# Kapstream ESG Policy

Version 11

Date of version: 1st November 2024

Next review: 30th September 2025

Owner: Board of Kapstream Capital Pty Limited

# Principles: ESG integration

Kapstream acknowledges the important role that Environmental, Social, and Governance (ESG) factors play in our investment strategies. We understand that these elements are pivotal in evaluating the long-term performance of companies we invest in. Our objective in analysing ESG risks and opportunities is to understand how effective or ineffective management of these factors influences a company's credit profile and valuation, aiming to mitigate long-term risks while capitalising on short term opportunities. We believe that this approach enables us to deliver strong outcomes for our investors.
Additionally, Kapstream is a signatory to the United Nations Principles of Responsible Investment (UNPRI) framework.

# Framework

Our ESG framework comprises three key components:

1) Negative screening and exclusions: we initiate our ESG strategy by setting baseline criteria, applying exclusions and screenings to establish minimum standards.
2) ESG rating: the second step is to identify and assess material ESG factors. We evaluate their potential impact on creditworthiness and the issuer's capacity to navigate associated risks or seize emerging opportunities and its pricing by the market. The purpose is to identify mispricings of opportunities and minimise unpriced risks.
3) Engagement: recognising the limitations of sustainability reports, we prioritise direct engagement to gain a fuller understanding of a company's ESG efforts.

## *Negative screening and exclusions*

Kapstream conducts systematic screenings for compliance with UN Global Compact Principles to protect human rights and combat modern slavery. Non-compliant issuers are engaged with for improvement, and if unsuccessful, holdings are sold.
Moreover, Kapstream elects to exclude direct investments in specific industries, a position reviewed periodically. Companies or entities that generate 10% or more of their total sales from the following are generally excluded:

- Armaments
- Tobacco
- Adult Entertainment
- Gambling
- Extraction, exploration, and production of fossil fuels.

The exclusion also applies to utilities that generate more than 10% of their gross revenue from the sale of electricity produced from thermal coal.

## *ESG rating*

Kapstream has developed a proprietary rating system to assess ESG risks, organising issuers into six distinct colour codes based on their Materiality and Trajectory. This framework facilitates a comparison of issuers across various industries by examining their ESG risks and their potential for either improvement or decline. With the forward-looking nature of this approach, we try to capture ESG premiums and avoid issuers whose security may see a sell-off in the medium / long term.
The assessment's core is the Materiality evaluation, which includes an analysis of industry-specific risks, geopolitical factors, management of industry risks, and any idiosyncratic controversies. Furthermore, as credit investors, Kapstream pays close attention to the impact of ESG risk and opportunity management on financial metrics, specifically looking into:

- **Revenue**: assessing if a company's management of ESG risks and opportunities could lead to changes in revenue, through gain or loss of market share for example;

- **Costs**: evaluating the likelihood of the company incurring higher costs, including fines;
- **Capital expenditures**: considering whether the company will need to allocate additional capex to upgrade assets.
- **Asset valuation**: analysing the risk of certain assets being devalued for not aligning with the shift to a lower carbon economy or in extreme cases, the risk of stranded assets.
- **Access to funding**: assessing if the company is in a sector that might experience withdrawal of funding by banks and investors or if the issuer could face refinancing challenges or benefit from lower funding costs due to strong ESG credentials.

In considering Trajectory, Kapstream undertakes both quantitative and long-term qualitative assessment to determine a view of whether identified ESG risks are improving or deteriorating.

Except for those in the worst category, Kapstream believes that investment in lagging issuers should not be systematically excluded. Instead, we endeavour to engage, and if we are not satisfied that improvement will be forthcoming, the issuer is avoided or existing positions are sold as soon as possible.
Through this approach, Kapstream not only assesses ESG risks thoroughly but also provides insight into the financial impact of these risks.

## *Engagement*

### ***Purpose***

Our engagement is driven by two main goals:

- Gather information to enhance our understanding of ESG risks and opportunities: this would normally be the case for first time investments or existing companies that do not face material issues;
- Bring about change and improvements: this is relevant with companies with little ESG disclosures or for which we have ESG related concerns.

Meeting those goals enables us to adopt a forward-looking view and avoid future risks or on the more positive side, capture opportunities before the market prices them in.

For issuers flagged as 'red', our engagement is prioritised and systematic, aiming to understand their plans to address the issues identified.

### ***Process and engagement topics***

Engagements can be conducted via email or in-person/virtual meetings, with a clear agenda usually set beforehand. The agenda includes the following:

- Purpose and reason for the meeting;
- Discussion topics;
- Desired outcomes.

A report summarising the outcomes achieved and follow up steps is written following the engagement. The engagement report also includes impact of engagement on our ESG and credit assessment and, if appropriate, actions to be taken.

Aligned with our ESG analysis framework, we focus on topics that are material to the industry as well as issues idiosyncratic to the company. Furthermore, recognising their extensive impact across all sectors, climate change and the management of climate-related risks and opportunities are systematically addressed in our engagement meetings.

### ***Escalation***

We actively communicate our views to companies and seek improvements where we believe there are shortcomings in performance, or a company has failed to apply appropriate standards, or to provide adequate disclosure. We recognise that engagements may not immediately trigger substantial changes. As such, we will continue our dialogue with the company over an extended period if necessary and follow-up meetings are typically scheduled after an appropriate interval to evaluate progress. Should these subsequent assessments reveal continued inadequacies with limited prospects for amelioration, adjustments to our investment stance, including potential divestment, may be warranted.

## Monitoring and Documentation

Once included in portfolios, issuers are monitored for any material changes to their ESG performance in addition to Kapstream's other investment criteria. To the extent one of these factors changes our view on the risks of the investment, Kapstream will evaluate if the position should be added to, reduced in size or fully exited.
All ESG reports and engagement activities, inclusive of notes and resulting outcomes, are recorded within an internal system. This enables us to monitor progress over time but identify trends so we can take a forward view. Our aim is to engage with each investee company at least annually, with more frequent interactions as necessitated by emerging issues.

## Review

The ESG policy will be reviewed at least annually or as required.