

Our ESG Philosophy

At Merlon, we believe deep consideration of governance, social as well as environmental issues – coupled with active ownership – enhances investment, business and community outcomes.

BELIEFS ALIGNED WITH OUR INVESTMENT PHILOSOPHY



A Long-Term Perspective

- Practices counter to the spirit of the law are unsustainable
- Practices which knowingly target vulnerable groups are unsustainable
- Practices which do not take reasonable steps to reduce significant harm are unsustainable



Independent Thinking

- Investment scenarios that capture ESG issues, such as climate
- Personal and societal values can shape research insights
- ESG considerations require dedicated and specialist capability



A Culture of Ownership

- Our success requires strong management of ESG issues
- Long term alignment supports strong ESG outcomes
- We actively engage with companies and other stakeholders

We believe ESG issues are a key investment value driver and it is our fiduciary duty to consider material ESG issues, as we would any other material investment issue, in our investment decisions to ensure we meet the best interests of investors. We focus on assessing the sustainability of a company's free cash flow because we believe that is the basis on which companies should be valued.

We believe that ESG issues play a key role in determining the sustainability of a company's free cash flow and we assess each investment opportunity with ESG issues in mind. We incorporate ESG considerations in our:

- qualitative analysis which forms the backdrop to assess sustainable cash flow that drives our central case valuation,
- valuation range, which incorporates upside and downside cash flow scenarios, and
- conviction score, which measures how our views differ from popular opinion by referencing the valuation range and other evidence.

Typically, companies that have greater exposure to ESG issues will have a wider range of valuation outcomes and thus a lower conviction score. We only invest in companies if the share price adequately compensates for ESG and other investment risks and opportunities.

Finally, we strongly believe we should operate our own business in the same manner we expect of our portfolio companies. We are signatories to the UN Principles for Responsible Investing (PRI), and are working towards Paris Agreement alignment, as well as TFCF Principles reporting compliance.

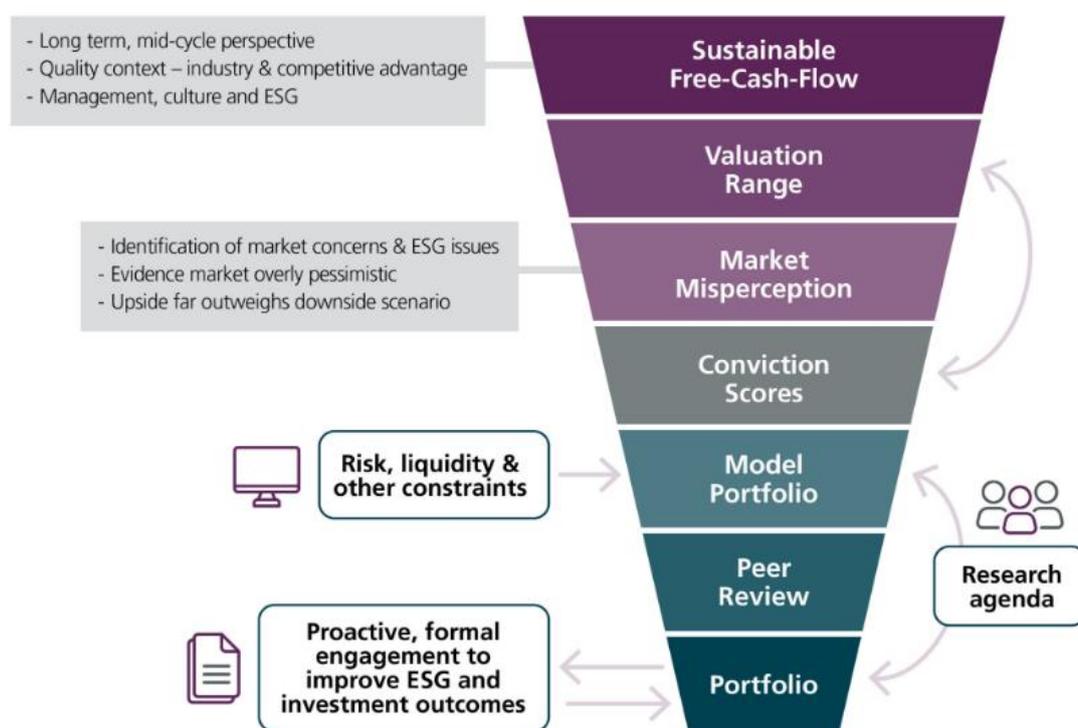
We explore our ESG Philosophy more fully [here](#).

