Hyperion Task Force on Climate-related Financial Disclosure – Inaugural Report

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Overview

Hyperion Asset Management ("Hyperion") has been a signatory to the Principles for Responsible Investment ("PRI") since March 2009 and became an official supporter of the Task Force on Climate-related Financial Disclosures ("TCFD") in 2019. This report is our inaugural TCFD report and relates to the period from 1 July 2019 to 30 June 2020, it provides our response to the TCFD recommendations. We will aim to increase our disclosure each year as we update this report. Our transparency reflects the commitment we have towards climate-related disclosure and we also actively encourage our portfolio companies to adopt the TCFD recommendations as well.

Sustainability has always been central to Hyperion's business and investment philosophy. We view ourselves as long-term business owners with an investment horizon of more than ten years. Due to this long holding period, it is imperative that we evaluate the sustainability of our portfolio companies and how they impact all their stakeholders. These stakeholders include the wider community and the long-term impact on the natural environment that supports this community. The assessment of the company's likely long-term effect on the natural environment including its carbon footprint is a core part of this stakeholder analysis.

Hyperion considers the impact on the natural environment for both:

1) its own business operations; and
2) the business operations of the companies it holds in its portfolios.

In support of the global reduction of carbon emissions, Hyperion has met its goal of being carbon negative for the 5 years to 31 December 2019 through the purchase of carbon credits.

Governance

Material climate related and ESG concerns or opportunities are discussed and addressed by Hyperion's Board as required. Additionally, new initiatives and strategies are considered, and policies are approved. Hyperion's Executive Committee meets monthly and as part of these meetings discusses any company-specific climate-related issues or opportunities. Furthermore, our Investment Committee meets every month when all members of the team have the opportunity to raise any concerns regarding climate or ESG risk for specific companies.

The Board has tasked Hyperion's Chief Investment Officer (CIO) and Deputy CIO with the responsibility of climate-related oversight and integration within our investment process. As asset managers, it is our fiduciary duty to evaluate climate change risks and opportunities of the companies in our portfolio for our clients, and therefore ESG and climate-related risk plays a primary role in our investment process. Due to this, Hyperion's investment team is the first point of contact as they conduct company and industry specific research. If a material risk is identified, it will be immediately raised with the CIO and Deputy CIO, who will evaluate it and take any required action.

Hyperion's Voting, Sanctions, Expert Network, Climate Change and ESG policies, along with our ESG Framework are publicly available on our website.

Strategy

Hyperion's ESG Framework and Policy outlines how we manage our responsibilities surrounding ESG and Climate-related issues.

We believe that good ESG and Climate Change strategy are important to sustainability and because we have a long-term investment philosophy (typical holding periods of 10+ years) sustainable business practices, particularly as they relate to the environment, are critical. We also aim to protect our clients from potential risks associated with poor ESG and Climate Change management. As such, sustainability, Climate Change, and ESG are core components of our philosophy. We believe our portfolios contain very low ESG and Climate risks due to this long-term focus and the substantial qualitative and quantitative research completed on all our holdings. We do not rely on investment houses or research departments to run screens. From an environmental perspective, we eliminate companies from our universe that are large carbon emitters, harm the environment, or are not managing their potential risks adequately. The initial step in our investment process involves screening for companies that meet our strict criteria.

Once a company gets past our initial screening process, ESG and Climate specific factors are included in our analysis. We identify a number of important qualitative factors such as: isolation of potential risks; composition, and quality of the board; impact of the business on the climate; company specific ESG policies and initiatives; and carbon intensity. This analysis extends to a company's broader stakeholder group, including its supply chain. This analysis ultimately feeds into a company's 'Business Quality Score' which is the key output of our analysis, and a factor in the portfolio construction process.

We believe that the justified and increased focus on ESG and Climate Change will ultimately impact all industries. As outlined by TCFD, we consider both transition and physical risks and opportunities. We must consider how government regulations, stakeholder pressure, and consumer preferences will evolve in the future and how this will impact Hyperion and the companies we invest in. We have outlined some risks and opportunities that we have identified below.

