March 2024

AUSTRALIAN FIXED INTEREST

QUARTERLY ESG REPORT

Environmental, Social & Governance (ESG)

For financial services professionals only.

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As Australia works towards its commitment of reaching net zero by 2050, two major projects will aid sustainable investors. One is the development of the Australian taxonomy which is a set of common definitions for sustainable economic activities. Its purpose is to make clear and consistent definitions of what is classified as a sustainable activity, making it easier for investors to identify opportunities and give them confidence and assurance when it comes to sustainability claims.

The other is Australia's mandatory reporting laws for ISSB disclosure by large companies coming into effect in July this year. Large companies (i.e. meeting 2 out of 3 of the following criteria - more than 500 employees, AUD $500 million+ in revenues and more than AUD $1 billion+ in assets) will be required to report information about their sustainability- and climate-related risks and opportunities. This will provide more granular information about current and future sustainability of the company as well as how they intend to respond to those matters. For smaller companies that don't yet qualify under the mandatory reporting, it is expected reporting will be in affect within a maximum of 3 years. That said, through our engagement we are learning that some of the companies that don't have to mandatory report in the initial stages are working towards doing so in advance of their own obligation.

We continue to progress our own journey in sustainability, always seeking to keep up with best practice. For further details on our ESG enhancements and accomplishments last year, please click **here**.

In this edition we share highlights of our engagement meeting with toll road provider Transurban, Woolworths on recent accusations of price gauging, recycling of soft plastics and issues in their supply chain, Royal Automobile Club of Queensland on community work and climate targets and the Canadian Pension Plan Investment Manager on managing governance across their portfolios. We also finish off with a discussion on sustainability measures being taken by the company behind the Formula 1 Grand Prix.

Transurban – the road to decarbonisation

When looking at approving any issuer for inclusion in our portfolios we take into consideration ESG risks. Specifically, we are looking to identify material ESG risks that may affect the credit profile of the company. Companies that have a high carbon footprint, and are in hard to abate sectors, have elevated, if not material ESG risks. Where we determine materiality, the issuer is not considered for our portfolios. Where it becomes more difficult is the analysis of companies that are the facilitator for heavy emitters, while not necessarily having a high carbon footprint themselves. Toll roads, airports, ports and even energy infrastructure (e.g. pipelines) are examples of these.

During the quarter we met with the sustainability team at toll road operator Transurban. They are an Australian-owned company who build and operate toll roads in Melbourne, Sydney and Brisbane, as well as the United States and Canada. Their team led with their commitment to sustainability right across the business to ensure their social licence to operate. This includes Science Based Targets initiatives (SBTi) and verified 2030 and 2050 (net zero) carbon targets covering scope 1, 2 and 3 emissions.

The company's 50% reduction in scope 1 and 2 emissions by 2030 (off a 2019 baseline) has already been achieved, mostly through the switch to renewable energy for electricity. We questioned the length of their power purchasing agreements (given increased demand in the market) and they noted contracts out as far as 2030.

The challenge for most companies (unless in a hard to abate sector) is their reduction in scope 3 emissions, which can be significantly higher than their own operational carbon footprint (scope 1 and 2). Transurban are targeting a 22% carbon intensity reduction in scope 3 which includes supply chain emissions for operations, major development project construction (i.e. building of the roads which includes embodied carbon), other fuel and energy not picked up in scope 1 and 2, waste, business travel and investments. While supply chain emissions have gone up in the last four years (against their 2019 baseline), overall they have managed to reduce scope 3 by 8% in FY23 driven (excuse the pun) by a reduction in project construction emissions and their investment portfolio. The project construction component however is very variable as it will depend on projects currently in production, so this fall is not necessarily a precursor for the future pathway. Transurban did note their ability to help influence their project partners by working together on technology and incorporating into the contracts predetermined embodied carbon emission targets, council sustainability ratings of the projects and materials used.