Our approach to ESG Integration

Our process aims to ensure we invest in a manner consistent with our philosophy. Therefore, to be a good investment we need understand the key investment issues, which include key ESG issues, and demonstrate these are already discounted in valuation scenarios. As such, Merlon has a deep approach to ESG integration. This includes:

- dedicated sections of our qualitative scorecard for ESG issues,
- heightened emphasis on ESG issues in our assessment of sustainable free cash flow,
- assessment of market sentiment including being too optimistic or too pessimistic about the potential impact of ESG issues on expected future cash flows, and
- valuation scenarios that cater for a range of sensible scenarios in relation to ESG issues.

PROCESS DRIVEN BY DEEP FUNDAMENTAL RESEARCH



Highly material ESG issues become key investment issues, which are reflected in valuation scenarios and conviction scores. Valuation scenarios and conviction scores in turn drive portfolio weights. Consistent with our investment approach, we regularly re-review the investment thesis, key issues and key ESG issues of all companies in our portfolio. This task is led by the responsible investment analyst and supported by the ESG and Sustainability Manager.

A more full discussion of our integration approach, along with examples, is available [here](#).

We focus on what is material

Merlon acknowledges that not all ESG issues will be relevant to all investments. As such, for each of our investee companies, Merlon considers what issues matter most according to a variety of sources:

- the Sustainability Accounting Standard Board’s Materiality Map for different sectors and industries,
- third party ESG rating agencies and data providers, including MSCI and Sustainalytics,
- company annual and sustainability reports,
- our own internal research, including proprietary surveys, and,
- other market participants, including other fund managers, proxy advisors, and brokers.

We believe an issues-based approach is more effective than a systematic scorecard-based approach as it allows us to focus our resources on a deeper and more comprehensive assessment of material ESG risks and opportunities. The table below lists some of the ESG issues that we have previously considered in our investment process, it is by no means exhaustive, and we are always learning as new issues come to light.

ESG issues considered in our process

Environmental	Social	Governance
<ul style="list-style-type: none"> • Climate change • Fossil fuel supply and demand • Energy transition risk • Remediation • Biodiversity • Product life cycle • Circularity • Energy use • Waste management • Water management • Air quality • Offset use policy • Electric vehicle adoption • Reserve life • Decarbonisation scenario analysis 	<ul style="list-style-type: none"> • Modern slavery and human rights • Human capital management • Health and safety • Employee turnover and engagement • Cybersecurity • Social licence • Supply chain visibility • Problem gaming • Problem drinking • Problem tobacco use 	<ul style="list-style-type: none"> • Board composition and structure • Board skills and competency • Capital allocation • Risk management • Shareholder alignment • Remuneration • Culture and diversity • Business ethics • Government relations • Related party transactions

Common ESG issues emerging in our research

Climate change risks and opportunities

Merlon subscribes to the scientific consensus that carbon dioxide in the atmosphere, predominantly due to human activity, has led to global warming with consequent changes in our climate. Merlon believes that uncertainty surrounding both the physical changes in our climate as well as the policy response around the transition to a low carbon economy can pose a risk to our investments across all industries to varying degrees. Equally, there will be companies that benefit from such a transition. As such, Merlon considers the physical and transition risks and opportunities of climate change as part of our fundamental analysis.

Physical risks can involve the increased frequency and severity of extreme weather events such as drought, flooding, cyclones, heat waves and rising sea levels. Transition risks include the risk of regulation around carbon emissions such as the introduction of a carbon tax, both within Australia and globally, which may affect demand for exports, foster the development of new technologies which are aligned with a low carbon world, change company profitability, as well as change consumer preferences for low emissions or energy efficient products.

