First Sentier Investors

GLI 2022 Sustainability Report

Contents

Introduction

Welcome to the First Sentier Investors (FSI) Global Listed Infrastructure Sustainability Report for the year ended 31 December 2022. This report intends to provide transparency on how we assess the environmental, social and governance (ESG) performance of companies we invest in, how we engaged with leadership and insights from our research during the year. Through reporting on our approach to ESG, we want to communicate how we integrate responsible investment principles into our investment approach.

Countries across the world are grappling with issues such as climate change mitigation, climate change adaption, energy security, reliability and affordability. We recognise these issues are complex and will require a wide range of financial and technology solutions. In particular, global listed infrastructure companies will be at the forefront of the global energy transition and will play an integral part in achieving net zero emissions.

As long-term and active investors, we know that the investment decisions we make today will impact future generations. We take an active approach to proxy voting to convey our views to boards and management on important topics including board composition, remuneration packages and climate transition plans. Through company engagement we seek to better understand risk in our portfolio, suggest areas for improvement, increase transparency on ESG issues, and support companies that are making progress in this area. We typically engage companies on material issues to achieve specific outcomes. More broadly, we participate in industry groups such as Climate Action 100+ to push for change on complex issues such as energy transition and the pathway towards net zero.

Aligning with FSI's firm-wide commitment, we are committed to building investment portfolios with a target of net zero by 2050 and are pursuing interim targets by 2030 to reduce the Weighted Average Carbon Intensity of our investment portfolios[1]. We will seek to prioritise the direction of capital to infrastructure companies that are aligned or aligning with a pathway to net zero by 2050 and encourage the investment of this capital into real assets that reduce absolute emissions. As stewards of our clients' capital, we will continue to engage with companies on these issues with a view to delivering more sustainable risk adjusted returns.

1. The team's net zero target applies to all Global Listed Infrastructure and Responsible Listed Infrastructure pooled vehicles, and to separate client accounts that are subject to equivalent investment guidelines.

Our approach

ESG issues are fundamental to infrastructure companies, given they have significant service obligations and moral accountability to the communities in which they operate. We assess infrastructure companies on a broad range of ESG-related factors, including but not limited to energy transition, climate risk, modern slavery and corporate governance. We are conservative investors of our clients' capital, recognising that capital preservation is critical to achieving long-term capital growth. We focus on fundamental value and conduct thorough due diligence to minimise risk. We place strong emphasis on proprietary research and direct contact with companies and regulators.

At a group level, FSI has identified four main investment stewardship priorities: climate change, human rights and modern slavery, nature and biodiversity and diversity. These priorities address the ESG issues that pose the most significant long-term financial risks to our investments, while also presenting the greatest opportunities.

Engage with management and board on ESG issues and performance

The most important source of research for the FSI Global Listed Infrastructure (GLI) team is internally generated analysis based on regular meetings we hold with senior management and other stakeholders including suppliers, competitors, regulators and industry bodies. When the GLI team engages with companies on ESG issues, we use meetings with management to better understand the situation from their perspective, and to openly raise concerns where we see a potential gap in ESG performance. If we don't see performance improvement, we will escalate the issue to the company's board of directors to outline our concerns. Ultimately, we will consider divestment if we do not see a willingness to change or address the issue.

ESG assessment integrated into investment process

The assessment of ESG issues, strategy and performance represents an essential part of our investment process. We seek to understand the risks for each company and assess them in our proprietary quality ranking which consists of 25 criteria that influence stock returns for infrastructure securities. A score is assigned to each criteria; a lower quality score makes it harder for a stock to be included within the overall portfolio. ESG assessment is both a science and an art that blends data points and qualitative engagements. We then build on those findings by conducting asset tours, and spending time with company management and board of directors. We have been doing this for over 15 years.

ESG Metrics

The GLI team maintains a database of key ESG metrics across the strategy's entire investible universe (focus list)[2]. These metrics include a range of climate-related statistics, including absolute carbon emissions, carbon footprint and carbon intensity. It includes key

2. GLI investment universe includes ~140 listed companies, which meet the GLI strict definition of core infrastructure

safety metrics like total recordable incident rates and lost time injury rates. We look at diversity measures including the number of independent directors and percentage of female directors, to track progress over time. We encourage companies to report climate-related statistics in a way that is consistent with the framework provided by the Task Force on Climate-Related Financial Disclosures (TCFD). A TCFD compliant carbon footprint report is generated on a quarterly basis for each of our underlying portfolios, and for the strategy overall, based on MSCI ESG data.

Principle Adverse Impacts

The Principal Adverse Impact (PAIs) on sustainability factors are part of the EU's Sustainable Finance Disclosure Regulation (SFDR) to improve the comparability of the sustainability profile of funds and aim to better display the negative impacts investments have on various sustainability factors. While many of the metrics that fall under the PAIs were already being assessed by our team as part of our ESG assessment outlined above, the new framework provides a consistent way to meet the strategy's obligations under SFDR. As part of our approach to PAIs, we commit to assess every active equity investment for relevant adverse impacts and documenting the results. Where adverse sustainability impacts are identified, we seek to engage with the company in accordance with the commitments made under FSI's Responsible Investment and Stewardship Policy and Principles.

Proxy voting and reporting

The GLI team votes on all issues at company meetings where we have the authority to do so. Voting rights are a valuable asset and are executed with care and diligence. We take this responsibility seriously and the research we gather ensures we make informed decisions. If we believe that our concerns and performance gaps are still not being addressed, we may vote against the company via proxy voting. During the 2022 calendar year, we invested in 74 infrastructure companies across 7 subsectors and in 16 countries around the world. We voted on 1,067 resolutions, of which we voted against management on 131 occasions (12%) on issues including lack of board independence, poor alignment of interests and inadequate climate-related targets. Our voting record is included for transparency on our website[3] and in the proxy voting section of this report.

United Nations Sustainable Development Goals (SDGs)

Within the GLI team's suite of products, the Responsible Listed Infrastructure Strategy has an additional mandate; namely, to invest in companies that can contribute to or benefit from sustainable development, as guided by the UN Sustainable Development Goals. Given its importance to any functioning modern economy, infrastructure has a central role to play in addressing global challenges that need to be overcome in order to deliver a sustainable future.

Key areas that investment in infrastructure can have a meaningful effect on include:

- SDG 6 - Clean Water and Sanitation
- SDG 7 – Affordable and Clean Energy
- SDG 9 – Industry, Innovation and Infrastructure
- SDG 11 – Sustainable Cities and Communities
- SDG 12 – Responsible Production and Consumption
- SDG 13 – Climate Action

Each of these main categories contains several more specific secondary or "sub" goals that infrastructure investment can have a direct influence on. We monitor how much capital expenditure (capex) is being spent by each company on activities that correspond directly to the sub-goals of each of the six SDGs outlined above.

Given infrastructure's capital intensive nature, we believe this represents a sensible and consistent way to monitor a company's contribution to sustainable development. Reflecting the importance of taking a balanced approach, all capex is taken into account. We then categorise it as positive, neutral or negative.

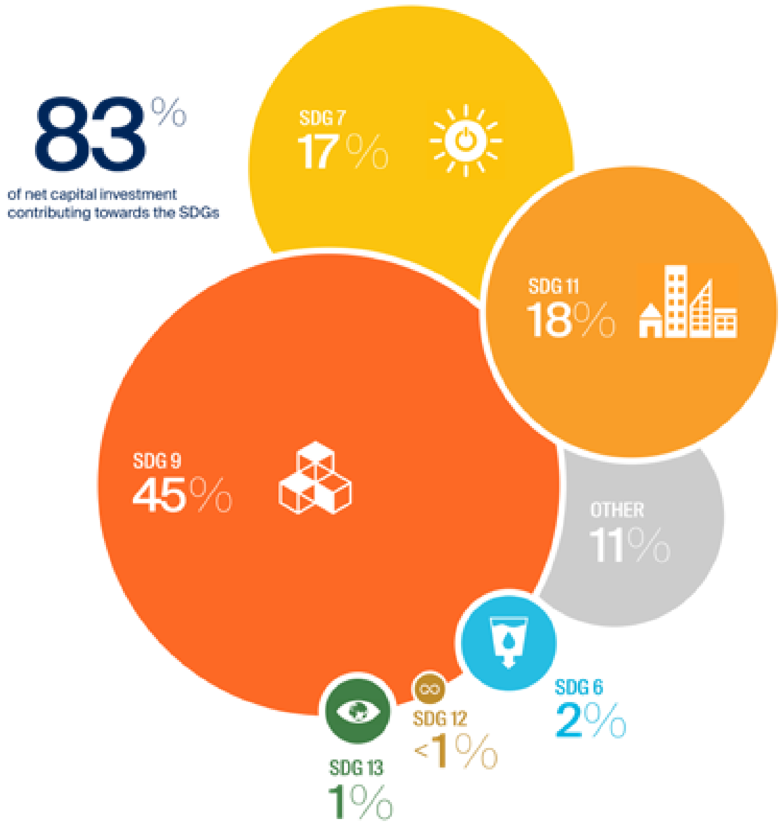
For example, Italian-listed utility company and renewables leader Enel Group is forecast to spend 50% of its capex on the buildout of renewable energy generation (such as wind farms and solar power) between 2023 and 2025[4]. Over the same period, 40% of its capex will be spent on networks, predominantly distribution grids. This will help to bring clean energy to the end-user[5].

3. FSI Proxy voting
4. This is directly supportive of SDG 7.2 (By 2030, increase the share of renewable energy in the global energy mix). Source: Enel Group, First Sentier Investors. Data as at 22 November 2022
5. This is directly supportive of SDG 9.1 (Rural access)

A further 4% of capex will be invested by the Enel X division in areas that support the transition to a clean economy (such as EV charging infrastructure and energy efficiency initiatives)[6]. The remaining 6% of the company's capex will be spent on their energy retail business. We deem this capex to neither positively or negatively affect any of the SDG sub goals, and so assign it to the neutral category[7].

Overall, we are of the view that the current holdings of the Responsible Listed Infrastructure Strategy make significant positive contributions to SDG 7 (Affordable and Clean Energy) and SDG 9 (Industry, Innovation and Infrastructure). This reflects the portfolio's high weighting in utility stocks. Many utilities are investing substantial amounts of capex both into renewable energy generation, such as wind and solar; and into the new or upgraded transmission and distribution networks that are needed to connect these clean energy sources with population centres where the demand is.

Responsible Listed Infrastructure Strategy's capex supporting sustainable development[8]



SDG 6: Clean Water and Sanitation.
SDG 7: Affordable and Clean Energy.
SDG 9: Industry, Innovation and Infrastructure.
SDG 11: Sustainable Cities and Communities.
SDG 12: Responsible Consumption and Production,
SDG 13: Climate Action. "Other" represents capex spent in areas with a neutral effect on the SDGs.
Source: First Sentier Investors and company reports.
Data as at 31 March 2023.