The interesting learning for us when looking at their emissions was that customer travel emissions (i.e. motorists) are not included, not even in scope 3. While Transurban do show them as an FYI, they are not required to report and include them as defined by the GHG Reporting protocol. Road transport emissions account for about 12% of global greenhouse gas (GHG) emissions, with Transurban maintaining they have built roads that are "designed to support more efficient driving: smooth surfaces; minimal bends and steep climbs; zero traffic lights and quick incident response to keep traffic flowing." They note this has resulted in a large reduction in travel time, saving vehicle emissions and ultimately a 28% reduction in GHG emissions compared to motorists taking alternate routes. However, we did question the increase in overall vehicles using their roads, which is due to the opening of new assets since 2019 and other roads being lengthened.

While they advocate for the use of the of electric vehicles on their roads, they won't be putting in charging stations as they want cars to keep moving to ensure the flow of traffic. No toll subsidies are offered for electric vehicles (EVs) sighting 'customer fairness'.

Through Transurban's regeneration of roadside ecologies project, five trees are planted for every tree removed during construction of projects. Their vegetation management includes the protection of species on the sites.

Rounding out our engagement we discussed social issues such as air quality control in their tunnels, diversity and inclusion targets for balanced gender representation (40% women, 40% men and 20% non-gender specific). Post our meeting they have reported gender pay gaps, showing a decline from 13.9% to 13% in the last three years for total renumeration, compared to the national median gap of 19%. They are also seeking to increase indigenous employment through targeted trainee projects.

Woolworths – A few things we need to discuss…

During the quarter we met with Woolworths, Australia's largest retailer that operates destination supermarkets and convenience stores. In this meeting we had three main topics we wished to discuss which included the Australian Competition and Consumer Commission (ACCC) price gauging accusations, an update on plastic recycling and greater detail on their modern slavery policy.

On the current ACCC price gauging accusations, Woolworths reiterated what has been widely reported as their retaliation, expressing that they do face strong competition in the domestic market from the likes of Coles, Aldi and Costco. Amazon, Bunnings and Harris Farm are also considered direct competitors with a range of Woolworth's items. We note the sensitivity around this topic and await the outcome of the ACCC inquiry which is expected to take a year.

Following the collapse of REDcycle (Australia's largest soft plastic recycling program) in November 2022, Woolworths (along with Coles) approached the minister's office seeking support from the government. A plastics task force was convened, taking control of the stockpile and storing them in a safe manner (e.g. one that was not a fire hazard). Of the stockpile, 3-4% was sent to landfill as they were not stored in a viable manner. Since then, Woolworths have been focused on trying to look at other available solutions. In early March, they announced a new soft plastics recycling trial which would go for six weeks. It is hoped that the soft plastics will be used in bitumen for our roads or in ceiling board to aid the construction industry, hereby creating a circular economy.

The cotton industry in China's Xinjiang region has been plagued with concerns over forced labour. We discussed this with Woolworths who flagged that their subsidiary Big W (importers of Manchester and clothing) do not source cotton directly from any suppliers in this region. However, they are cognisant of the inherent risk that comes from cotton in its supply chain. They acknowledged that companies who deal with cotton are more likely to be importing from China, given 80% of cotton imports come from there, and we assess this as an inherent risk in their supply chain. Acknowledging this risk, Woolworths did conduct a pilot for Big W whereby they investigated their top suppliers as well as their value chains. The finding was that none of them were linked to forced labour.

Another issue facing Woolworths the was the discovery of debt bondage in Malaysia, leading to their first case of modern slavery identification in 2022. By 2023, they had worked to remediate this issue with the supplier. This was done by improving housing conditions, constructing lavatories, returning passports that had been detained amongst other things. Further, Woolworths implemented penalties and changed the structure of recruitment fee incentives. Workers affected were also repaid. Woolworths have since developed a responsible recruitment addendum and are promoting ethical recruitment across certain Asian countries.