Investment opportunities arise out of companies that develop technologies or solutions to deal with the physical aspects of climate change as well as those companies that are better prepared and less exposed to the negative effects of a transition to a low carbon economy. We consider all investee companies through this lens in our analysis.

Merlon is investigating Paris Agreement alignment and TFCDD Principles reporting compliance. We estimate our Scope 1 & 2 carbon emissions to be very low due to the size and nature of our business. Financed / portfolio / downstream Scope 3 emissions will likely be our largest emission source and will vary over time as our portfolio composition changes. We are investigating Scope 1, 2 and 3 calculation methodology currently.

Modern slavery

A key social consideration for Merlon is the treatment of vulnerable groups. Vulnerable groups could include employees, customers and members of the broader community. Merlon recognises that modern slavery, as well as being a serious ethical concern, can also pose a financial risk to businesses from both a reputational perspective and from a disruption to their supply chains.

Companies with staff or sourcing operations offshore appear most affected, however, there are instances of modern slavery within Australia, particularly in high-risk industries such as agriculture, textiles, financial services (through their supply chains), mining, construction, property, food and beverages, and healthcare. When analysing companies in these higher risk industries Merlon will conduct additional due diligence to ensure the company has appropriate policies in place to manage these risks and treats its employees fairly. With companies that have supply chains in high-risk regions overseas we take a similar approach, ensuring that the investee company has awareness of the risks of modern slavery within its supply chains and has policies in place to mitigate these risks.

Diversity

Merlon believes a company, including itself, with diverse gender, backgrounds, experiences, and skills is required to challenge ingrained views and to avoid the downfalls of “groupthink”. We consider the proportion of diverse persons on boards, in senior leadership roles, and throughout the whole business as part of our governance assessment. Through our engagement activity, we also encourage our investee companies to improve the gender balance of their boards & throughout their organisation.

Merlon similarly values candidates and third-party research providers who bring valuable alternative perspectives to the business in order to challenge “groupthink” as it arises in our own business.

Remuneration structure

We acknowledge that there is not a single or standardised approach to remuneration that makes sense for all businesses at all points in time. As a general statement however, we favour a high level of variable compensation for senior management delivered in shares that vest over a longer time frame – five to eight years compared to three years typically. We likewise value transparency centred around specific and objectively measurable targets that align with long-term shareholder value creation assessed over timeframes that are, again, longer than is typically the case. Finally, we recognise that no remuneration approach can cater for all eventualities, remuneration practices need to remain competitive with current Australian market practice and sometimes a level of Board discretion is required.

Again, we attract and retain talent using these remuneration principles at Merlon.

Our approach to Engagement

Merlon takes its engagement activities very seriously. As an owner-managed firm with significant co-investment alongside our clients, the investment team are strongly aligned with clients on engagement matters. Further, all formal communications with portfolio company Boards are subject to approval by the Merlon Board. We have a strong preference for ESG integration paired with active ownership, rather than divestment or exclusion strategies.

Our engagement approach has two clear goals. First, optimise our investment decisions by further enriching our research and learning from the companies we engage with. And second, positively affect the future decisions made by our portfolio companies for better investment and ESG outcomes.

Formal introduction letters

We have established a structured and proactive engagement approach with board and management teams. This includes a formal letter of introduction to the Board of Directors for each portfolio company, which:

- introduces Merlon, our beliefs and open the door for future communication,
- outlines our investment thesis, including valuation range, key assumptions, and key issues,
- provides an overview of our approach to ESG matters,
- summarises the key ESG issues identified in our review, and,
- seeks future constructive engagement with the company.

We believe this initial introduction letter establishes a valuable relationship should we need to engage with in the future on difficult matters (such as capital allocation, remuneration, and the distribution of franking credits). We believe this has the potential to deliver better investment and societal outcomes.

Crafting these letters is a deeply collaborative activity that starts between the responsible investment analyst, and the ESG and Sustainability Manager. The portfolio company's investor relations team are then invited to give feedback, and often do with the input of their senior management. The Merlon Board approves the letter with feedback incorporated prior to the finalised letter is sent to the company Board.