6. This is directly supportive of SDG 7.1 (Access to electricity), 7.2 (Share of renewable energy), 7.3 (Energy efficiency)
7. Source: Enel Group and First Sentier Investors. Data as at 22 November 2022.
8. Capex numbers reflect forecast spending levels of current portfolio holdings over the next 12 month period. "Net capital investment" figure of 83% consists of 86% positive contribution and 3% negative contribution. Positive, neutral and negative labelling represents the opinion of the FSI GLI Team. SDG 6: Clean Water and Sanitation. SDG 7: Affordable and Clean Energy. SDG 9: Industry, Innovation and Infrastructure. SDG 11: Sustainable Cities and Communities. SDG 12: Responsible Consumption and Production, SDG 13: Climate Action. "Other" represents capex spent in areas with a neutral effect on the SDGs. Source: First Sentier Investors and company reports. Data as at 31 March 2023.

Our climate change commitment

Decarbonisation is happening in our asset class, particularly by utilities who are responsible for more than 90% of the emissions in our opportunity set. Our target reflects the developments that we are already seeing in this space and enables us to engage and encourage companies to make greater efforts on this front.

The GLI team are committed to reducing greenhouse gas emissions across our investment portfolios[8] consistent with an ambition to reach net zero emissions by 2050. This aligns with our firm-wide commitment to reduce greenhouse gas emissions across investment portfolios by 2050 or sooner. We recognise there is an urgent need to accelerate the transition towards net zero emissions and support global efforts to limit warming to 1.5 degrees.

As a responsible and active manager of capital on behalf of our clients, we commit to the following[9]:

- Build investment portfolios aligned to net zero by 2050
- Pursue interim targets, by 2030, to reduce the Weighted Average Carbon intensity (WACI)[10] of our investment portfolios to -35% (Global strategy) or -50% (Responsible strategy) below the 2019 benchmark index[11]
- Take account of portfolio Scope 1 and 2 emissions and consider material Scope 3 emissions[12]
- Prioritise the direction of capital to infrastructure companies that are aligning or on a pathway to be aligned with net zero
- Encourage the investment of this capital into real assets that reduce absolute emissions (rather than prioritising the use of offsets)
- Engage with companies to improve disclosures (e.g. GHG emissions, TCFD reporting, transition plans) and accelerate change (e.g. coal power closures by 2030[13]), with a focus on those companies that produce the most carbon emissions
- Implement an escalation and voting strategy consistent with achieving net zero
- Provide information and analysis on net zero progress and climate risks and opportunities
- Collaborate with industry stakeholders (e.g. PRI[14], IIGCC[15], NZAM[16], CA100+[17]) to provide a consistent and collective voice when engaging with companies

The GLI team's climate statement can be found on our website.

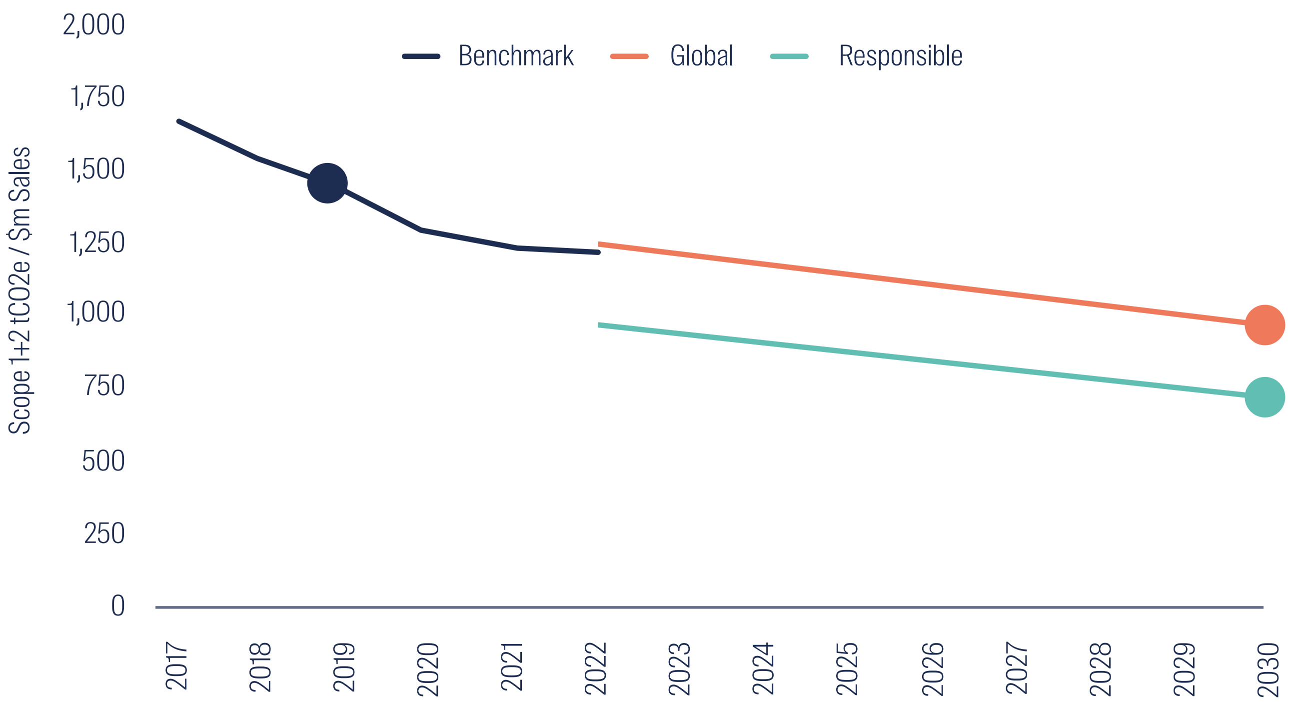
8. The team's net zero target applies to all Global Listed Infrastructure and Responsible Listed Infrastructure pooled vehicles, and to separate client accounts that are subject to equivalent investment guidelines.
9. These commitments and targets are based on information and representations made to the relevant investment teams by portfolio companies (which may ultimately prove not be accurate), together with assumptions made by the relevant investment team in relation to future matters such as government policy implementation in ESG and other climate-related areas, enhanced future technology and the actions of portfolio companies (all of which are subject to change over time). As such, achievement of these commitments and targets depend on the ongoing accuracy of such information and representations as well as the realisation of such future matters. Any commitments and targets set out in this material are continuously reviewed by the relevant investment teams and subject to change without notice.
10. Intensity being a measure of carbon efficiency, and WACI measures the exposure within a portfolio to carbon-intensive assets compared to the benchmark.
11. 2019 was selected as the base year as it represents the most recent and complete dataset which was not impacted by the pandemic.
12. Scope 3 includes encompasses emissions that are not produced by the company itself, and are not the result of activities from assets owned or controlled by them, but those that it's indirectly responsible for, up and down its value chain. Companies may currently face challenges in reporting accurate and reliable Scope 3 emissions data. Where a company is unable to calculate its Scope 3 emissions for some or all of the categories outlined in the GHG Protocol's guidance, it should still identify the relevant upstream and downstream Scope 3 emission categories relevant to it.
13. As per International Energy Agency (IEA) guidelines phase out by 2030 in developed markets and 2040 in emerging markets.
14. United National Principles for Responsible Investment
15. Institutional Investors Group on Climate Change
16. Net Zero Asset Managers
17. Climate Action 100+

Interim targets

We commit to pursuing interim targets to reduce the WACI of our investment portfolios by -35% for our Global Strategy and -50% for our Responsible strategy, by 2030 relative to the 2019 benchmark index[18]. This target was developed through a detailed evaluation of our portfolios emissions, progress achieved to date and their likely achievements in the years ahead.

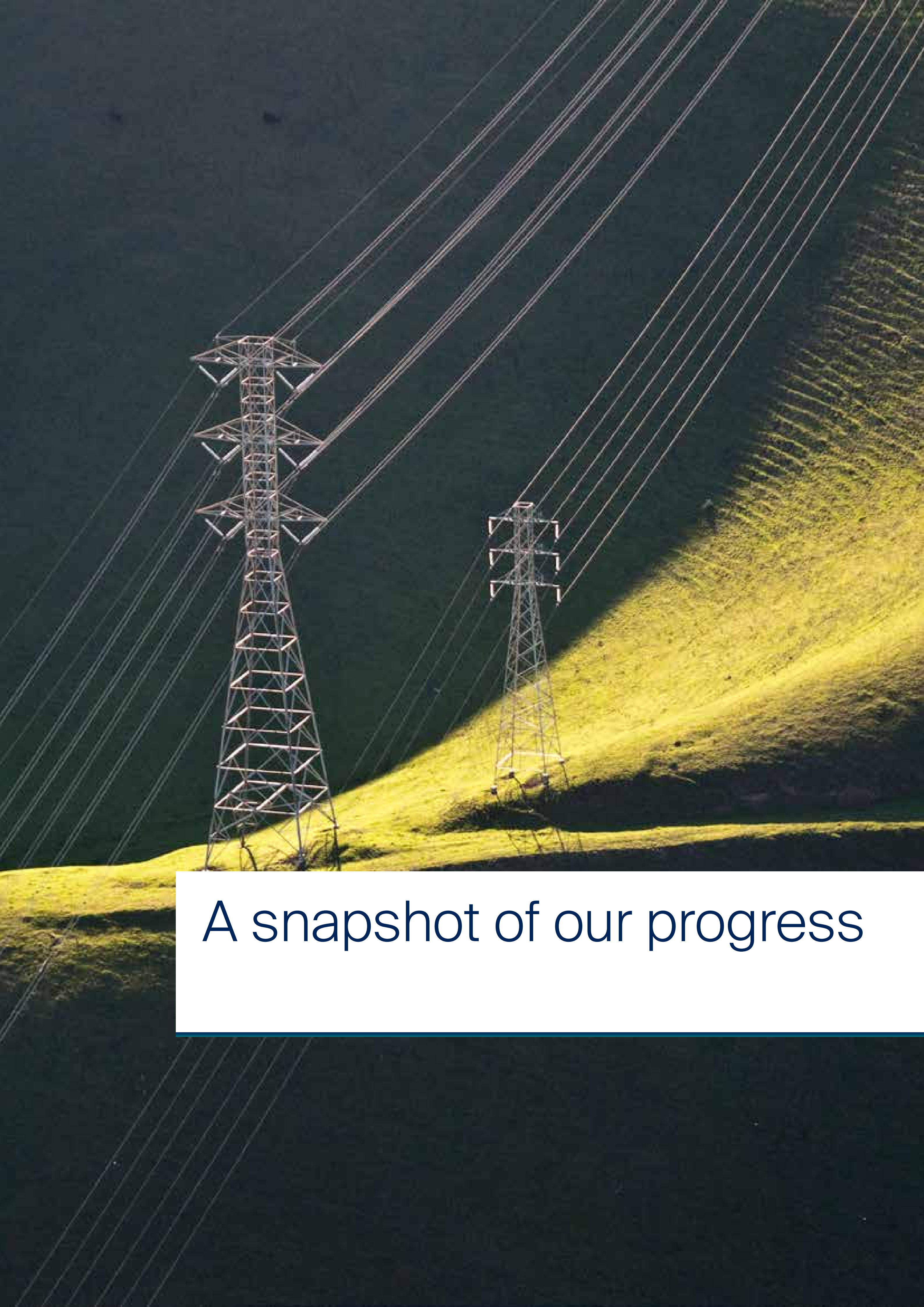
The Paris Agreement calls for a -45% reduction in emissions by 2030 from a 2010 baseline. It is important to recognise that companies have already made significant progress on this target. US utilities represent more than 90% of total emissions in our portfolios and we estimate that from 2010 to 2019 these companies had already reduced emissions by -29%. Therefore to deliver their fair share requires a further -23% reduction from 2019 to 2030. Adjusting absolute emissions to emissions intensity we arrive at the -35% target for our Global Strategy.

