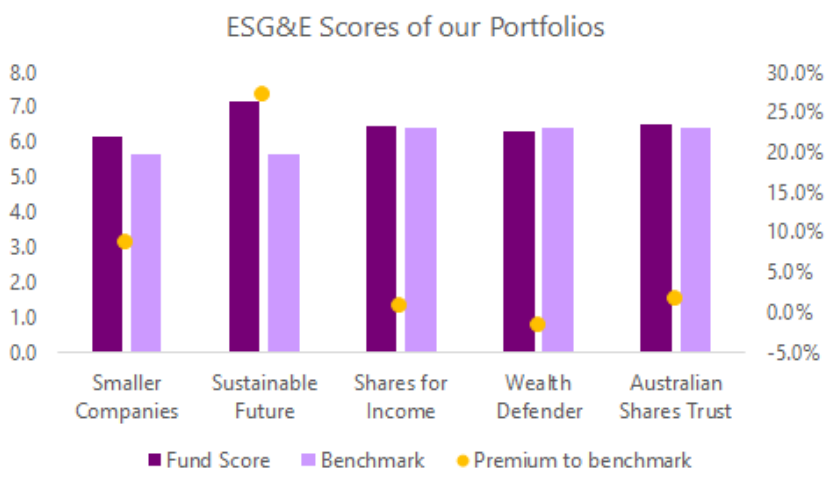
The company's ESG performance and characteristics are one of the considerations in portfolio construction. Stocks with ESG&E related concerns are either unlikely to be held or have a lower weight in the portfolio relative to other stocks with similar characteristics.

Source: Perennial Responsible Investment Policy

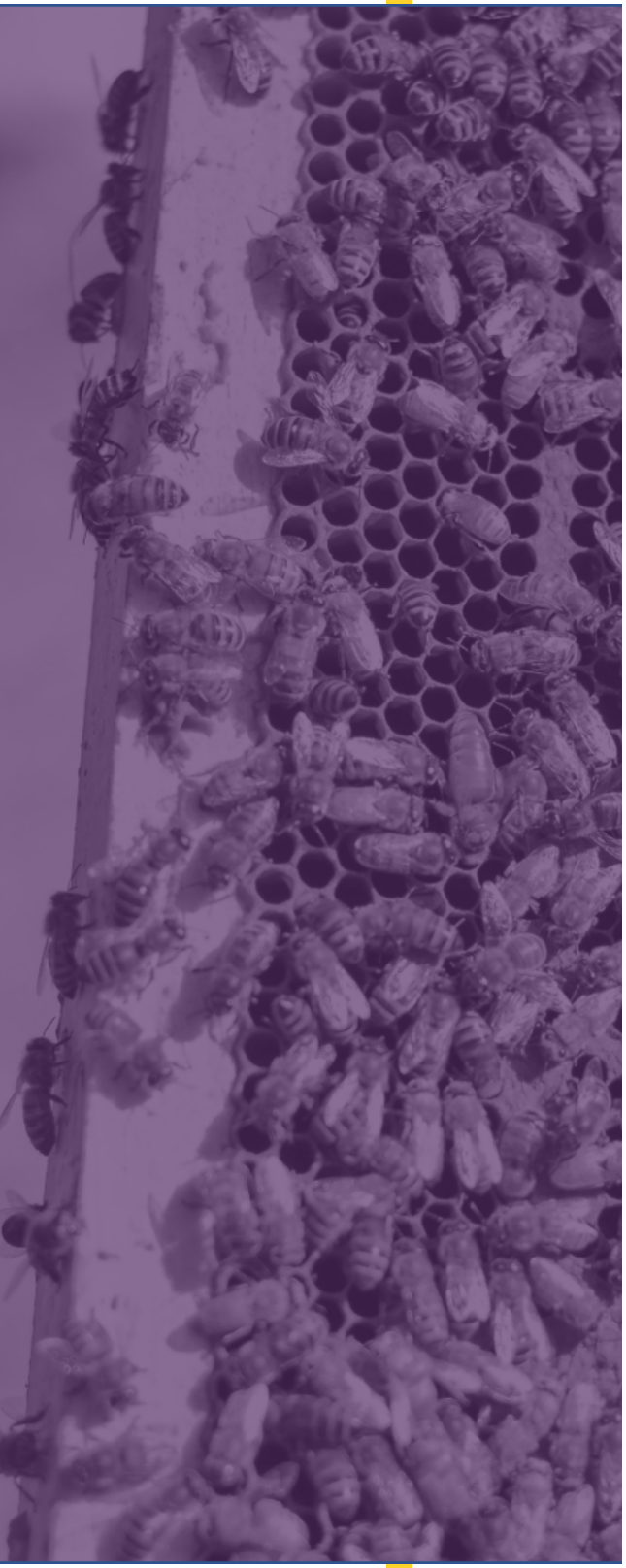
ESG & ENGAGEMENT SCORE (ESG&E SCORE)