Very occasionally, we will engage with government bodies or Members of Parliament where relevant to our investments. However, we do not engage in any other political activities, donate to political parties or their members, or industry organisation, nor are we members of such organisations or think tanks.

Merlon's dedicated ESG and Sustainability Manager has overall responsibility for driving engagement activities and ensuring a consistent approach, as well as regularly reporting progress to the Merlon Board, the UN PRI, and other key stakeholders.

More details and examples of our engagement approach are available [here](#).

Voting

Voting is a special form of engagement, as it is one of the only times that a Board will directly hear from all shareholders. We believe voting our shares is one of the most important acts of responsible investment. To this end, one of the reasons we do not have a securities lending programme is to ensure we can always vote our shares (noting that some of our institutional mandates have industry standard override clauses).

When deciding how to vote our shares we begin with a detailed review of all relevant information from proxy reports and company reports, as well as reflecting on our prior engagements with Directors. Generally, we are aligned with the recommendations of the Board and proxy advisors (Ownership Matters and ISS), however from time to time our views differ. When we decide to vote against a Board's recommendation, we seek to again engage with them before lodging our vote. This gives the Board the opportunity to provide further information they deem relevant or make commitments to change. These engagements are often informal (emails, phone calls, video conferencing) due to the tight timeframes involved. Due to these tight timeframes and rapid changes, we do not currently publish all our voting intentions in advance. However, we occasionally publish our voting intentions through the media as an escalation and signalling measure.

Merlon's dedicated ESG and Sustainability Manager has overall responsibility for driving voting decisions, tracking voting decisions, engaging with Boards as required, and ensuring a consistent approach across the portfolio, as well as reporting voting decisions to the Merlon Board, the PRI, and other key stakeholders.

We are currently refreshing our Engagement Policy. It will be available on our website as soon as the refresh is completed and approved by our Board. Future versions of this document will include a link to our Engagement Policy.

Responsibility for ESG integration

Merlon recognises the importance of ESG related matters in assessing potential and monitoring existing investments and that the skills required to develop a deep understanding of ESG related issues and coordinate engagement activities is becoming more specialised and resource intensive. As such, we have a dedicated and specialist senior internal ESG resource.

Rebecca Greige is Merlon's dedicated ESG and Sustainability Manager and is responsible for developing our ESG framework, overseeing ongoing engagement, regular client and Board reporting, and policy development. This role is an important enduring part of the team and is backfilled when required. ESG analysis within the investment process is collaborative effort between the investment analyst, and the ESG Manager with input from external ESG research providers.

Managing conflicts of interest related to responsible investment

Conflicts of interest related to responsible investment are managed in the same way as any other conflict of interest at Merlon. Rebecca Greige is responsible for managing our Governance, Risk and Compliance Framework. We will update this document to specifically include conflicts of interests related to responsible investment risks in the future.

ESG & Merlon's conduct as a business

In 2024, the Merlon principals initiated the process to acquire Fidante partner's minority interest in Merlon Capital Partners. This process was completed in July 2024, establishing Merlon as 100% employee owned and fully aligns the business with our investment philosophy, ESG philosophy and our clients. All Merlon employees have equity exposure in the business.

We take ESG very seriously; our ESG beliefs apply not only to our investment approach but also to the way we conduct ourselves as a business. We recognise that business success, including Merlon's,

requires strong management of ESG issues. Fundamentally we believe that ESG is a financial issue not just a series of non-financial metrics.

As noted earlier in this document, we strongly believe we should operate our own business in the same manner we expect of our portfolio companies. Reiterating our earlier comments, we note:

On governance: Following the buy-out of the Fidante partner's minority interest in the business, Merlon Capital Partners established an Independent Advisory Board comprising of 3 independent Advisory Board members and two Executive Directors. A key focus of the Advisory Board ("the Board") is to ensure a high level of alignment between the investment team and the interests of investors over the long-term. Independent Advisory Board members include experts from various fields with a breadth of executive experience across the financial services, retailing, mining, and broader industrial sectors.