Weighted Average Carbon Intensity



Source: First Sentier Investors. Data as at 30 June 2023

18. Benchmark data provided by MSCI



A snapshot of our progress

570 meetings held

23 countries

15 subsectors[19]

1,067 resolutions voted on

12% voted against management[20]

Net Zero commitments made by

71% of our portfolio companies[21]

31% reduction in weighted average portfolio carbon intensity over last 5 years[22]

30%

An average 30% female representation on our portfolio company boards (23% 5 years ago)[23]

Interim 2030 WACI targets for GLI strategy:

-35% for GLI strategy

-50% for RLI strategy

UN PRI Ranking[24]

Graded 4 stars or above in 7 out of 9 categories

Leader

RIAA ranking

19. Company meetings held during the 12 months to 31 December 2022
20. Proxy voting for the 12 months to 31 December 2022
21. Portfolio holdings as at 30 June 2023
22. Represents portfolio holdings as at 30 June 2023 for the five year period December 2017 to December 2022
23. Information sourced from FSI as at 31 December 2022;
24. Information sourced from FSI as at 31 December 2021; Firm level rankings

ESG focus areas

During 2022, the GLI team focused on assessing ESG risk and performance in four key areas – **energy transition, climate risk, modern slavery and corporate governance.**

Whilst we see energy transition and climate change as the biggest area for infrastructure companies to focus on, we also wanted to tackle human rights and modern slavery risks, and the need for good corporate governance.

Energy transition

Energy transition was at the forefront of our engagement with companies. Transition risk represents the single largest climate-related risk for listed infrastructure companies, as the world moves away from fossil fuels and towards lower-carbon sources of energy. However, energy transition also represents a substantial opportunity. Attempts to reduce carbon emissions are having significant implications for the way in which electricity is generated, transmitted and distributed.

Climate risk

Physical impact risk from climate change and global warming pose systemic risks to society and the global economy. It affects the availability of resources, the price and structure of the energy market, the vulnerability of infrastructure assets and the valuation of companies. As investors in infrastructure assets, we understand that climate change poses a complex problem which has already impacted, and will continue to impact, different assets in different ways. We believe it is our responsibility to understand and mitigate these risks within our investment portfolios.

Modern slavery

As stewards of our clients' assets, we believe we have a responsibility to identify and act to eliminate human rights abuses, including, but not limited to, modern slavery. This is part of a wider societal responsibility that impacts the performance of our investments. Companies have legal, moral and commercial responsibilities to respect human rights and to manage the risks of modern slavery on their operations. If these responsibilities are not met, a company may face regulatory, financial, reputational and legal risks.

Corporate governance

Infrastructure companies provide essential services such as energy, transportation, water and telecommunications that are vital to the functioning of societies and economies. They are often large scale projects with significant capital expenditure requirements. Effective corporate governance means companies are managed with the interests of all stakeholders considered: shareholders, employees, customers, suppliers, the environment and the broader community.

The following section provides insights on the trends and overall portfolio performance we have seen in these focus areas during 2022. We have used specific case studies to provide examples of companies we invested in and actively engaged with throughout the year.

Engagement examples in this report

Name	Sector	Region	Primary engagement objectives	Page
Energy transition				
NextEra Energy	Utilities/Renewables	United States	Collaborative engagement (Climate action 100+) Establish net zero emissions target	19
Xcel Energy	Utilities/Renewables	United States	Accelerate transition towards renewables Prioritise investment in electric vs gas utilities Establish targets for scope 3 emissions	20
PPL Corp	Utilities/Renewables	United States	Bring forward closure of existing coal plants Incorporate ESG metrics into remuneration targets	22
Transurban	Toll Roads	Australia NZ	Extend renewable PPAs to all regions Increase investment in electric vehicle adoption Greater transparency of scope 3 emissions	23
Climate risk				
Entergy	Utilities/Renewables	United States	Prioritise investment in resilience spend Balance net zero targets with mitigating climate risks Further investment in climate change modelling	25
SSE	Utilities/Renewables	United Kingdom	Incorporate climate change into forecasts Minimise impact of wind farms on ocean and marine life (Biodiversity)	27
Modern slavery				
Vinci	Toll Roads	Europe xUK	Improve modern slavery policy and procedures Understand response to Russia Ukraine exposure	30
Rubis	Energy Midstream	Europe xUK	Strengthen approach to modern slavery risks Accountability for supplier audits and risk assessment	31
Corporate governance				
West Japan Railway	Railroads	Japan	Increase number of independent directors Separation of Chairman and CEO duties Increase diversity of skills and experience on the board	36
Aena	Airports	Europe xUK	Improve alignment of interests with minority shareholders Ensure capital discipline in international expansion	38

Energy transition

Transition risk represents the single largest climate-related risk for listed infrastructure companies, as the world moves away from fossil fuels and towards lower carbon sources of energy. This transition has implications for freight railways, whose coal haulage volumes will decline materially over the next ten years. It will affect the energy midstream space, where oil and refined product pipelines could face stranded asset risk by 2040. While natural gas is likely to represent a key transition fuel, a long-term decline in demand is likely to begin once battery storage technology has advanced sufficiently.

However, energy transition also represents a substantial opportunity. Attempts to reduce carbon emissions are having significant implications for the way in which electricity is generated, transmitted and distributed. Renewable energy is currently experiencing a virtuous cycle of falling costs, improving productivity and growing market share. In contrast, non-renewable energy is in a vicious cycle of declining market share, reduced revenues and rising costs.

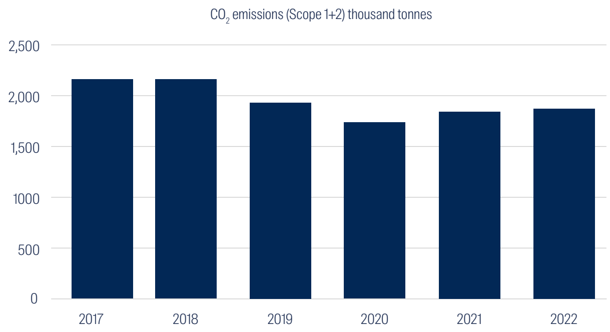
Portfolio carbon metrics

Across our portfolio companies we have seen a -13% reduction in absolute emissions over the last five years[25]. This reduction reflects a range of initiatives including: closing coal power plants and replacing with wind, solar and batteries, signing renewable power purchase agreements, reducing transmission line losses, capturing landfill methane and processing into renewable natural gas, converting vehicles from diesel to compressed natural gas or electric, or switching ventilation systems from fixed to variable speed. The list of initiatives and technologies continues to grow.

Importantly this reduction in emissions came despite substantial growth in the underlying businesses and changes in scope related to acquisitions. As an indication this -13% decline in absolute emissions translates to -31% decline in WACI when adjusted by revenue.

25. Represents portfolio holdings as at 30 June 2023 for the five year period December 2017 to December 2022

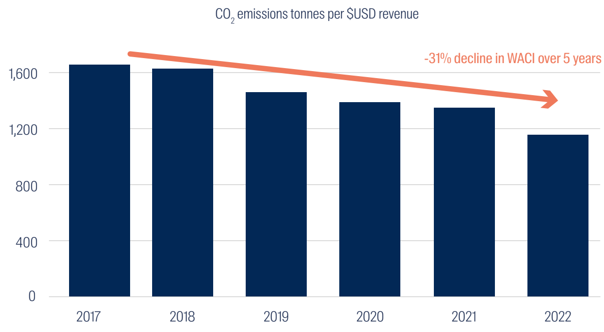
Absolute carbon emissions



Source: First Sentier Investors

100% portfolio coverage

Carbon intensity

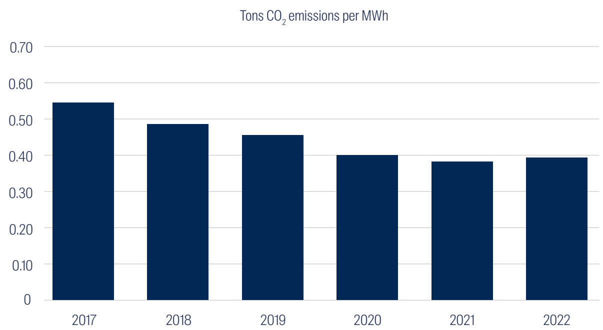


Source: First Sentier Investors

More than 90% of our portfolio's emissions come from utilities so naturally this is where we invest the most time on analysis and engagement. With the main source of emissions being power generation, utilities tend to express carbon intensity as a function of power produced. This measure of carbon intensity has reduced by -28% over the last 5 years as utilities have switched from power generation fuelled by coal to natural gas to renewables.

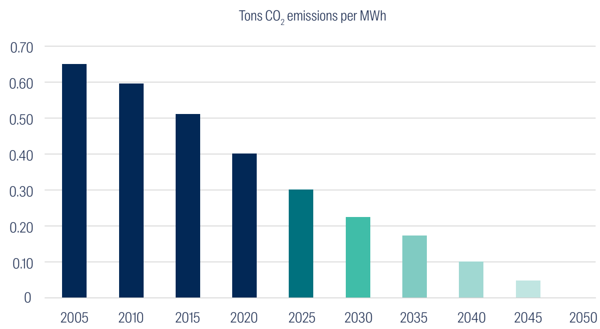
This measure of carbon intensity is also useful to consider pathways towards net zero. All of our portfolio utilities disclose historic carbon intensity and many provide a pathway forward. We can also analyse information from integrated resource plans and plant asset lives to project the likely carbon intensity of the generation fleet over time. Our portfolio utilities have already reduced carbon intensity by close to -40% from 2005 to 2020 and we believe they are on a path consistent with net zero by 2050. We acknowledge that the degree of certainty in this regard falls materially after 2030 / 2035 given resource planning and government incentives are typically limited to 10-15 years and networks / storage are untested with 100% renewables at scale.