RACQ – From helping the community to reducing their carbon footprint

The Royal Automobile Club of Queensland (RACQ), owned by over 1.7 million members, offer services of roadside assistance, motoring services, insurance, banking, travel and solar products. While we invest in the banking arm (entity Members Bank), the sustainability framework of the company is set at a corporate level.

We met with the group's senior environmental impact specialist and the head of sustainability to better understand the ESG credentials of this issuer, and to discuss their recently developed sustainability framework, "A Force For Good", which focuses on climate risk, cost of living and road safety.

RACQ led with the fact that they have always had a focus on social and community impact, which includes grants to charities, sporting and indigenous clubs. They offer a large education program on road safety which is free to schools, and their roadside fleet do community rescues for non-members when children, vulnerable adults and animals are locked in cars.

Whilst continuing with community work, the "A Force For Good" framework was set by the board, which is implemented by the executive teams of the underlying businesses. By November 2023, they had surpassed their target of 49% of electricity consumption coming from renewable sources, by reaching 100%. However, we did note that 49% was a weak target, and not in line with peers such as Royal Automobile Club of Victoria who reached 100% four years ago. They have locked in long term contracts to secure this power source and have put solar on some of their buildings with proposed plans to put more in place (e.g. Bundaberg office - while they don't own the building, they have a long term lease in place and have negotiated with the landlord to be able to pay to put solar on the roof).

They have three main buildings, one of which has a six star accredited NABERS energy rating. While the others aren't eligible, they have upgraded energy efficiency and added solar. The company's biggest direct emissions come from vehicles on the road, which they are switching to electric. We questioned how these will be charged given the high percentage of coal in the QLD energy mix, which they acknowledged is a problem, however, they will be encouraging staff to charge at one of their 55 Queensland Electric Super Highway charging sites powered by renewables.

RACQ are targeting net zero by 2030 in operations. For the bank, financed emissions are a challenge and for this they have set a 2050 target. For the most part these are household mortgages and includes their carbon footprint. RACQ have engaged carbon accounting providers to work out estimates of what this is, and then provide education to mortgage holders on energy efficiency. They offer four green products, including green home loans, green car loans, green personal loans and green bank cards, which are incentivised with decent funding discounts. The group also has an investment portfolio which has negative screens with revenue thresholds for fossil fuels, alcohol production, controversial weapons and tobacco.

On the social side, the group's gender statistics are skewed towards women. This is likely the result of work life balance and flexible working arrangements in many of their call centres. They do emphasis their focus on diversity and inclusion.

PSPIB – Investing in a company's ability to monitor good governance

During the quarter we met with the Public Sector Pension Investment Board (PSPIB), a 100% Canadian owned entity who have been exclusively mandated by the Canadian Government to invest the net contributions of four Federal Pension Plans. These are the Public Service Pension Plan, the Canadian Armed Forces Pension Plan, the Royal Canadian Mounted Police Pension Plan, and the Reserve Force Pension Plan – the total of these plans is in excess of CAD $243.7 billion.

While they are an investment manager, they do leverage their strong financial position by issuing debt. This currently sits at around 10% of the assets under management. They have launched a sustainability framework (ICMA approved), with two green bonds already in circulation (issued in Canadian dollars). Projects include renewable energy, energy efficiency pollution prevention and control, sustainable land use, water and wastewater management, circular economy, green buildings and clean transportation. The aim is to issue one green bond a year, targeting 10% of total debt (currently at 7.5%). The program is rated medium green by CISERO. They shared that the higher green rating would be overly restrictive and impairs ability to achieve investment objectives. They note a 'greenium' was evident in their inaugural issue, but this has eroded, with their subsequent green bonds expected to price in line with their normal funding curve. Diversification and quality of investors is cited as the advantages of issuing off their sustainability bond framework.