The ESG&E score is a proprietary scoring system set up and run in-house by the Perennial sustainability team with input and insight from the sector analysts. Each company is given a score for Environment, Social and Governance performance as well as a score for company Engagement.

Environment, Social and Governance are each weighted 20%, while Engagement has a 40% weighting. This provides a total score out of 10, which is then compared to the benchmark.



ESG&E scores as at 30 June 2020



OUR DEDICATED SUSTAINABLE FUTURE STRATEGY

Our Sustainable Future Strategy, which is available through the Perennial Smaller Companies Sustainable Future Trust and the eInvest Future Impact Small Caps Fund (ASX: IMPQ), seeks to invest in smaller and mid cap companies that are contributing to a sustainable future. There are three categories of companies we seek to invest in:

- Sustainable Future Enablers
- Engaged Improvers
- Positive ESG scores

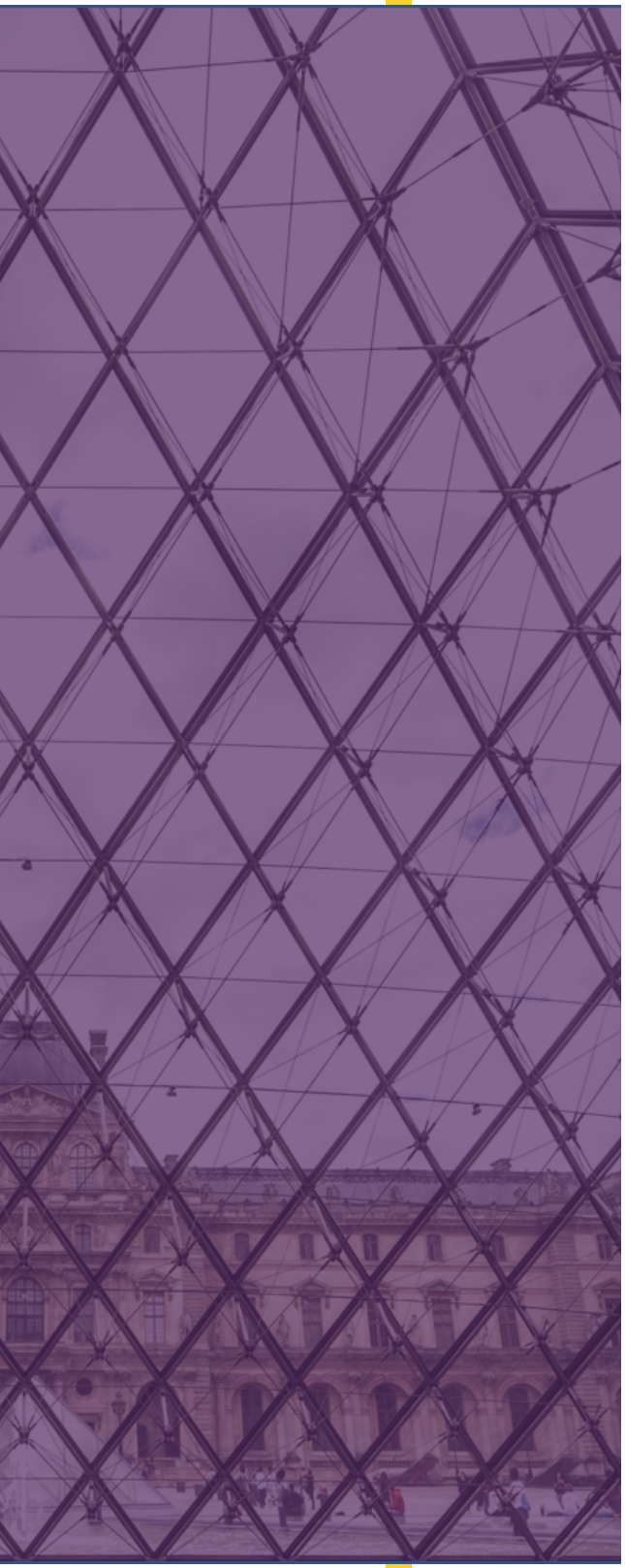
SUSTAINABLE FUTURE ENABLERS

Sustainable Future Enablers are making a positive contribution to creating a sustainable future. They operate in industries such as renewable energy, water treatment or remediation, environmental services, healthcare, education and/or have strong governance frameworks.

ENGAGED IMPROVERS

Engaged Improvers operate in industries that might not traditionally be considered sustainable, however, they have put ESG and sustainability at the core of their business and are focused on improving ESG outcomes.

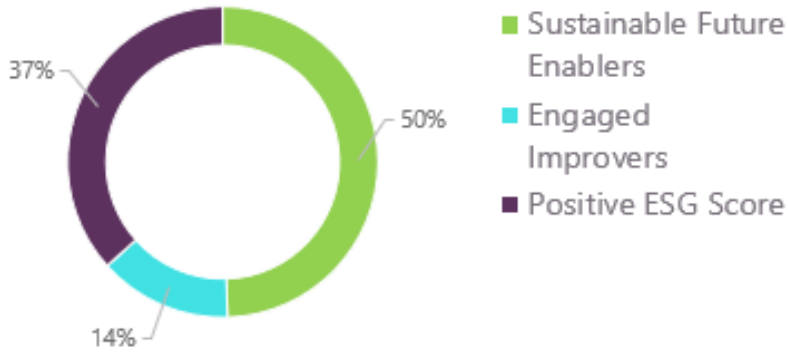