Carbon intensity | Utilities only



Power generated by utilities represents 90% of portfolio emissions

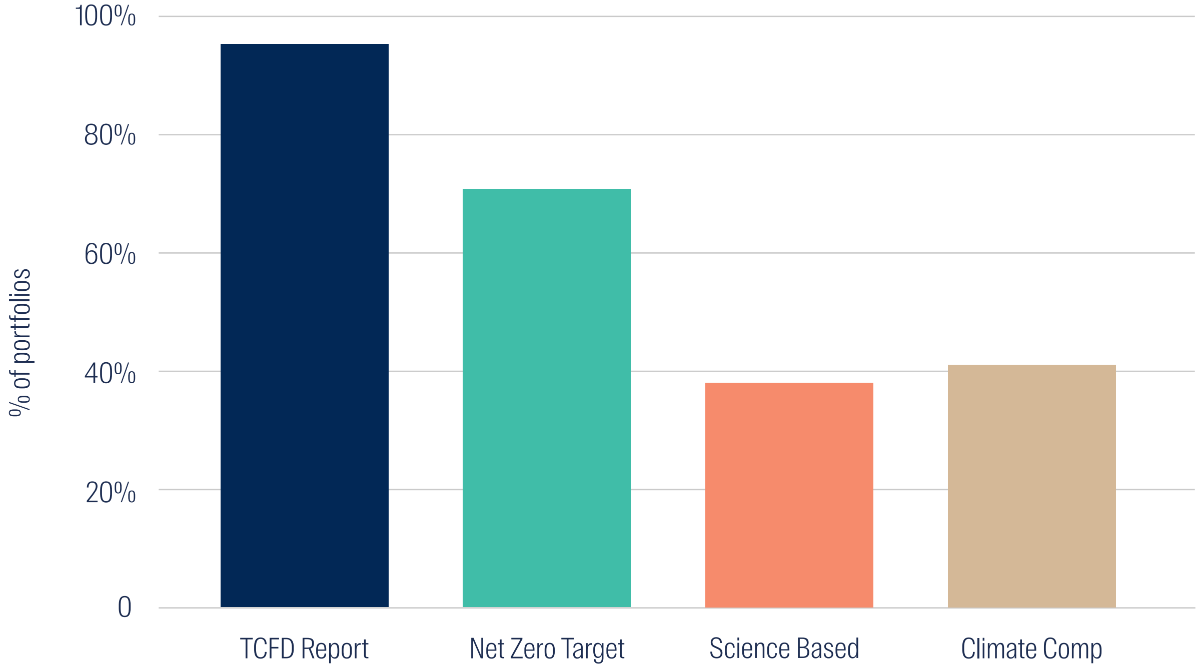
Net zero pathway | Utilities only



Source: First Sentier Investors

So what level of conviction do we have that these pathways to net zero will be achieved? The chart below provides a snapshot of the level of disclosure and commitment to energy transition across our current portfolios:

Commitment to energy transition



Source: First Sentier Investors

95% report against TCFD

Reporting against the recommendations of the Task Force on Climate-Related Financial Disclosures has become the global standard. Disclosures around governance, strategy, risk management, metrics and targets should help investors understand how companies consider and assess climate-related risks and opportunities. Companies that do not support TCFD disclosures are generally in emerging markets. A few do not formally support TCFD but do have credible disclosures and commitments. For example, Flughafen Zurich (Zurich Airport) supports the Global Reporting Initiative (GRI) and Airport Carbon Accreditation (ACA) and has set a target for net zero without offsetting by 2040. We will continue to engage to achieve 100% support of TCFD.

71% have set a net zero target

Most companies target net zero by 2050. A few have set more aggressive targets including NextEra Energy by 2045 and CenterPoint Energy by 2035. Companies that have not set a net zero target are generally in energy midstream, emerging markets or wireless towers. Other sectors like railroads and waste have set strong interim targets but are not yet ready to commit to net zero. For example, waste company Republic Services has set an (SBTi approved) interim target for -35% reduction in emissions by 2030 but does not yet see a pathway to 100% capture of landfill methane gas. We will continue to engage with these companies to push for a commitment to net zero.

37% are confirmed as science based

Adding a pathway to achieving net zero including interim targets is critical for transparency and accountability. We will continue to engage with companies to align net zero pathways with science and seek external validation. The Science Based Targets Initiative (SBTi) is widely used for validation of net zero pathways. We acknowledge criticisms that it relies on a single scenario to achieve net zero and does not capture historic carbon reductions – this is important for US utilities given what was achieved between 2005 and 2020. We will also seek further disclosure of specific plans to achieve these outcomes, for example coal plant closures and renewable / storage / transmission projects.

42% have climate-linked compensation

Incentives drive behaviours and we believe execution of the pathway towards net zero is more likely to be successful if management are remunerated accordingly. Depending on the materiality for the company and the responsibilities of the individual, we recommend 10-30% of variable remuneration is linked to ESG-related risks. For an example of best practice, Xcel Energy has linked 100% of short-term incentives to ESG metrics including safety, reliability, customer, environment and diversity, with a 50-150% overlay for earnings per share relative to guidance range. It has also linked 38% of long-term incentives to carbon reduction with 62% on relative total shareholder return[26].

Challenges

Carbon intensity metrics can sometimes increase year on year due to changes such as in demand, corporate structure and weather impacts. Whilst longer term targets such as Net Zero 2050 are important, our immediate priority is to set medium-term expectations and assess company performance against those measures. We challenge management on where they expect to get to by 2025 and 2030. We need to be forward looking and also identify the laggards who could be the leaders of the future.

We recognise the challenges of addressing scope 3 emissions. Many companies do not have the systems in place to track and report emissions that occur outside their operation but associated with their activities. A lack of standardised methodologies and reporting frameworks also makes it challenging to compare emissions across different companies. We will continue to engage with companies to raise awareness about the importance of Scope 3 emissions.

Future steps

We actively encourage companies to take this issue seriously and report high quality data in line with TCFD recommendations. Across all ESG issues, we need sustainability reporting that has the same rigour as financial reporting (i.e. double materiality) and we are aware of our responsibility as active investors to encourage this from the companies we invest in. We will report on our progress against our net zero commitment at an underlying portfolio level on an annual basis.

26. Source: Xcel Energy. Data as at 24 May 2023.

Defining a net zero goal for a decarbonisation leader: NextEra Energy

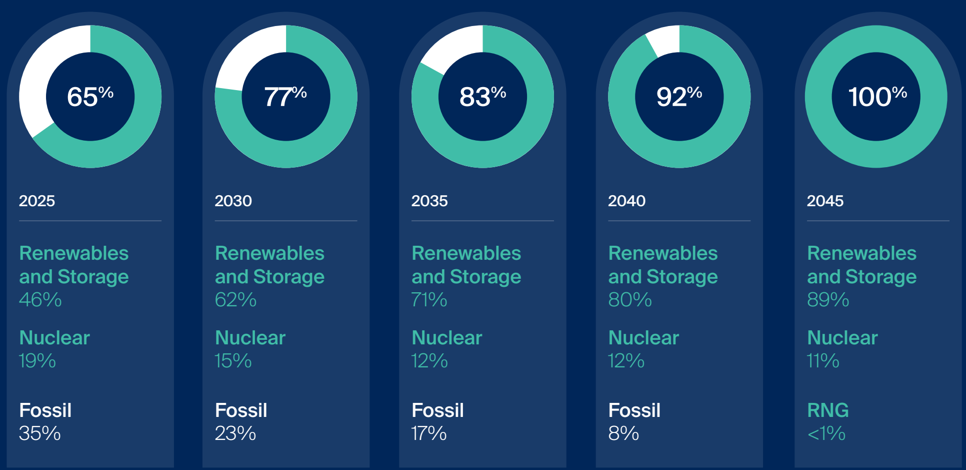
NextEra Energy has a plan to lead America's decarbonisation efforts, leveraging low-cost renewables to drive affordable, clean energy for customers[27]. Although it is an industry leader in the push for reducing carbon emissions in its own operations and in its solutions, it was slow to set a net zero target.

A Florida-based integrated utility, NextEra Energy (NextEra) is the largest renewables developer and owner in the US[28]. Climate change mitigation and adaptation are key investment opportunities for this company but despite its position in leading the decarbonisation charge, it lacked a clear net zero target for its efforts.

Taking a two-pronged approach to encourage NextEra to define a net zero target, our team individually engaged with NextEra as well as being part of Climate Action 100+, an investor-led initiative ensuring the world's largest corporate greenhouse gas emitters are taking necessary action on climate change. Our team has been members of the Climate Action 100+ working group for NextEra since 2019.

After several years of individual and collective engagement, NextEra announced, in June 2022, an ambitious goal of achieving 'Real Zero' by 2045 in its updated climate strategy[29]. The Real Zero goal sets a new benchmark for energy producers, making NextEra's intent to eliminate all carbon emissions from its operations without the use of carbon offsets to achieve success. Pleasingly, NextEra has also set interim milestones every 5 years, adding visibility and accountability to this long-dated target.

Projected Generation



27. A real plan for real zero
28. Source - https://energydigital.com/top10/top-10-biggest-renewable-energy-companies
29. NextEra Energy sets industry-leading Real Zero™ goal to eliminate carbon emissions from its operations, leverage low-cost renewables to drive energy affordability for customers

Source: NextEra Energy – Zero Carbon Blueprint Report;

Minimising Xcel's carbon footprint by accelerating renewables investments

Xcel Energy has made significant progress in closing legacy coal-fired assets to minimise its carbon footprint but could be doing more to accelerate its transition towards renewables.

A regulated utility with operations across 8 US states, Minneapolis-based Xcel Energy (Xcel) provides electricity and natural gas services to approximately 3.7 million electric customers and 2.1 million natural gas customers[30]. The company is well-positioned to deliver steady, low-risk earnings growth by transitioning towards renewables. However, we felt there was potential to accelerate its decarbonisation story by maximising tax credits offered by the Inflation Reduction Act (IRA) to incentivise investments in solar, wind and energy storage. Our view was that Xcel should also prioritise investment in its electric utilities over natural gas utilities given the former has a rapidly declining carbon footprint.

In October 2022, we met with the Xcel's CEO and Chief Sustainability Officer in Denver, Colorado to discuss the decarbonisation of its electric and natural gas utilities. Xcel re-emphasised its ongoing commitment to reducing its carbon footprint – investing in renewable energy, closing coal-fired power generation and reducing its greenhouse gas (GHG) emissions from natural gas via renewable natural gas and hydrogen. It reinforced the message that sustainability efforts should go hand in hand with service reliability and customer affordability. Management are clearly aligned with carbon reduction goals.

Executive remuneration is linked to three key targets:

1) 80% carbon emission reduction by 2030, 100% by 2050

2) Customer bills need to increase by less than inflation

3) Long term EPS (Earnings per share) and DPS (Dividend per share) growth of 5-7%

Xcel is evaluating the impact of the IRA on its renewable energy investments and subsequent coal plant closures. It agrees that the economics of renewables has improved post the IRA. However, the company cautioned that its very cold service territories meant energy storage technology (battery lengths need to improve from 4-6hrs to 10-12hrs) are a real impediment to accelerate coal plant closures. Despite this challenge, there is little doubt that while coal closures may not be brought forward, capacity factors and emissions would be materially reduced.