Advisory Board members will play a key role in Merlon's investment process and portfolio company engagement. Specifically, Advisory Board approval will be required prior to formally engaging with portfolio company boards and upsizing portfolio positions.

The Merlon Advisory Board was formed and held its first meeting in November 2024. The Board is expected to convene for ten meetings per year, as well as participate in Merlon's Annual Strategy Day.

On climate change: Merlon is investigating Paris Agreement alignment and TFCF Principles reporting compliance. We estimate our Scope 1 & 2 carbon emissions to be very low due to the size and nature of our business. Financed / portfolio / downstream Scope 3 emissions will likely be our largest emission source and will vary over time as our portfolio composition changes. We are investigating Scope 1, 2 and 3 calculation methodology currently.

On diversity: Merlon values candidates and third-party research providers who bring valuable alternative perspectives to the business in order to challenge "groupthink" as it arises in our own business. Merlon has a strong culture and track record of treating employees and prospective employees fairly and equitably. Of our recruits since inception two out of six have been female. With respect to diversity within the Merlon Advisory Board, one out of three members are female.

To further increase diversity of thought, Merlon operates an internship programme aimed at providing opportunity to graduates to work in funds management and experience Merlon's robust investment process. This programme has been in place since 2016 and is a way for us to invest back into the education of future leaders in finance. Since inception, Merlon has hired one of the participants on a permanent basis. We also aim to increase diversity of the team through this programme. To date, 40% of interns have been female, which is over indexed when compared to the number of applicants.

On remuneration: We acknowledge that there is not a single or standardised approach to remuneration that makes sense for all businesses at all points in time. As a general statement however, we favour a high level of variable compensation for senior management with longer performance measurement time frames – five to eight years compared to three years typically. We likewise value transparency centred around specific and objectively measurable targets that align with long-term investor and shareholder value creation assessed over timeframes that are, again, longer than is typically the case. Finally, we recognise that no remuneration approach can cater for all eventualities, remuneration practices need to remain competitive with current Australian market practice and sometimes a level of discretion is required.

It follows that Merlon targets total compensation that is competitive and aligns with market rates. In developing and approving this ESG policy, the Merlon Board has opted for a transparent remuneration framework with a variable bonus pool linked to a set of performance metrics measured over a 7 year time frame that align with investor and shareholder value creation.

Goal	Weight	Lower Threshold	Performance Target	Upper Threshold
1. Rolling 7 year performance vs peers	25%	Median	Top 40%	Top 30%
2. Rolling 7 year performance vs market	25%	0%	1.5% pa	3% pa
3. Rolling 7 year absolute performance	25%	RBA Cash	Cash+ 2%pa	Cash+ 4%pa
4. Rolling 7 year run-rate revenue growth	15%	4%pa (ex-market)	8%pa (ex-market)	12%pa (ex-market)
5. Rolling 7 year team retention	10%	60%	70%	80%

A budget for the bonus pool is approved by the Board prior to the beginning of each financial year as part of Merlon’s annual budgeting process. For periods commencing after 1 July 2023 the budgeted bonus pool will be separated into five components corresponding to the items in the table above. No amounts will be available to employees where the lower performance thresholds are not met; half the budgeted amounts will be awarded if the lower thresholds are achieved with amounts scaling to the budgeted amount if performance targets are met and then scaled to up to two times the budgeted amount if upper thresholds are delivered.

To further enhance long term alignment with investors, commencing 1 July 2023 Merlon employees are required to hold investments in Merlon managed funds equivalent to at least half of bonuses received over preceding rolling 7-year periods.

On board engagement with ESG matters: All formal engagements with company directors require Merlon Board approval. Material modifications to this ESG Policy require Merlon Board approval.

Future updates

Merlon’s ESG Policy Statement is a living document that evolves as our ESG knowledge grows and integration deepens. This is the third version of this document. We aim to review this document every two years, unless a material change triggers a revision prior to this date, with changes subject to Merlon Board approval.