> *We strongly believe in sustainable product development and doing business ethically. We're focused on minimising environmental impact, and look to contribute to the wider community. We believe we have an opportunity, and responsibility, to help create a better world.*
>
> *Kathmandu (ASX: KMD)*
> *2019 sustainability report*



POSITIVE ESG SCORES

Positive ESG Score companies are those that score well on our in-house ESG&E scoring system. All companies in the portfolio must have an ESG&E score that beats the benchmark.

Below is an example of how our Sustainable Future Strategy is typically constructed:



Composition of the Sustainable Future Trust as at 30 June 2020

How is our Sustainable Future Strategy different from other "ethical", "sustainable" or "responsible" funds?

Typically, "ethical", "sustainable" or "responsible" funds will take an existing portfolio and use exclusions or negative screens to remove stocks involved in industries like tobacco, alcohol, thermal coal, mining or weapons. They will often allow a revenue threshold in assessing the exposure of companies in their screen. Whilst our Sustainable Future Strategy includes negative screens to ensure zero revenue exposure to relevant industries by confirming with companies, more importantly, it also:

- seeks to utilise our investment expertise in ASX listed small and mid caps to find interesting companies that are making a positive contribution to creating a sustainable future and typically also have interesting growth prospects – often outside Australia. We currently have around 50% of the portfolio in these "Sustainable Future Enabler" stocks; and
- does not invest in companies which we consider to have reputation risk, which is a broader concept than the typical narrow negative screen.