We continue to engage with Xcel, encouraging them to accelerate the closure of their existing coal plants and strengthen their decarbonisation targets.
We would like to see them implement interim targets for Scope 3 emissions to increase accountability and ensure a more accurate assessment of their carbon footprint.

30. Corporate profile

Xcel coal plant closures (MW)

Source: Xcel Energy, First Sentier Investors[31]

> Xcel Energy is an example of a US Utility sector that we think can improve and accelerate their decarbonisation story. This is likely to come through the early retirement of coal-fired generation assets and increased investment in renewables such as wind and solar, leading to an earnings and multiple re-rating.

31. *Tolk coal plant closure in 2028 pending approval by TX and NM commissions, currently 2032

Constructive conversations with PPL Corp's management

Engaging with management helped to deepen insights about PPL Corporation's challenges regarding ESG metrics, uncovering opportunities to provide guidance on issues.

After selling its UK assets in 2021, PPL Corporation (PPL) became a US-only fully regulated utility. Headquartered in Pennsylvania, its main assets include two integrated regulated electric and gas utilities in Kentucky, a regulated electric transmission and distribution utility in Pennsylvania and a recently acquired regulated electric and gas transmission and distribution utility in Rhode Island.

PPL's energy transition has lagged industry peers. It has long time horizons for retiring its coal assets, with coal plants running well into 2030. For example, its Trimble County Plant in Kentucky is not scheduled for retirement until 2060. Similarly, it has not provided clarity on how ESG metrics are integrated into its long-term incentive (LTIP) remuneration plans.

We raised these issues in a meeting with PPL's independent Chairman, Chief Executive Officer, Chief Sustainability Officer, General Counsel and Investor Relations Director, encouraging management to bring forward the closure date for its coal assets and boost investment in cleaner energy.

In this engagement, PPL acknowledged that improvements could be made in reducing carbon intensity in its coal portfolio and were open to our suggestion that there were opportunities to incorporate broader reductions in carbon intensity measures in its LTIP plans. We were able to provide guidance on an approach that PPL could consider, suggesting that management could implement a rolling 3-year carbon intensity approach. We also deepened our understanding of how the board thought about incorporating ESG metrics to the management team's long-term incentives, asking questions that helped broaden their thinking about components to be factored in, like vehicle emissions and electricity consumption at facilities.

Encouragingly, in December 2022, PPL announced a plan outlining its intent to replace 1,500MW of aging coal-fired generation, or nearly one-third of Kentucky's coal fleet by 2028[32]. The plan includes adding two new combined-cycle natural gas plants, nearly 1,000MW of solar generation, 125MW of battery storage and more than a dozen new energy efficiency programs. We feel we were part of a broader push for action in this area.

The conversation is by no means over and we continue to engage with PPL on accelerating the closure of their existing coal plants and strengthen their decarbonisation targets in line with the evolving climate science, technology, policy and community needs.

32. PPL Corporation's Kentucky utilities file plan to replace 1,500 megawatts of aging generation by 2028

Room for improvement for an industry leader: Transurban

Transurban is making progress in reducing emissions but we felt they could go further by signing renewable power purchase agreements across their entire network.

Transurban (TCL) is one of the world's largest toll road operators, building and managing urban motorways in Australia and North America. We believe it is one of the best businesses of its kind, with a strong management team, independent board and attractive tolling agreements. TCL's Sustainability Strategy is aligned with the UN Sustainable Development Goals and they are targeting a 50% reduction in absolute emissions by 2030[33]. Despite the good progress in reducing emissions we felt TCL could go further.

We identified 3 opportunities where TCL could make improvements:

- Extending renewable power purchase agreements (PPA) to all regions
- Contributing to reducing customer emissions by supporting electric vehicle (EV) adoption
- Encouraging greater transparency and disclosure of scope 3 emissions

We engaged with TCL's Chairman and management, including its CEO, CFO and Head of Sustainability to discuss what could be done to refresh existing initiatives and what might be introduced.

Scope 1 & 2 emissions
95% of TCL's emissions are derived from the purchase of electricity. The company has recently extended PPAs from Sydney to Melbourne and Brisbane, which is expected to contribute to -65% reduction in GHG emissions when operational in FY23. Renewable PPAs have only been signed for 80% of electricity demand as TCL expects a 10% improvement in their own energy efficiency and 10% improvement in carbon intensity power from the grid. We encouraged management to extend PPAs across their entire portfolio including North America.

Scope 3 emissions
TCL is targeting a 55% reduction in emissions intensity for major projects and 22% for purchased goods and services. Lowering the content of portfolio cement in the WestConnex[34] tunnels reduced embodied emissions by around 50%. It was also able to divert 90% of major project waste and 60% of operational waste from landfill.

EV charging
TCL is investigating the installation of EV charging infrastructure along its toll roads in Australia. These are likely to be off-motorway as entry-exit ramps are complicated. We encouraged TCL to increase the development of charging infrastructure and sent them best-practice examples from Europe including Eiffage and Fastned.

Sustainable driving initiatives
TCL is introducing sustainable driving initiatives including awareness campaigns to highlight the environmental benefits of using toll roads. TCL estimates 27-30% reduction in emissions vs alternative routes which are more likely to experience impacts from traffic lights, congestion and accidents. Other initiatives include driver education programs with an estimated 5-6% reduction in fuel emissions from smoother driving styles.

33. Towards net-zero emissions
34. Westconnex is a 33km predominantly underground motorway in Sydney, Australia

Climate risk

Climate change and global warming are increasing the frequency and unpredictability of extreme weather events like droughts, fires and floods, which pose systemic risks to society and the global economy. It impacts the availability of resources, the price and structure of the energy market, the vulnerability of infrastructure assets and the valuation of companies. As investors in infrastructure assets, we understand that climate change poses a complex problem, which has already impacted, and will continue to impact, different assets in different ways. We believe it is our responsibility to understand and mitigate these risks within our investment portfolios.

Examples of climate risk for infrastructure assets include:

- Extreme weather events including hurricanes, storm surges, floods and high wind events
- Droughts and the impact this has on water resources
- Increased risk of wildfires causing damage to utility electricity transmission networks
- Rising sea levels causing damage to coastal infrastructure assets.

Climate change-related criteria are incorporated into the quality scores that are assigned to each company that we research and analyse. Our quality scores consider factors including operational risks and the impact extreme weather events may have on a company's cash flows or licence to operate. We conduct regular meetings with senior management and other stakeholders including suppliers, competitors, regulators and industry bodies. Given the investment experience across the team, we understand companies and markets intimately and believe we are best positioned to form a view on the companies' approach to climate change and the materiality of climate change-related risks and opportunities.

Our engagements on climate risk align with the four pillars of the TCFD disclosures: governance, strategy, risk management, and metrics and targets.

Challenges

We recognise that climate change is a long-term challenge and that its impacts unfold over extended periods. This requires a shift in mindset and the adoption of new tools and methodologies to understand its impact over time. Climate change is also characterised by significant uncertainty, making it challenging to quantify and model risks accurately. Data reliability and availability are an ongoing challenge; however company disclosure is improving with the introduction of mandatory climate disclosure across many of the jurisdictions we invest in.

Future steps

Whilst TCFD reporting is still not mandatory in many countries, we actively encourage companies to take this issue seriously and to report high quality data in line with TCFD recommendations. We believe better data will allow for the implementation of more consistent climate metrics and targets, and allow for greater transparency on investors climate performance.

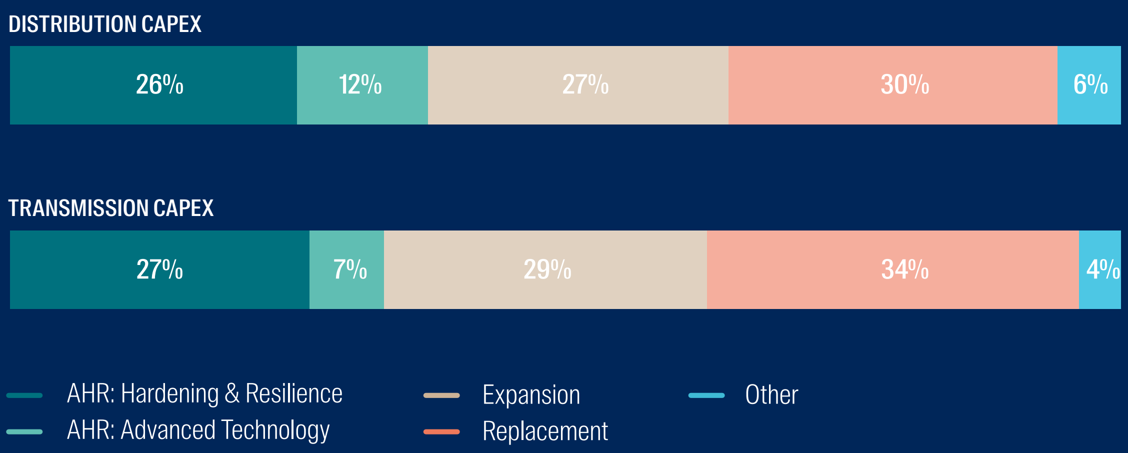
The race towards resilience in the face of severe weather events: Entergy Corporation

Despite its 2050 net zero target and the intent to replace its coal capacity with renewables by 2030, Entergy Corporation is racing to ensure resilience of its assets that are most vulnerable to unpredictable and severe weather events.

Entergy Corporation (Entergy) is a US-regulated electric and gas utility serving 3 million customers across Arkansas, Louisiana, Mississippi and Texas. The majority of its assets are located in southern US states that have been subject to severe hurricanes, thunderstorms and tornadoes. Climate change can make these events more intense and frequent, destroying infrastructure, disrupting services, and requiring costly repairs and reconstruction.

In 2021, extreme weather events resulted in over US$2.7bn in damage to Entergy assets. Concerned with the resilience of their assets, we had in-person and virtual meetings with Entergy throughout 2022 to better understand how they were safeguarding their assets, their expectations for regulatory cost recovery and the extent to which climate change modelling could assist them with system hardening plans.

Adaptation, Hardening and Resilience (AHR) as drivers of US utility T&D investment



Individual numbers may not total 100% due to rounding.

AHR: Adaptation, Hardening & Resilience. T&D: Transmission & Distribution.

Source: EEI Financial Analysis and Business Analytics, EEI member company survey, First Sentier Investors. Data based on EEI Business Analytics 2022 surveys.

Case study continued...

To mitigate climate change risks, Entergy is investing US$15 billion in resilience initiatives. These initiatives include investments toward generation portfolio upgrades and renewable generation, undergrounding of the grid network, and robust emergency and incident response planning to prevent and mitigate system damage from climate events, laying the foundation for newer technologies such as energy storage. Ultimately, these investments will support Entergy in providing customers with improved reliability, efficiency and resilience.