Understanding the ESG risks for a company like this and being able to assess materiality as a holder of their debt is quite nuanced. While they manage a large investment portfolio, and are shareholders and debt holders of other companies, their revenue comes from the fees they charge for the service of managing and investing funds on behalf of members . They do not derive direct revenues from the underlying investments that they manage, and their scope 1 and 2 carbon footprint is a function of their operations as opposed to that of the companies they invest in. Therefore, carbon metrics associated with PSPIB's investment portfolio represents an indirect source of emissions as guided by the GHG Protocol's. Our focus when conducting this engagement meeting is getting an understanding of the governance process they have for managing their investment portfolio. This includes being satisfied that they have sufficient measures in place to mitigate controversies and exposures to controversial industries and are best in class at working with the companies they invest in to decarbonise and maintain a social license to operate.

The only negative screen on their portfolio is in landmines. They are not believers in blanket exclusions, preferring to engage rather than exclude, noting they can utilise their capital and influence through engagement. Company engagement and proxy voting is a strong focus with numerous meetings conducted and outcomes diligently recorded. They are also in a privileged position of having board positions in many private companies with access to data and influence on strategy (i.e. check governance, review climate targets, enhance reporting). They have set a 2050 net zero target for their asset portfolio (considered to be their scope 3) and an interim target by 2026 to reduce holdings of carbon intensive assets that lack transition plans, working to ensure assets representing 50% of their carbon footprint have firm credible decarbonisation pathways. Tracking carbon metrics is a focus, with coverage of companies invested currently at 56%. They have set an 80% target of carbon coverage (scope 1 and 2) by 2026.

PSPIB is not involved in any controversial product lines, has 58% female board members and 100% independence of board directors. They acknowledged that they are still building out the social side further. We recognise their strength in company engagement an ability to influence the companies they invest in, and we are comfortable with their trajectory for continued good governance.

Formula 1 – driving towards a more sustainable future

The Australian Formula 1 Grand Prix graced Albert Park Lake in Melbourne in March. While a lover of the sport myself, and being lucky enough to be at the track, I did question the irony of an ESG specialist being at the event. The Formula 1 (F1) has a large carbon footprint, but interestingly only 0.7% is a result of the racing car emissions. The other 99.3% of their emissions comes from event operations (7.3%), logistics including the movement of teams across the globe for races (45%), facilities and factories (19.3%) and business travel of employees (hotels, transport etc at 27.7%).

To their credit, and under the strong influence of seven-time world champion driver Sir Lewis Hamilton, the company has improved its sustainability credentials and has committed to be a net zero carbon sport by 2030.

With relatively low emissions derived from the cars themselves, it is other areas of their business that need to do the heavy lifting to achieve their targets. However, of interest is that F1 is working with all the large oil companies to develop a 100% sustainable fuel, which will be used in all F1 cars from 2026. The fuel will be carbon neutral, meaning the carbon used to produce that fuel will offset the carbon emitted from the engine. While still in production by the oil companies, it is likely the sustainable fuels (synthetic or biofuel) will use non-food biomass and household waste so as not to compete with first generation food sources (e.g. it will use potato peels not potatoes). Where this is interesting, is this fuel can be used in road cars now, without modification, helping to decarbonise transport which is responsible for 15% of global emissions (~12% in car emissions).