PROCESS FOR COMPANY SELECTION IN THE SUSTAINABLE FUTURE STRATEGY

1 POSITIVE FOCUS:

The Strategy seek to invest in companies that at the time of acquisition:

a) Conduct businesses that are making a positive contribution to creating a sustainable future, defined as deriving the majority* of their revenue from business operations that:

- are generating renewable energy, improving energy efficiency or seeking to reduce greenhouse gas emissions; or
- are involved in water treatment or remediation; or
- are focussed on providing environmental services or otherwise focussed on environmental friendly outcomes; or
- contribute to social welfare outcomes; or
- relate to health outcomes; or
- support education outcomes; or
- have strong governance frameworks including a diverse and independent board; OR

b) Have a Perennial Environmental, Social, Governance and Engagement Score ("ESGE Score") that exceeds the ESGE score of the benchmark index.

2 EXCLUSIONARY ITEMS/NEGATIVE SCREENS:

The Trust does not invest in companies that derive any revenue from:

a) the manufacture, distribution or sale of tobacco or alcohol products; or

b) the manufacture, distribution or sale of weapons or armaments; or

c) extraction or sale of thermal coal, uranium, oil or gas (other than recycled oil); or

d) gambling or betting operations; or

e) the production, sale or distribution of pornography; or

f) the manufacture or distribution of toxic pesticides; or

g) old growth forest logging; or

h) operations or transportation associated with the live exportation of animals offshore.

Our Sustainable Future Strategy is available through the following products:

- The Perennial Smaller Companies Sustainable Future Trust: https://perennial.net.au/our-trusts/sustainable-future/
- The eInvest Future Impact Small Caps Fund (ASX: IMPQ): https://einvest.com.au/impq/

These funds are actively managed portfolios of mainly small and mid-cap listed companies that are focused on making a positive contribution towards a sustainable future. We seek companies that are developing innovative solutions to solving the world's issues like education, social issues, water management, pollution, waste and emissions. We have a negative screen which excludes companies involved in industries which we believe are detrimental to society, however, our focus is on finding those companies that are doing good things according to our criteria above.

*majority refers to >50% of annual income.

KEY ESG TOPICS FOR 2020

In the last 12 months, we engaged with companies on a broad range of material ESG topics. However, the key ESG & Sustainability themes for corporates and investors during 2019/20, in our view were:

SUPPLY CHAIN & MODERN SLAVERY

The Commonwealth Modern Slavery Act (2018) requires companies with over A$100m in revenue to prepare an annual modern slavery statement. The first reporting of The Act began in 2020. The Government has the power to publicly name entities that fail to comply. In NSW, corporations with annual turnover of A$50-100m are required to report under The Act, and criminal penalties can be imposed on corporations that fail to meet reporting requirements. The legislation follows a similar Act in the UK. A key discussion for investors and sell side research analysts during 2019/20 was whether companies were prepared to report under The Act. This includes supply chain mapping, processes to prevent modern slavery risks and understanding the requirements of The Act.

CLIMATE CHANGE

The alignment of companies with the Paris Agreement to achieving net zero emissions by 2050 was a key engagement and discussion topic among investors. We saw a number of companies provide improving disclosure of Scope 1, 2 and 3 emissions as well as set long term targets. There were also multiple examples of advocate shareholders submitting climate related proposals to the AGM including at Origin Energy (ASX: ORG).

GOVERNANCE

A strong corporate governance framework remains as important as ever. Over the last 12 months, we saw a focus on gender diversity. In particular, the percentage of women on ASX boards. This is in alignment with the work of the 30% Club, which advocates for a minimum 30% representation of women on ASX 300 boards. We became signatories to the 30% Club in 2019.

SAFETY

Safety continues to be a key focus in the "S" or social component of ESG. We monitor the safety record, policies and procedures, fatalities and LTIFR (lost time injury frequency rate) of holding companies and take this into consideration through proxy voting.

UNITED NATIONS SUSTAINABLE DEVELOPMENT GOALS (SDGs)

The United Nations SDGs are a "blueprint to achieve a better and more sustainable future for all" (United Nations 2020). Many companies and investors have aligned their operations with the 17 goals. The goals cover themes such as health & well-being, education, diversity & equality and environmental outcomes.

Source: United Nations

ESG investing and corporate social sustainability gained momentum over 2019 and we have continued to see the acceleration over 2020 so far. It is important that as investment managers, we integrate material ESG factors into our investment process to manage risk, demonstrate best interest to clients and strengthen our social licence to operate.