Complementing these initiatives is investment in restoration projects to enhance biodiversity and local ecosystems in the communities surrounding its operations. For example, wetlands play a crucial role in storm protection for Entergy's assets while also contributing to economic prosperity for many of its communities.

Entergy's proactive approach to rebuilding its grid system to recover costs following the weather events of 2021 have been highly supported by the regulators, highlighting the company's good governance and a genuine commitment to fair service delivery for communities.

The business sets a high bar for balancing its net zero targets with mitigating climate risks, making it a leader among US utilities in the transition to a net zero future. We see an increase in the company's investment in less-vulnerable underground grid networks and further investment in climate change modelling as important future steps.

Considering the impact of renewables development on nature and biodiversity: SSE

In the push for developing renewable energy sources, businesses will also need to consider broader environmental impacts.

SSE is a regulated electric and gas utility based in the UK with a growing book of renewable assets. It is one of the largest developers of offshore wind in the world, including the development of the world's largest offshore wind energy project, the 3.6GW Dogger Bank Wind Farm off the east coast of Yorkshire, England.

Given SSE's extensive development program, both terrestrial (land-based) and marine, we wanted to better understand how the company is minimising the environmental impact of its construction work and, where possible, seeking to leave these areas enhanced. We also discussed ways in which we, as investors, can monitor these impacts.

What became clear is that quantifying biodiversity net gain at the corporate level (in effect – aggregating unique, local projects with a range of different environmental considerations into a single overall figure) is challenging. For example, in one zone the key consideration was gannets (a large seabird); in another, it was a golden eagle.

Projects further out to sea are even more complicated. Companies including SSE are finding innovative ways to minimise disturbance to marine life, for example by finding ways to reduce the noise impact of laying the foundations for offshore wind farms, or changing configurations to minimise disruption to the flow of fish.

Given this complexity, SSE's response has to be tailored to the demands presented by each specific terrestrial or marine zone. Some changes that have been made include adjusting the tip height of a wind farm's turbines to below the height of avian flight paths; creating "no fishing" zones for fishermen; and finding ways to increase certain types of habitat.

We were encouraged by the release of SSE's latest biodiversity report in November 2022, which seeks to assess its impact on nature and biodiversity, and will continue to have two-way dialogue with company management about ways that SSE can further reduce its impact on the environment, and improve its disclosure on this topic.

Modern slavery

At FSI, we understand we must do all that we can to ensure our investment decisions, operations and supply chains do not contribute to the risk of modern slavery. The GLI team is dedicated to enhancing our systems and processes to combat various forms of slavery and human trafficking, including forced labour, child labour, domestic servitude, and workplace abuse. We acknowledge that suppliers employing lower wage staff may pose higher risks, and we encourage companies to thoroughly map out both their direct and indirect suppliers.

In 2020, FSI formed a modern slavery working group, led by the FSI Responsible Investment team. The group aimed to enhance our efforts in human rights by integrating risk identification and governance into our processes. As part of their work, they developed and published the Modern Slavery Toolkit.

The toolkit sets out the steps that investment teams take at both pre- and post-investment stages:

1. Risk identification: Utilising various data sources and considering factors like complex supply chains to identify potential risks.
2. Risk mitigation: Providing guidelines and sample questions for engaging with companies at risk of modern slavery. It also highlights other forms of leverage, such as policy advocacy and partnerships.
3. Escalation: Outlining actions for escalating, remediation, and ongoing monitoring of any identified instances of modern slavery.
4. Internal governance: Describing the internal governance framework in place to monitor modern slavery risks and the effectiveness of our approach.
5. Reporting: provides a reporting template for investment teams to be completed each year.

The GLI team assessed the risk of modern slavery in our focus list, considering sectors, geographies, and companies. External data sources, including the Transparency International Corruption Perceptions Index, helped identify countries associated with modern slavery risks. Each company in our focus list was ranked based on the vulnerability index of the countries where they operate. Our engagement efforts are prioritised towards companies with higher exposure in countries ranked higher on the index. Two company engagement examples on this important ESG issue are described below.

Challenges

Infrastructure companies have complex supply chains that involve procuring materials, equipment, and services from various suppliers. Companies may not be fully transparent about their supply chain practises, making it challenging to obtain reliable and comprehensive information. These risks tend to be higher in developing markets such as parts of Asia and Latin America, hence our focus on companies operating in these markets.

Modern slavery laws and regulations vary across jurisdictions, creating a lack of consistent global framework for assessing these risks. The UK and Australia have existing modern slavery legislation, Canada is in the process of enacting a Modern Slavery Act, and Japan is developing guidelines on Human Rights Due Diligence. To improve data quality, it will be crucial to translate qualitative social objectives, such as modern slavery, into quantitative indicators.

Future steps

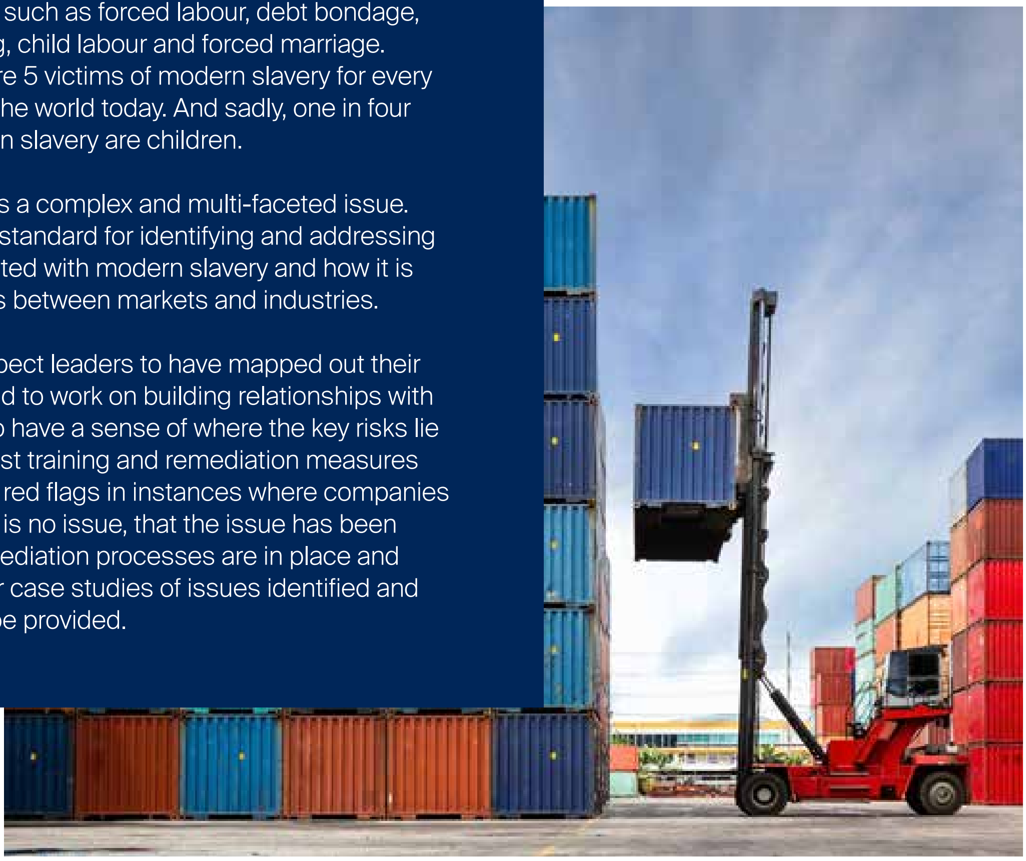
We will continue to engage with our focus list companies to promote the mapping of their complete supply chain, including direct and indirect suppliers. In our discussions, we intend to focus on remedies and preventive measures to address the challenges mentioned earlier. As we gather more data, case studies, and best practices, we will contribute to updating FSI's Modern Slavery Toolkit, ensuring continuous improvement in our investment approach.

Addressing the sheer scale of modern slavery

The International Labour Organization[35] has estimated that there are nearly 50 million victims of modern slavery, including crimes such as forced labour, debt bondage, human trafficking, child labour and forced marriage. It means there are 5 victims of modern slavery for every 1,000 people in the world today. And sadly, one in four victims of modern slavery are children.

Modern slavery is a complex and multi-faceted issue. There is no gold standard for identifying and addressing the risks associated with modern slavery and how it is addressed varies between markets and industries.

Generally, we expect leaders to have mapped out their supply chains and to work on building relationships with their suppliers, to have a sense of where the key risks lie and to have robust training and remediation measures in place. We see red flags in instances where companies assert that there is no issue, that the issue has been resolved, no remediation processes are in place and if no examples or case studies of issues identified and addressed can be provided.



35. International Labour Organization, "Forced Labour, modern slavery and human trafficking"

Vinci: Heightened modern slavery risks in construction sector

Vinci supports workers in the face of armed conflict and starts tackling modern slavery risks with a move to partner with a union federation.

Vinci is one of the world's largest investors in transport infrastructure. Significant concession assets include 4,400km of toll roads in France and 45 airports across 12 countries. With a workforce of over 220,000 people, it operates in 120 countries, including France, the UK, Germany, and the Middle East. While its concession businesses contribute most of the operating profit, Vinci also operates a substantial contracting business, providing engineering and construction services, particularly in emerging markets.

Following the escalation of the conflict between Russia and Ukraine in February 2022, Vinci needed to assess its position concerning construction activities and toll road assets in the region. To understand Vinci's exposure to the Russia-Ukraine conflict and to inquire about its modern slavery policy and procedures, we promptly arranged a call with the company's corporate social responsibility (CSR) team.

Russia Ukraine

Vinci's priority was ensuring the safety of its workers in Russia and Ukraine. Despite the conflict, around 1,000 employees chose to remain, primarily Russian nationals. Additionally, numerous Ukrainian employees in Poland left their jobs to return to Ukraine and join the war effort. Vinci promptly helped employees affected by the unfolding refugee crisis in neighbouring countries.

Vinci confirmed that its direct exposure to Russia in its construction and concession business was limited. In 2021, the company generated approximately €30 million from this market, accounting for around 0.2% of total revenue. Vinci also holds an equity stake in the Moscow St Petersburg motorway, which does not significantly contribute to its net income. As of December 2022, Vinci had not decided whether to divest this asset and continues to own it.

Modern slavery

In recent years, we have extensively engaged with Vinci regarding the issue of modern slavery, considering the company's construction business and its exposure to emerging markets, which increase the risks associated with this problem.

The scrutiny was particularly focused on Qatar due to infrastructure development for the 2022 Football World Cup, where Vinci and its Qatar subsidiary QDVC faced investigations for alleged "forced labour, servitude, and concealment." Vinci employs around 6,000 migrant workers through its Qatar subsidiary and various subcontractors. The company denied the accusations, asserting that it provides migrant workers with suitable working conditions.

After several years of constructive dialogue, Vinci signed a framework on worker's rights, including fair recruitment, making it the first agreement of its kind in Qatar between a union federation and a Qatari company.