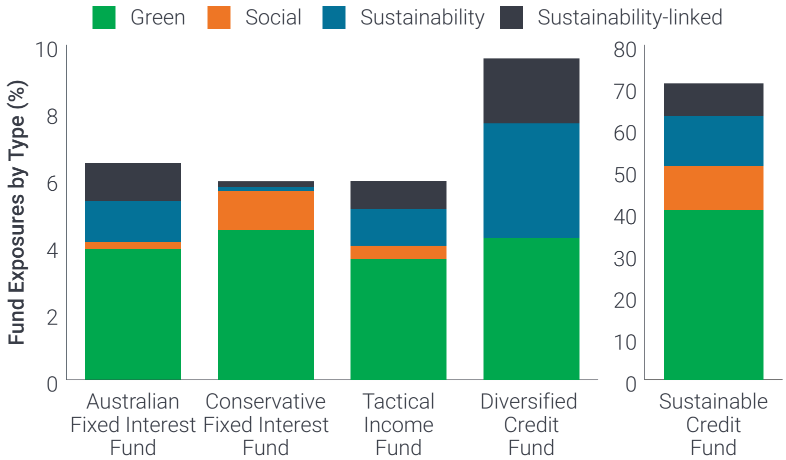
This is a move in the right direction for F1 cars, but it is too soon to call it the answer to reducing global car emissions. Where supply and cost may not be an issue for F1, they are for the rest of us. While the sustainable fuel used in F1 cars has a rule around not being able to be derived from food sources, the majority of biofuels are produced from food-grade feedstocks such as corn, sugarcane, palm oil, sunflower oil, and soybean oil. They are therefore in direct competition for land and water with food crops required to feed our growing population, potentially resulting in food shortages and price increases. The supply is unlikely to ever be available for widespread use globally in cars (unless carbon extraction from the atmosphere is ramped up as an alternative to biomass). In addition, the cost to produce sustainable fuels are significantly more than petrol making it untenable for widespread use.

We support the efforts of F1 to reduce their own carbon footprint and making it more guilt-free to attend their events. As an investor, these developments are relevant to us given airlines, airports and the auto industry all fall into our investment universe, and this offers hope for an acceleration in the decarbonisation of these industries. While sustainable fuels may never be the complete answer to reducing motor car emissions, the increased awareness, technology research and development can only be seen as a positive.

Conclusion

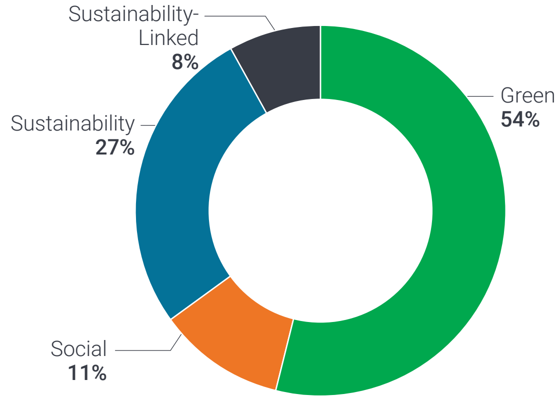
Contradicting the strong start in issuance levels in 2024 for the green, social, sustainable and sustainability-linked (GSSS) labelled bond market, S&P released their sustainable bond issuance report in February forecasting only a modest rise in issuance this year. S&P noted increased adoption of sustainable taxonomies, growth in bond issuance from emerging markets and a focus on accelerating the energy transition as favourable contributors to growth. However, higher interest rates and possibly an economic slowdown in Asia and Europe will be headwinds. The result will be a rise in GSSS bonds in line with the rest of the bond market. Unsurprisingly, they predicted that green bonds would continue their dominance in GSSS bond markets and suggested increased share from middle- and low-income countries with large funding needs. Transition bonds are also predicted to have their strongest year on record in 2024.

Fund exposures – Labelled securities



Total labelled exposures

$1.375bn consolidated across all funds and mandates



Source: Janus Henderson Investors, Bloomberg as at 31 March 2024. Note: References made to individual securities should not constitute or form part of any offer or solicitation to issue, sell, subscribe or purchase the security. Portfolio exposures are subject to change with notice. The Australian Fixed Interest, Conservative Fixed Interest, Tactical Income, and Diversified Credit Funds do not have sustainable investment objectives, nor will they be marketed as sustainability-related products. The Manager incorporates environmental, social and governance ("ESG") information or insights but it is not bound by these considerations.