Emilie O'Neill
ESG & Equities Analyst, Perennial

RECENT ESG INITIATIVES

Over the last 12 months, we have continued to improve our processes, systems and strategy related to ESG investing. We believe that ESG is critical to consider in the investment process and is related to our success as a business. As part of our strategy, Perennial participated in a number of industry initiatives with the purpose to learn from other investors, increase our presence in the ESG space and strengthen our ESG credentials. In 2019/20, we signed onto:

CLIMATE ACTION 100+ & WORKING GROUPS

Perennial became a signatory to the Climate Action 100+ in 2019. CA100+ partners with investors to ensure the worlds largest emitters take the necessary action on climate change. A key goal of the group is for asset owners and managers to collaborate on engagement activities to encourage corporates to:

- Curb emissions
- Improve governance and
- Strengthen climate-related financial disclosures.

We joined two working groups including Origin Energy (ASX: ORG) and South 32 (ASX: S32) during the year.

30% CLUB

Early in 2019, we signed onto the 30% Club which has the objective of 30% representation of women on ASX boards. We have engaged with numerous companies to encourage they appoint an additional female director to the board in the instance where there was not 30% representation, and we strive for equal representation where possible.

RIAA MEMBERSHIP

In 2019, we also joined the Responsible Investment Association Australasia (RIAA). RIAA champions responsible investing and a sustainable financial system in Australia and New Zealand. We joined over 300 members engaged in responsible, ethical and impact investing across Australia and New Zealand. We sponsored the 2020 Responsible Investment conference, although this did not proceed physically given the global COVID-19 pandemic. We are also in the process of having our dedicated sustainability strategies certified as responsible investment products.

ENGAGEMENT

As an investor, we seek to engage on ESG and other issues with companies in which we invest as well as companies within our investment universe that we do not hold, from time to time. The sustainability team is responsible for overall co-ordination and implementation of our ESG engagement policy. We typically meet with companies several times a year. At these meetings we seek to engage with the company on relevant issues, including issues relating to ESG.

Perennial has over

1,200

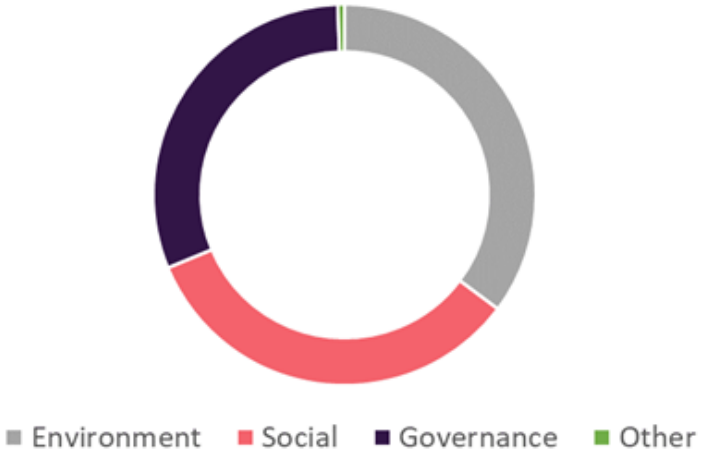
meetings with company management teams annually

We engage with managers and boards about material ESG risks and opportunities. We did this at

~150

meetings in 2019/20

PERENNIAL'S 2019 COMPANY MEETING RECORD: PERCENTAGE OF ESG-FOCUSED MEETINGS BY TOPIC



Source: Perennial Company Meetings Register

We will also engage with companies on ESG when a specific ESG issue arises or where a broader ESG issue impacts a company. We may also participate in industry or investor collaborative engagement projects from time to time and have joined Climate Action 100+.

When a company specific ESG issue arises we will typically seek to engage with company management on the issue. If we have significant unresolved concerns in relation to the issue, we will seek to escalate the issue by one or a combination of the following:

- writing to Company management;
- meeting with the Chairperson or Lead Independent Director; or
- writing a formal letter to the Board of Directors.