Vinci is also taking steps to prevent workers' rights abuses among its labour suppliers and subcontractors by conducting labour rights audits. These audits involve anonymous worker interviews, examination of employment processes (such as recruitment fees, passports, contracts, wages, health insurance, and grievance mechanisms), and the implementation of improvement plans. COVID-19 restrictions initially affected Vinci's ability to conduct these internal audits, but as travel rules eased, they resumed the assessments.

Bringing modern slavery risks to the fore with Rubis

Companies with large global footprints like Rubis are inherently more exposed to modern slavery risks given their large contract workforce and complex supply chains.

Rubis is a French international company specialising in the storage, distribution and sale of petroleum, liquefied petroleum gas (LPG), food and chemical products. In 2022, Rubis acquired an 80% stake in Photosol SA, a French solar project developer and power producer. This investment aimed to expedite Rubis' transition to renewable energies and decarbonisation. Considering Rubis' presence in 40 countries across Europe, Africa, and the Caribbean, we emphasised the importance of addressing potential modern slavery risks in its operations.

In 2022, we had a number of engagement meetings with Rubis, including one focused on modern slavery and supply chain risks. Following this session, we sent a formal letter to management, outlining our inquiries regarding the company's identification of modern slavery risks, existing policies, and processes for addressing instances of modern slavery.

We sought clarification on specific issues such as:

- Recruitment practices, particularly if workers are hired through agents, and the measures in place to ensure labour outsourcing companies do not retain workers' passports or charge them recruitment fees or related costs.
- The concentration of migrant workers or minorities in Rubis' supply chain.
- Accountability for supplier audits within the organisation, including the frequency of these audits. We also inquired about the steps taken to ensure auditor independence and coverage of key risks in their assessments.

Rubis conducted risk analysis to identify and address potential areas of concern, including modern slavery risks. However, no major risks or instances of modern slavery were identified, particularly in the employment of migrant workers within its supply chain.

The company is committed to respecting human rights, as stated in its Code of Ethics. Training and compliance with the Code of Ethics are mandatory for all employees, and reporting instances of potential noncompliance is encouraged through the confidential Rubis Integrity Line, available 24/7. Contracts in less developed markets, such as the Caribbean and Africa, are progressively including specific clauses related to modern slavery, reinforcing compliance with local regulations, International Labour Organization (ILO) core conventions, and Rubis' Code of Ethics.

Recruitment agencies used by Rubis are strictly monitored and limited to shipping activities. Seafarers operating Rubis-owned vessels are required to sign declarations confirming they have not paid any fees to recruitment agencies. For time-chartered vessels, Rubis ensures that shipowners take actions to prevent modern slavery, including staff training, enhanced scrutiny on manning services, and adherence to ILO Maritime Labour Convention vetting standards.

Given the potential higher modern slavery risks in less developed markets, ongoing engagement with Rubis on this issue and monitoring for policy breaches or identified risks remains important.

Corporate governance

Effective governance and board oversight is critical for translating sustainable targets to outcomes. We look at factors including director independence, board size, gender diversity and relevant skills and experience when assessing governance standards.

We also look to ensure that the board of directors meets regularly, retains control over the business and is clear in the division of its responsibilities, as well as maintaining a system of risk management. Alignment of interest is important because it ensures that decision making processes are focussed on maximising shareholder value whilst also promoting accountability, risk management and long term sustainability.

What makes a good board?

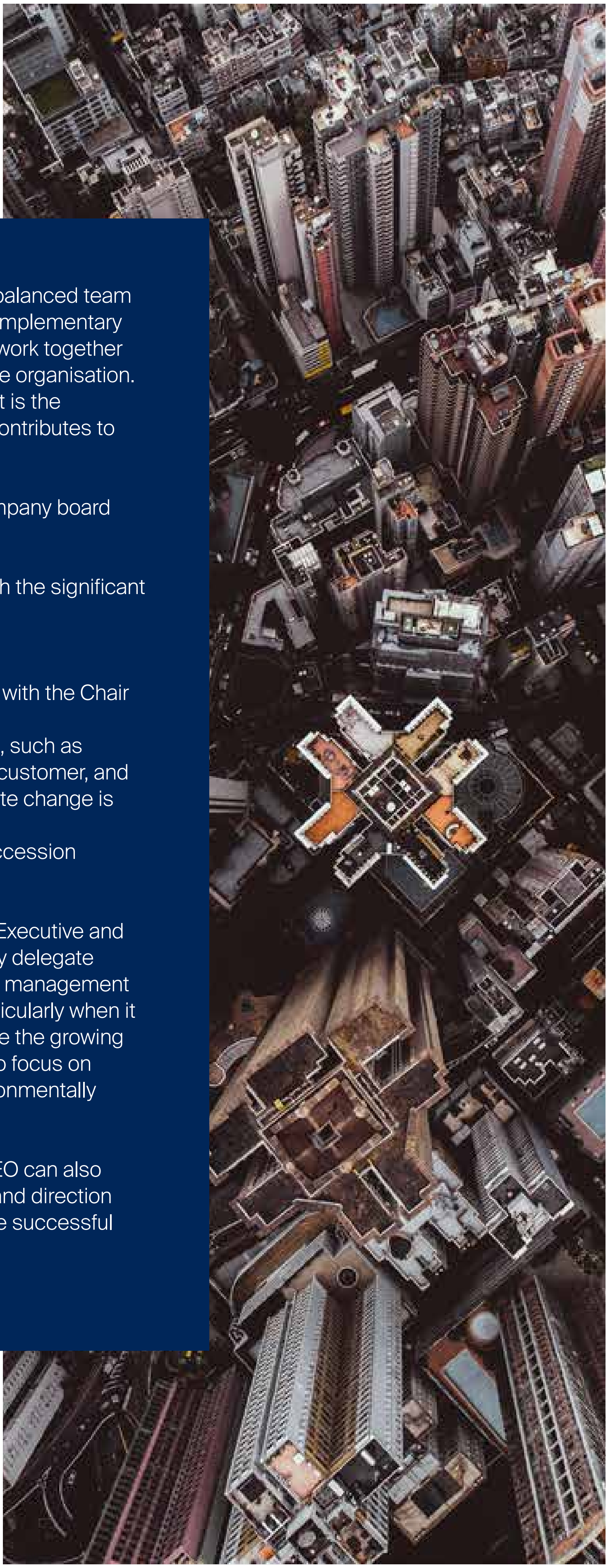
A board that truly adds value is one with a balanced team of high-performing individuals that have complementary skill sets and a culture that allows them to work together to make the most effective decisions for the organisation. Whilst leadership from the chair is crucial, it is the participation of every board member that contributes to the overall effectiveness of a board.

We believe a good listed infrastructure company board has the following characteristics:

- Board size of between 8-10 directors, with the significant majority independent
- Diversity by gender (at least 30% female representation), age and race
- Separation of Chairman and CEO duties, with the Chair being independent*
- Balance of skills and relevant experience, such as industry, finance, regulation, technology, customer, and local knowledge. Sustainability and climate change is a skillset of increased importance
- Regular board refreshment and clear succession planning.

Good boards set the strategy, appoint the Executive and oversee the execution of that strategy. They delegate effectively, have honest conversations with management and are committed to the organisation particularly when it comes to problem solving. We also observe the growing importance and pressure for Boards to also focus on sustainable, socially responsible and environmentally aware business practises.

*We acknowledge that a joint Chairman/CEO can also bring alignment if there is a clear strategy and direction with ‘skin in the game’. We have seen some successful founder-led examples.

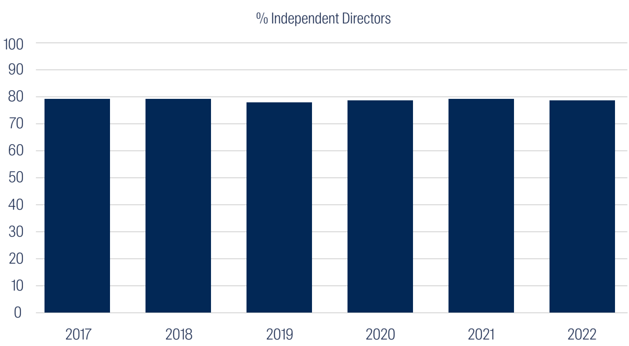


In 2022, we focused on two key corporate governance areas: board independence and gender diversity.

Board independence

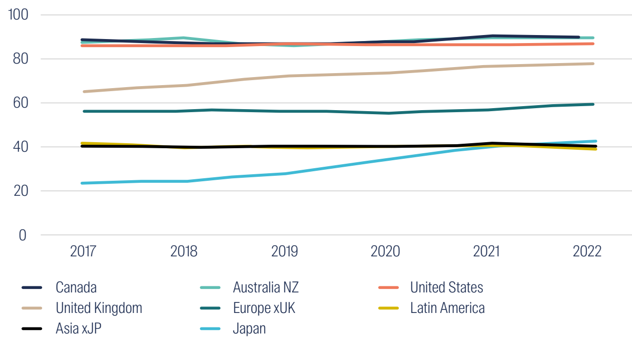
Over the past five years, we believe that board independence has consistently remained robust across our portfolios. This reflects the emphasis on developed markets within our portfolio. Notably, infrastructure companies in the United States, Canada, and Australia have set a benchmark for best practices, with typically 80-90% of directors being independent. Japan remains a laggard but there has been a noticeable improvement in recent years, driven by reforms aimed at enhancing corporate governance and attracting foreign investment. We are committed to fostering further progress in this area and will actively encourage companies to prioritise board independence.

Board independence Portfolio holdings as at 30 June 2023



Source: First Sentier Investors

Board independence Focus list ~140 listed infrastructure companies



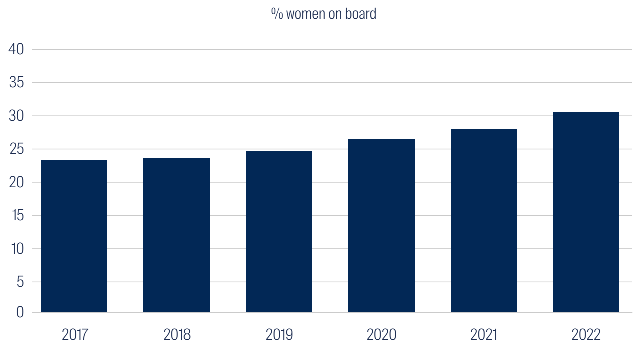
Source: First Sentier Investors

Gender diversity

For several years, we have been diligently evaluating companies based on their board gender diversity. This is due to the fact that gender balance is typically disclosed publicly and forms an integral part of a company's assessment of its social and governance performance. We firmly believe that a diverse board and leadership team, encompassing a wide range of thoughts, experiences, and perspectives, fosters more comprehensive and informed decision-making processes. Furthermore, diverse companies tend to be more adept at effectively managing risks. We believe by having a diverse workplace and leadership team, potential risks that might be overlooked in a less diverse environment can be identified and addressed proactively.