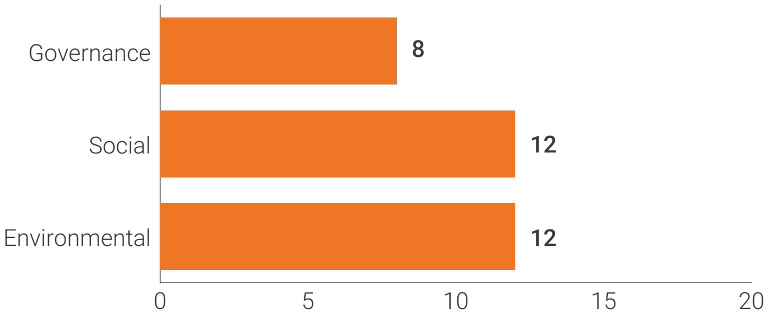
Labelled bond portfolio holdings mapped to UN Sustainable Development Goals

			1 No poverty	2 Zero hunger	3 Good health and well-being	4 Quality education	5 Gender equality	6 Clean water and sanitation	7 Affordable and clean energy	8 Decent work and economic growth	9 Industry, innovation and infrastructure	10 Reduced inequalities	11 Sustainable cities and communities	12 Responsible consumption and production	13 Climate action	14 Life below water	15 Life on land
Government	Canada Pension Plan	Green							■						■		
Government	NHFIC	Social	■									■	■				
Government	NSW Government	Sustainability	■		■	■		■	■	■	■		■				
Government	QLD Government	Green						■	■		■				■		
Government	VIC Government	Sustainability			■	■		■	■	■	■		■	■	■		■
SSA	African Dev Bank	Social	■	■	■	■	■	■	■	■	■	■			■		
SSA	Asian Dev Bank	Social					■										
SSA	EIB	Green							■								
SSA	KFW	Green							■				■		■		
SSA	Kommunalbanken	Green	■			■	■		■		■		■	■			
Credit	ANZ (Tier 2)	Sustainability			■	■		■		■		■	■				
Credit	Brighte (Solar ABS)	Green							■		■						■
Credit	CBA	Green			■			■	■		■		■	■			
Credit	Investa Property	Green							■		■		■				
Credit	ICPF Finance	Green											■		■		
Credit	Lend Lease	Green						■	■	■	■		■	■	■		
Credit	Macquarie Uni	Sustainability			■	■			■	■	■	■	■	■		■	■
Credit	NAB	Green/Social		■					■		■		■	■			■
Credit	NBN Co	Green							■	■	■			■			
Credit	OCBC	Green			■				■	■	■				■		
Credit	QIC Retail	Green							■		■		■				
Credit	Transpower New Zealand	Green							■		■				■		■
Credit	University of Melbourne	Green			■	■			■	■	■	■	■				
Credit	University of Tasmania	Green							■				■		■		
Credit	Wesfarmers	Sustainability	■		■		■		■					■			
Credit	Westpac	Green						■	■		■		■	■			■
Credit	Woolworths	Sustainability		■	■		■			■	■	■	■	■	■	■	■

Source: Janus Henderson Investors, various recent company annual reports and framework reports. As at 31 March 2024.
Note: SDG 16 (Peace, Justice and Strong Institutions) and 17 (Partnerships for the Goals) not covered by these securities.