Table 1: Climate Change Risks

Type	Climate-Related Risks	Potential Financial Impacts
Transition Risk	**Policy and Legal Risk**	
	This relates to the potential risk that businesses face as a result of Governments responding to climate change by implementing regulations such as increasing pricing of Greenhouse Gas (GHG) emissions, capping supply and use of resources, and increased emissions reporting obligations.	• Lower returns on capital • Increased costs/and or reduced demand for products or services • Increased business expenses relating to things such as higher levels of disclosure and introduction of or increases in tariffs. • Asset write-offs as they become illegal to use.
	Technology Risk	
	The rise of more energy efficient and lower emissions technology that replaces existing technology.	• Increased investment • Costs to transition to lower emission technology

		• Increased Research and Development costs
	Market Risk	
	This relates to how consumers' behavior could change. This could be through consumers' possibly not buying products or using services of companies that are not addressing Climate-related issues and as well as climate-friendly products becoming substitutions for existing non climate-friendly products. Additionally, the risk that raw materials and natural resources (e.g. water, energy, land) costs will increase.	• Reduced demand leading to loss of revenue • Increases in production costs • Re-pricing of assets
	Reputation Risk	
	Destruction of company or industry reputation due to not meeting consumers' expectations surrounding climate change issues.	• Reduced demand leading to loss of revenue • Reduction in capital availability • Increased public relations and market expenses to try and save its reputation
Physical Risks	**Acute**	
	This includes natural disasters such as floods, cyclones and fires.	• Reduced revenue from decreased production • Increased insurance premiums • Increased capital costs due to replacement of damaged assets • Staff unable to get to work
	Chronic	
	These risks relate to events such as rising sea levels and temperatures.	• Increased electricity costs • Increased capital costs due to replacing damaged assets • Asset write-offs and impairments

Climate-related opportunities

Hyperion has from time to time identified climate-related opportunities and specific companies that could benefit from the transition to sustainable energy and transportation. In addition, the companies we hold in our portfolios are generally robust and less sensitive to economic growth rates compared with most listed businesses. Therefore, the companies in our portfolios should be able to handle a low growth, climate disrupted world much better than most listed companies. In a relative sense our portfolio companies will not be as impacted as most listed companies if governments decide in the future to more aggressively tax CO2 emissions.

We expect the rate of growth in the global economy to decline over the coming decade and beyond due to several structural headwinds. One of the most challenging of these is the constraints on our natural resources and the environmental impact of using fossil fuels as our main source of energy. Structural disruption due to renewable energy is likely to be far-reaching, initially impacting resource, utility, transport, and infrastructure sectors. Further, the finite nature of our natural resources makes unbridled consumerism unsustainable. We have structured our portfolio to reflect this and enable our investors to prosper from this disruption through a group of companies that are implementing strong ESG values and/or actively moving the world to a cleaner future.

An example of this is the disruption we see occurring as society and governments look to lower carbon emissions and how this will impact the automotive industry as internal combustion engine vehicles are phased out due to government regulation and consumer preference.

Another example is the structural change occurring in the energy industry as fossil fuel production is reduced/retired and more renewable energy is implemented. Due to the unpredictability of natural resources, renewable energy production can be volatile. Therefore, software and storage need to be utilized to help manage the grid and provide energy during times of high demand.

Risk management

Hyperion's portfolio construction process ultimately allows us to manage climate-related risks that are identified by our company research. Hyperion's proprietary portfolio construction process uses a combination of quantitative and qualitative inputs. The primary quantitative factor is a company's ten-year internal rate of return (IRR). Ceteris paribus, stocks with a higher ten-year IRR have a higher portfolio weighting. This 'raw weight' is adjusted by a proprietary Business Quality Score that is calculated for each stock researched by Hyperion. Within this Business Quality score, various qualitative factors including ESG and climate change risks are evaluated and impact a company's score and in turn its portfolio weight. It follows, therefore, that a poor ESG and Climate evaluation will result in a lower Business Quality Score and hence reduce the company's chances of being included in portfolios.

We believe activities that are detrimental to the environment are not to be invested in as it will lead to increased costs or lower returns on capital for that company over time. There will be certain industries where the environmental impacts of a company's activities are so great that the company is considered non-investable. In these situations, the company will be excluded from Hyperion's portfolios regardless of other circumstances such as valuation. As a result, our portfolios tend to be underweight resource stocks and zero weight fossil fuel related stocks.

Our view is that poor governance and activities that have a detrimental impact on society or the environment will result in such companies being unattractive investments as the company's overall sustainable competitive advantage and ability to achieve and implement objectives will be impacted. Our conclusions can result in stocks either being excluded from consideration for Hyperion portfolios or, in less extreme circumstances, being held at below average weights.