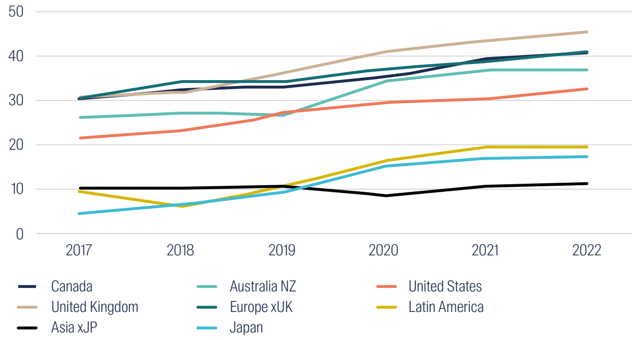
In recent years, there has been a steady improvement in the percentage of women on boards at the portfolio level, with the figure reaching 31% by the end of the year in 2022. Notably, the United Kingdom has emerged as a leader in gender diversity, achieving a 50% representation for utilities companies SSE, Pennon, and Severn Trent. The UK Financial Conduct Authority (FCA) took a significant step forward in April 2022 by introducing new rules that mandate listed companies to report information and disclose their progress towards targets in terms of the representation of women and ethnic minorities on their boards and executive management teams. This move signifies a commitment towards promoting diversity and inclusivity in corporate leadership.

Diversity Portfolio holdings as at 30 June 2023



Source: First Sentier Investors

Diversity Focus list ~140 listed infrastructure companies



Source: First Sentier Investors

At a firm level, we continue to be involved in industry collaborations designed to boost gender diversity on boards (Australian Institute of Company Director's 30% Club) and senior management (40:40 Vision). We are also committed to bringing more women into our own investment teams and continue to work towards our commitment to have women comprise at least 40% of investment management staff by 2033 (currently 30% for the GLI team).

Challenges

We tend to be cautious when investing in emerging markets, where poorer corporate governance can impact investor confidence. Many infrastructure companies in emerging markets are controlled by a single or group of dominant shareholders, often family-owned or connected to the government.
This concentration of power can lead to conflicts of interest, abuse of power, and inadequate checks and balances, resulting in poor governance outcomes. Emerging markets often have less stable political environments and weaker regulatory frameworks compared to developed countries. Frequent changes in government policies, regulations, and laws can create uncertainty and increase the risk of investing in infrastructure projects.

Future steps

We continue to actively engage with companies to promote good governance practices. Active ownership encourages companies to be more accountable, transparent, and responsive to shareholder concerns. By voting on important governance matters, such as board composition, executive remuneration and shareholder rights, we can support changes that enhance governance standards and align company practices with shareholder interests.

Challenging the board composition at JR West

Japanese companies have a poor history when it comes to best practice board compositions especially when it comes to gender diversity, which will see greater shareholder scrutiny.

West Japan Railway (JR West) is a major railway company in Japan with a passenger rail network covering the Kansai region, including Osaka and Kyoto. It is the owner and operator of the Shinkansen or 'bullet train' service. Despite owning a technologically advanced rail network, JR West's board composition does not align with global best practices.

In 2022, JR West's board encompassed 17 directors, with 47% independent members and only 12% female representation. This does not align with the characteristics that we feel comprise a good listed infrastructure board.

We have raised corporate governance concerns with the Japanese railway companies for many years. In 2022, we cast proxy votes against JR West on the issues of board size, board independence and lack of gender diversity at senior management and board level. JR West also lacked regular board refreshment and clear succession planning.

There are several areas we have been concerned with:

- Although Chairman and CEO duties are separated, the majority of directors are also executives of the company, raising questions for us around how shareholder interests are represented at the board level
- There appears to us to be little diversity of skills and experience on the board with the majority of board members having largely similar skill sets. We would have liked to see the company expand its skillset into adjacent areas such as technology, innovation, digital and customer.

In 2022, we sold our position in JR West following a period of outperformance. At the same time, the stock was moving towards the bottom of our value and quality process, with low scores for a number of quality measures including board, governance and alignment of interests. This made it harder to own the stock as it moved closer to our price target. Typically, as soon as value is realised in a lower quality stock, we sell out.

We may have been a longer-term holder if JR West were able to address some of these key ESG issues. We continue to engage with Japanese companies to encourage them to increase board independence, improve diversity and provide more transparency and comprehensive reporting on their governance practices.

Japanese companies have a poor history when it comes to gender diversity at both the senior management and board level. It is not uncommon for us to meet with companies in Japan and find them with little to no female representation in leadership roles. The World Economic Forum's Global Gender Gap Report 2023[36] ranked Japan 125th out of 146 countries in terms of gender parity, down 45 places compared to its 2006 ranking. The result is that men still dominate business and political leadership in Japan.

36. World Economic Forum Global Gender Gap Report 2023

Opportunities to align with shareholders: Aena

Since becoming a listed company, Aena's new minority shareholders have an opportunity to seek alignment on key issues.

In 2015, Spanish airport operator, Aena, transitioned from a government entity to a listed company with majority 51% government ownership. This evolution has provided opportunities to engage with Aena to seek improvements in the alignment of the company with new minority shareholders.

After identifying three capital management and alignment concerns, we sent a letter to Aena addressing the following areas: dividend policy, real estate investment, and capital discipline in international expansion. In July 2022, we engaged with Aena's management in a call to discuss these issues. The outcomes of this discussion are summarised below.

Dividend policy

The COVID-19 pandemic affected the Spanish aviation sector in 2020 and 2021, reducing flight activity. Aena, the airport operator, faced additional challenges due to government legislation providing rent relief to tenants, resulting in lower rent for Aena than what was originally agreed. The accounting treatment of this rent relief had an adverse impact on the company's net profit for 2022 without affecting the free cash flow generation in the period.

We communicated to Aena that the government's intervention should not harm shareholder dividends and urged the company to adjust dividend calculations accordingly. Aena responded positively and announced in November 2022 that it would adjust the dividend to account for the impact of the rent relief. This unexpected increase in dividend pleased the market and resulted in a positive response from investors, highlighting the benefits of engagement in improving investment outcomes for our clients.

Real estate investment

We believe the market significantly undervalues the potential of Aena's over 300 hectares in developable land. We recommended accelerating development and forming joint ventures with real estate partners. Additionally, we emphasised the importance of improved disclosure to inform the market about the value of these assets.

During the company's strategy day in November 2022, Aena showcased a more detailed and comprehensive plan for these investments. This increased transparency allowed the market to better understand the untapped value of the real estate land bank.

International expansion

As a highly cash flow generative business with extensive expertise in the development and operation of airports, Aena has sought to expand their footprint to other markets via acquisitions in both the UK and Brazil. While we see potential in these activities, we caution that these auctions have become highly competitive, with a significant influx of capital into the sector. We advised Aena to maintain investment discipline to protect shareholder capital.

In August 2022, Aena acquired airports in Brazil through a public tender. We believe the purchase price was high, and there are significant challenges in executing the required capital investments included in the concession. We remain cautious about Aena's overseas investments.

In our future engagements, we will concentrate on executive remuneration at Aena. We will seek to recommend aligning executive pay and structures with industry standards, including the introduction of share-based incentives. This change would enhance management-shareholder alignment and mitigate the risk of value-detracting foreign acquisitions.

Proxy voting

The GLI team exercises voting rights on all issues where it has the authority to do so. Voting rights are crucial for upholding corporate governance, risk management and protecting investor interests. We believe voting rights are a valuable asset, which should be managed with the same care and diligence as any other asset.

Engaging with a company provides an opportunity to gather information and insights directly from company management. Through meetings with the company we are able to understand the company's strategy and gain a deeper understanding of its governance practises. It enables us to evaluate shareholder proposals, board nominations, executive compensation plans and other matters put to a vote.

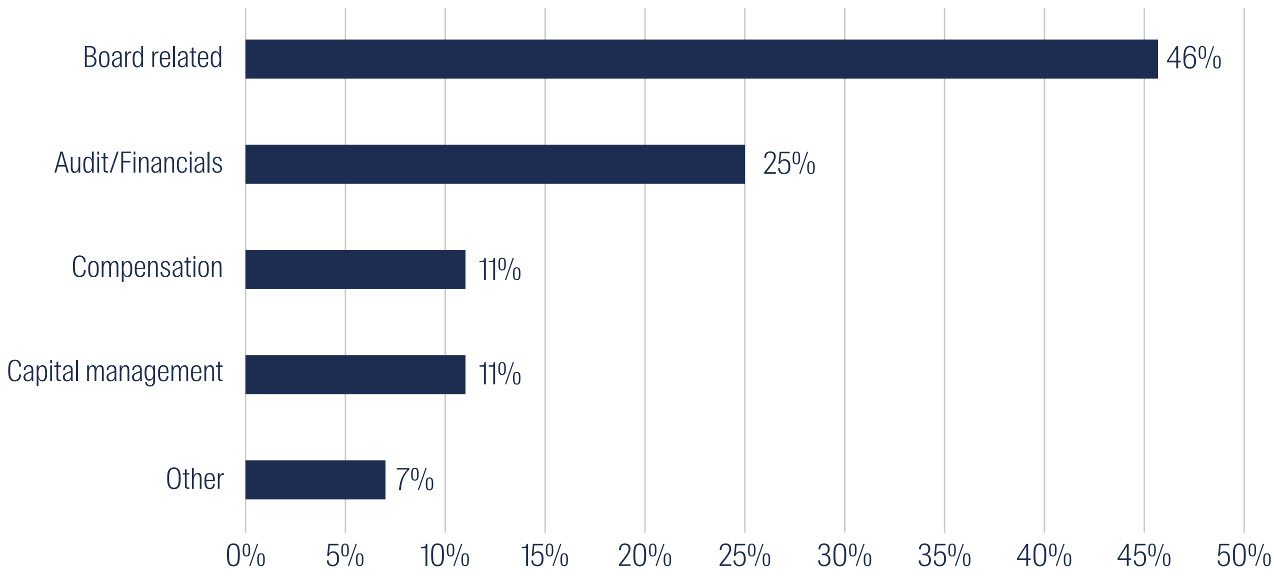
While we seek recommendations from independent research providers, we maintain full control over our voting decisions. If we plan to vote against a proposal, we may engage with the company beforehand for consultation, with a view to achieving a satisfactory solution. If concerns persist, we escalate the issue to the board. Ultimately, divestment is considered if there is no willingness to change or address the issue.

Our team maintains records when we vote against management or against the recommendations of our proxy voting advisor, Glass Lewis. Our proxy voting record, at a strategy level, is available on the First Sentier Investors website.

Proxy voting over 2022

During the 2022 calendar year, we invested in 74 infrastructure companies across 7 subsectors and in 16 countries around the world. We voted on 1,067 proposals, of which we voted against management on 131 occasions on issues including lack of board independence, poor alignment of interests and inadequate climate-related targets.

Breakdown of votes against management



Source: Glass Lewis for the 12 months to 31 December 2022

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