If the issue remains unresolved, we will consider divesting our holding in the Company. In engaging with companies we recognize that the information that may be able to be disclosed to us may be limited due to implications under insider information legislation and we will remain conscious of our obligations in relation to such legislation during the course of any engagement.

ENGAGEMENT CASE STUDIES

case study 1:

Governance for a healthcare company

During the 2019 AGM season, we raised concerns regarding a small cap healthcare company's diversity & independence of non-executive directors and the appropriateness of the incentive structure for executives. We organised a call with the CEO with the objective to understand the culture of the board and whether our concerns were being addressed by the company. We raised our concerns with the CEO and listened to his views on the topics of diversity and independence of non-executive directors including skills, background and gender. We also discussed executive incentive structure and whether this was appropriate for the retention of key staff and alignment to the future strategic direction of the company. Given this discussion, we wrote to the board regarding our intention to vote against items in the AGM and expressed our concerns in relation to board independence, encouraging them to adopt further diversity and skills on the board and implementation of a formal incentive structure to appropriately reward and retain management with key performance metrics aligned to the future strategic direction of the firm. We subsequently voted against those items in the AGM. However, our discussions and email had impact because at the AGM, the chair announced a new gender-related LTI (long-term initiative) for the CEO which previously did not exist. He also made comments on diversity including the recognition of its importance and a female appointment to the board. A second female director has been subsequently appointed.

case study 2:

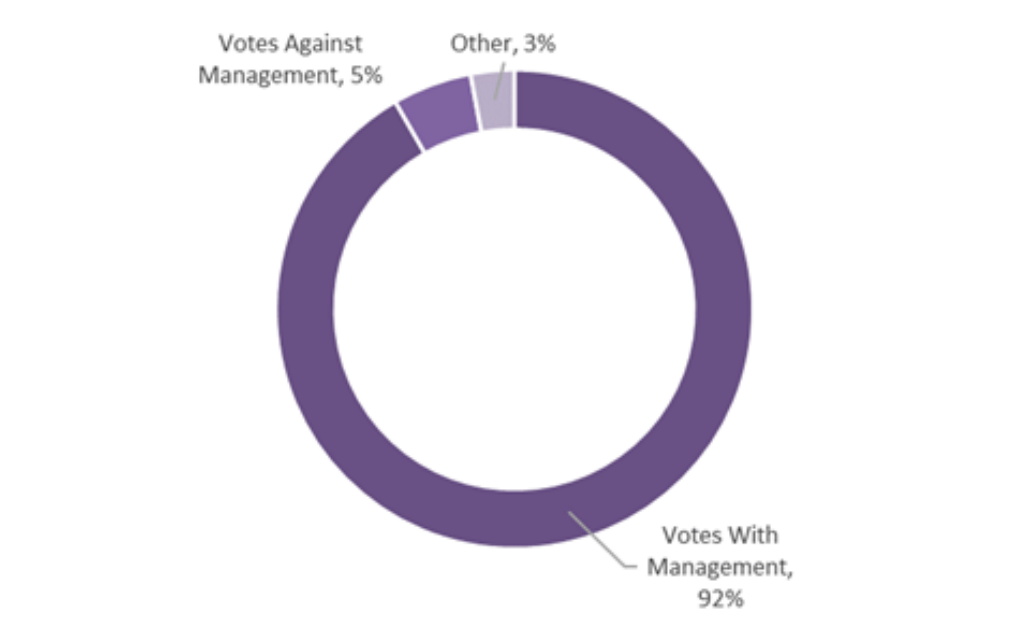
Ongoing engagement with a community developer

