WaveStone ESG Report
Quarter ending March 2025

ESG Quarterly: AGM Season and ESG in Remuneration (REM)

In this quarterly report we take a closer look at executive remuneration covering three key aspects:
(i) the use of ESG metrics within executive Long-Term Incentives (LTIs);
(ii) elevated levels of remuneration strike during the 2024 AGM season, with particular focus on investor concerns relating to executive remuneration of non-Australian domiciled ASX CEOs; and
(iii) a comparative analysis of return or EPS related LTI hurdles, assessing how these hurdles compare against consensus estimates, and what this implies for executive pay outcomes.

WaveStone's overall approach

Assessing executive remuneration is key to both our investment process as well as engagement with boards of portfolio companies as part of our Active Ownership program. It involves assessing whether executive remuneration levels ("REM quantum"), the design of the remuneration hurdles and vesting conditions ("REM structures"), and the transparency in disclosures ("REM disclosures") reflect practices that are in line with good governance standards. Our aim is to ensure that these elements are strategically aligned with the creation of long-term stakeholder value, rather than being driven solely by short-term motives.

As a fundamental bottom up long-term investor, this analysis helps us identify companies whose executive pay practices support Sustainable Competitive Advantage (SCA), good corporate governance, and a commitment to delivering value for shareholders, employees, and other stakeholders over the long term. Through this lens, evaluating remuneration is not just about tick the box during AGMs but about value add to our investment process in gauging whether the incentives are strategically set to deliver long-term value. Our insights from research support our Active Ownership program i.e. engagement with boards, specifically members of the remuneration committee in seeking improvements to REM where necessary.

Analysis coverage

This report presents our analysis of companies within WaveStone's portfolio, with all referenced information reflecting data available as of each company's most recent AGM.

1.1 ESG metrics in Long Term Incentives (LTIs)

Typically, ESG factors such as climate change, safety culture, diversity, are long-term, multi-year journey for companies. Majority ASX-listed companies today have committed to long-term ESG goals or targets with climate change (net zero) being the most common. Against this backdrop, we evaluate the extent to which ESG-related metrics are embedded in the LTI component of executive remuneration frameworks across our portfolio companies.

The short answer is only a minority. While ESG metrics are commonly included in Short-Term Incentive (STI) plans, few companies (less than 25% of WaveStone's portfolio) have incorporated these metrics into their LTI plans.

Below we outline some case examples from our research broken down by category of ESG related metric featuring within LTI component of executive remuneration frameworks:

Climate/Emissions Related Hurdle

Climate related ESG metrics are the most common ESG metric where companies have such within executive LTI programs. Further from our research of companies in WaveStone's portfolio, climate related targets within executive LTIs were found to be most prevalent for companies in the Materials sector. In our view, this perhaps attributes to the following key reasons:

- *Environmental impact*: companies in the materials sector, such as mining, have significant environmental footprints. Incorporating ESG metrics helps address this materiality consideration, also aligning with stakeholder expectations.
- *Evolving regulatory requirements*: regulatory requirements across jurisdictions continue to evolve from project approval requirements, disclosure requirements, litigation risk, regulatory standards etc. Including ESG metrics within executive LTI plans can serve board's oversight role in demonstrably prioritising the agenda for executives.
- *Reputation management*: companies within Materials sector are often closely scrutinised for greenwashing risks and social licence to operate. Long-term ESG goals and incentives can serve to demonstrate alignment with a company's stated sustainability goals/objectives and enhance public trust.