19 engagement meetings in the past 12 months

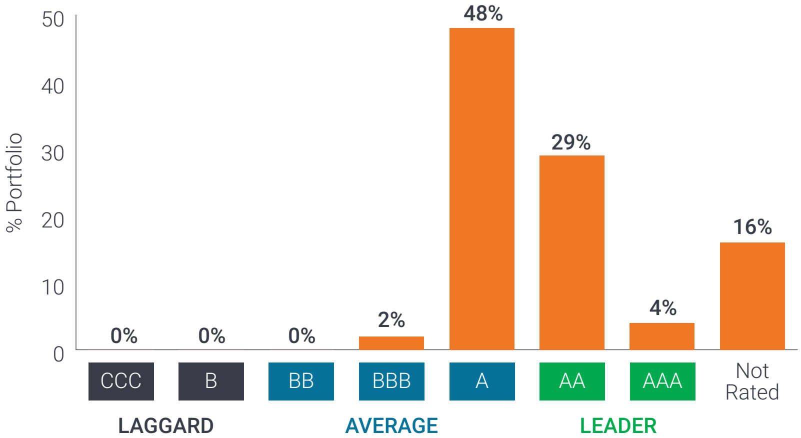
Engagement breakdown



These are companies that the Australian Fixed Interest team has met with over the last 12 months to 31 March 2024 (a rolling 12 month period). It includes group calls and 1-1 meetings with management at corporates and market update calls from banks. It counts all engagements including multiple meetings with the same company.

MSCI – ESG Risk Rating Summary for Janus Henderson Australian Fixed Interest Fund

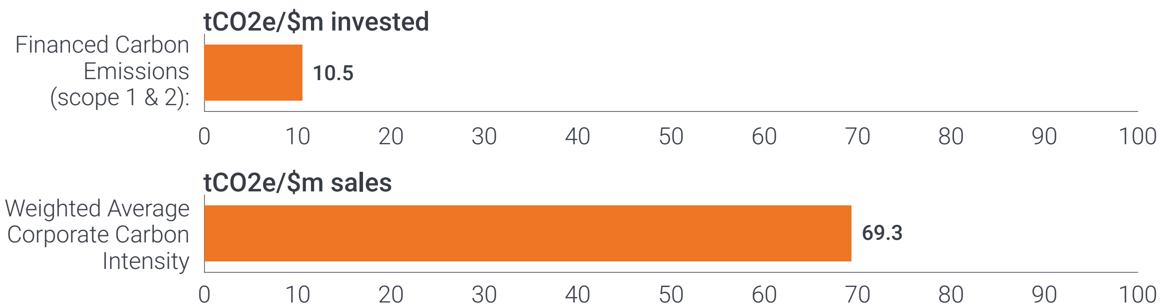
ESG ratings distribution



- The ESG Risk Rating measures the degree to which a company's economic value is at risk driven by ESG factors, as assessed through MSCI's calculation of the company's unmanaged ESG risks.

Source: Janus Henderson Investors, MSCI as at 31 March 2024. The Australian Fixed Interest Fund does not pursue a sustainable investment strategy or have a sustainable investment objective or otherwise take ESG factors into account in a binding manner.

MSCI – Corporate Carbon Intensity Overview for Janus Henderson Australian Fixed Interest Fund



Source: Janus Henderson Investors, MSCI as at 31 March 2024. As of 31 March 2024, the coverage ratio was 43%. This data excludes sovereign debt. Part of this publication may contain MSCI proprietary information that may not be reproduced, used, disseminated, modified nor published in any manner without the express written consent of MSCI. Nothing contained in this publication shall be construed as to make representation or warranty, express or implied, regarding the advisability to invest in or include companies in investable universes and/or portfolios. The information is provided "as is" and, therefore MSCI assumes no responsibility for errors or omissions. MSCI cannot be held liable for damage arising from the use of this publication or information contained herein in any manner whatsoever. Past performance is not a guide to future performance.

Our Australian Fixed Interest ESG investment team

The Janus Henderson Australian Fixed Interest team's ESG capabilities are managed by a subset of the wider team, with strong credit analysis, issuer engagement and fixed interest ESG assessment experience.

Jay Sivapalan
Head of Australian Fixed Interest
Responsible for ESG and positive investments oversight.

Shan Kwee
Portfolio Manager – Credit
Responsible for ESG and positive investments portfolio management.

Liz Harrison
Fixed Interest Strategist – ESG
Responsible for ESG process and company engagement.

Artee Khiatani
Credit Analyst – ESG
Responsible for company engagement and positive investments.

Dinesh Kuhadas
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Janus Henderson INVESTORS

The views expressed in this report are those of the Janus Henderson Australian Fixed Interest team. All figures are in Australian dollars, unless otherwise stated.

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