We have engaged with an owner, operator and developer of land lease communities for the last two years. Prior to investing, we wanted to better understand the supply chain to ensure it was one which was socially sustainable and if not, encourage the company to work towards achieving this. We also wanted to seek evidence of the company making positive progress toward an ethical supply chain. In 2019, we engaged with the company with the objective to improve the ESG and corporate sustainability disclosures and discuss ESG related risks and best practice. Perennial met with management of this company post the release of the company's FY18 results. We raised our concerns with management about their decision to import some flat pack homes from China. The company responded positively to our concerns and flagged their intentions to review their supply chain on the back of our recommendation. When meeting with the company in early 2019 post the release of their interim accounts, the company has made substantial progress on this, with management advising us of the random testing of imported homes and the likelihood of engaging a company in Asia to audit the company's supply chain. The company is also well aware and responding to their obligations under the Modern Slavery Act. In late 2019, we met with representatives from the investor relations team to discuss ESG risks, the impact of climate change, circular economy and ESG disclosure and reporting. The scope and process was to understand how the company is thinking about these issues, and to provide advice on best practice, and what we want to see regarding ESG disclosures. We expect to see further ESG disclosure later in the year given our engagement.

PROXY VOTING

As an active manager, we take our proxy voting responsibilities very seriously. Perennial should vote on all company resolutions considered at general meetings where it has the voting authority and responsibility to do so, regardless of the materiality of the resolution. Voting rights are a valuable asset which should be managed with care and due diligence. Ultimately, shareholders' ability to influence management depends on shareholders' willingness to exercise those rights. We publish our proxy voting records semi annually on our ESG and Responsible Investment website page at https://perennial.net.au/our-story/corporate-social-responsibility-esg/. In circumstances where we intend to vote against management recommendations, best practice is to inform management of our concerns and provide an opportunity for a response.

PERENNIAL'S FY20 COMPANY MEETING RECORD: PERCENTAGE OF ESG-FOCUSED MEETINGS BY TOPIC



Source: Perennial Company Meetings Register in FY20

PROXY VOTING CASE STUDIES

case study 1:

Vote against remuneration report at a materials company given safety record

We became aware of two fatalities at a materials company during the year. We organised a call with management which was joined by the analyst on the stock as well as the sustainability team. During the call we discussed the circumstances surrounding the incidents, the existing safety controls and the subsequent actions taken post the tragedies. Safety record was one incentive metric in the remuneration report, and executives had their discretionary pay adjusted. However, in our view the adjustment was not material enough given the extremely poor safety record during the year and we chose to vote against the remuneration report. We will monitor the safety statistics going forward and will take further action if we do not see a robust improvement.

case study 2:

Governance concerns of a water remediation & management company

We advised the management of a water remediation company that we had a number of governance concerns when considering our proxy voting at the AGM. Those issues included the independence of the chair and other board members, the independence of the audit committee, the relatively high fixed remuneration for management and disclosure around incentives. Additionally, we encouraged the company to increase its female representation on the board and to strive for a least 30% representation in line with the 30% Club. The company actively engaged with us on these concerns and we worked with the company to provide recommendations for potential female appointments to the board. We were pleased with the response, engagement and progress of management and the board, and voted in favour of the company at the AGM. Despite voting in favour of the company, we also continued to encourage the appointment of a lead independent director and further disclosure on the hurdles for the short term incentives (STI). We will monitor the progress of the company over the next 12 months.

case study 3:

Voting against management at an insurance company

In light of the remuneration report, we wrote to the board of an insurance company regarding our concerns on high fixed levels of remuneration for executives and lack of gender diversity on the board and at management level. The high level of fixed remuneration makes it difficult to adjust executive pay in times of poor performance. Female representation on the board was at 22%, which did not meet its own 30% target. The board responded in a timely manner with comprehensive detail around these two concerns. Despite this, on balance, we decided to vote against the remuneration report and equity grants to the CEO.

THANK YOU

Thank you for your interest in ESG and how we approach ESG at Perennial. As you can see in this report, Perennial is taking an active approach to integrating ESG and Sustainability into our investment strategies and corporate strategy more broadly.

The launch of the dedicated Sustainable Future Strategy provides investors with a genuine sustainable investment option that is a unique offering in the market. Investors can access this via investing in either the Perennial Smaller Companies Sustainable Future Trust or via the eInvest Future Impact Small Caps Fund (ASX: IMPQ).

For more information on Perennial's ESG strategy, please visit our ESG and Responsible Investment webpage at https://perennial.net.au/our-story/corporate-social-responsibility-esg/ or reach out to the team.

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