Active Stewardship

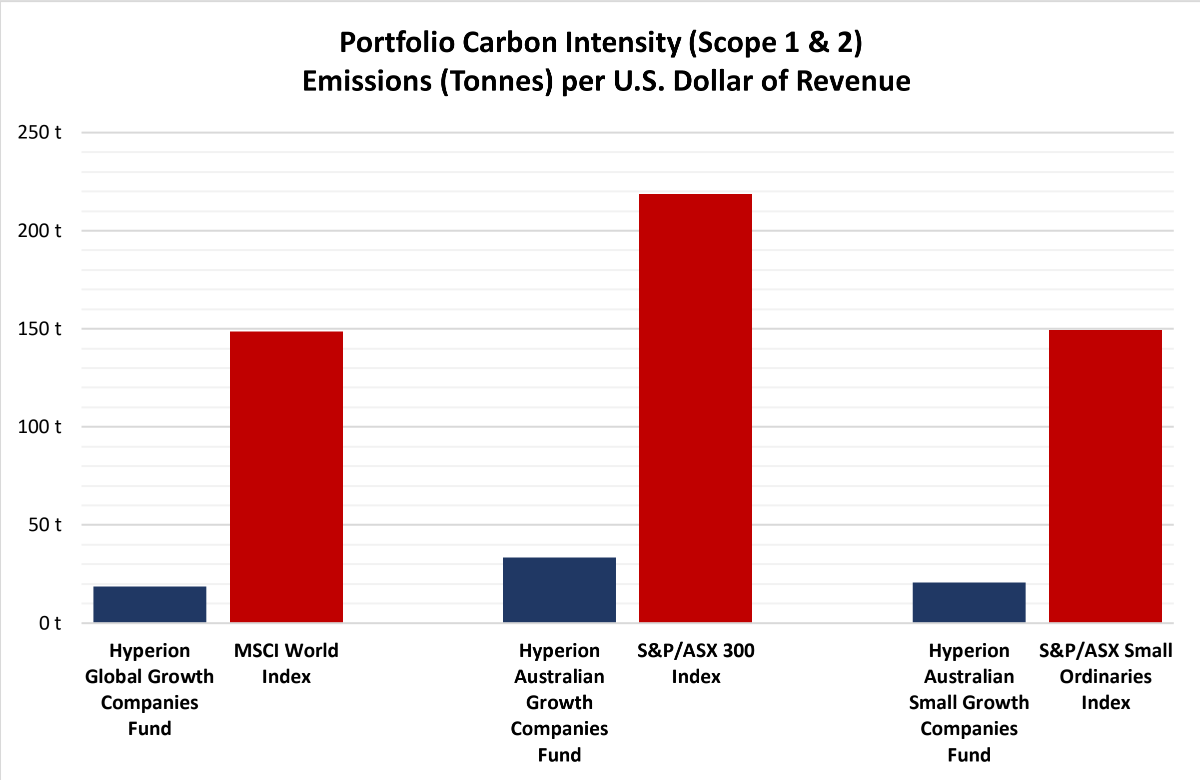
Another method of risk management used by Hyperion is engaging with our portfolio companies and expressing our concerns on ESG and Climate-related matters. Additionally, we encourage our portfolio companies to implement better Climate-related reporting and to lower their carbon footprint.

Through our proxy voting, which we do for the majority of our clients, we actively conduct our own research and also use third-party providers such as ISS and Ownership Matters to provide the best outcomes for our clients. If we disagree with a company's management, we will look to engage with the company and discuss our concerns prior to voting.

Metrics and Targets

Hyperion has long had the goal of ensuring our portfolios have a significantly lower weighted average carbon emission score than their respective benchmarks. Since we started tracking this data in 2010, we have succeeded in this regard, with Hyperion's portfolios' carbon emission scores being consistently and significantly lower than their respective benchmarks. Typically, our portfolios are less than 15 percent of their respective benchmark's carbon intensity. We regularly monitor our portfolio's carbon intensity and carbon emissions.

As of 30 June 2020, the Hyperion Global Growth Companies Fund, the Hyperion Australian Growth Companies Fund, and the Hyperion Small Growth Companies Fund all had weighted average carbon intensity levels significantly lower than the relevant benchmark.



Source: Sustainalytics (FactSet), Hyperion Asset Management

Firm activities

Hyperion, itself, has been carbon negative for the past 5 years. We endeavor to further reduce our carbon footprint over the coming years and encourage our supply chain to do so as well.