Below are case examples where companies have included climate related objectives within executive LTI plans:

Case example: Northern Star Limited (ASX: NST)

ESG metric weighting	Hurdle description
20%	For FY25 grant: absolute Scope 1 and 2 carbon emissions reductions of 250kt CO2-e between 1 July 2024 and 30 June 2028 (against a 1 July 2021 baseline) for 100% vesting, requiring demonstration of an additional 50kt CO2-e emissions reduction to that required to be achieved by 30 June 2027 under the FY24 LTI

Case example: Sandfire Resources Limited (ASX: SFR)

ESG metric weighting	Hurdle description
10%	on track to achieve a 35% reduction in Scope 1 and Scope 2 emissions by 2035 from 2024 baseline

Case example: Lynas Rare Earths (ASX: LYC)

ESG metric weighting	Hurdle description
10%	Progress against emissions reduction actions in accordance with the following timeline: • Finalise and roll out Scope 1, 2 and 3 methodology and implement across all operations (by end FY25) • Determine GHG emissions baseline for Lynas Malaysia and set site emissions reductions targets (by end FY26) • Achieve planned progress against site specific emissions reductions targets (by end FY27)

Case example: Rio Tinto (ASX: RIO)

20% of CEO's LTI is linked to a decarbonisation scorecard as follows:

Objective	Details
Residual emissions	• actual reduction in Scope 1 and 2 emissions taking into account stated ambition of a 50% reduction by 2030. • The board will take into account the relative contribution of nature-based offsets, with contribution capped at 10% of the reduction.

Project delivery	• successful delivery of abatement projects • working with the Decarbonisation Office in regards a number of priority decarbonisation projects for which investment approval has been granted, or is expected to be granted in the near future. • Performance will be evaluated based on an assessment of project delivery measuring conformance to plan for both spend and schedule.
Technology development	• Progressing towards net zero will require technology advancement and research and development breakthroughs that convert into implemented projects. • This metric assesses Group spend committed to research and development and the successful implementation of projects that have a meaningful impact on the abatement of emissions (including spend associated with reducing Scope 3 emissions).
Transition strategy	transition strategy outcomes that are significant to the company: • Pacific Operations (PacOps) decarbonisation; aluminium and copper recycling and ELYSISTM implementation. For the 2025-2027 • scorecard, PacOps decarbonisation and aluminium recycling will be retained, alongside a new initiative, lithium growth replacing ELYSISTM implementation.

Source: Most recent company annual reports

Customer Experience Related Hurdle

This metric is common for companies in the Financials sector and commonly within STIs. *Insurance Australia Group (ASX: IAG)* includes customer experience as an ESG metric within their executive LTI plan.

IAG updated its remuneration framework in FY24 to include Customer Experience as a non-financial hurdle within its executive LTI plan. One third of the CEOs LTI is now linked to Customer experience metric as measured by transactional Net Promoter Score (tNPS).

tNPS provides a measure of customer experience across IAG's key brands (NRMA Insurance, SGIO, SGIC, RACV, CGU (excluding partners), WFI, AMI and State) that correlates to complaints, attrition and gross written premium (GWP). tNPS is measured by an independent external company and is determined by a question that asks customers their "Likelihood to Recommend" following an assisted or digital interaction with one of IAG's brands.

Sustainability Targets as a downward modifier

Case example: Goodman Group (ASX: GMG)

GMG has sustainability targets as a downward modifier within executive LTI plan. 75% of the executive LTI grant is linked to Operating EPS hurdle. The company notes that vesting outcomes pursuant to this hurdle may be reduced by up to 20% if the Sustainability Condition is not met, below being their sustainability targets:

1. Carbon emissions from operations	Calculate and offset carbon emissions from Goodman's direct global operations excluding customer emissions and embodied emissions.
2. Emission reduction targets	In addition to continued commitments to renewable energy and carbon emissions, the Group commits to Scope 1 & 2 greenhouse gas emissions reductions of 42% by 2030 in line with the 1.5°C Paris agreement pathway
3. Renewable energy	Target 100% renewable electricity use (including use of renewable energy certificates and other market-based mechanisms) within Goodman's direct operations based on the current business strategy and subject to availability and government regulation.
4. TCFD	Maintain public climate risk disclosures updated annually
5. Occupancy	>95% to demonstrate utilisation of sites and therefore appropriate use of resources.
6. Embodied carbon	Measuring and including embodied carbon in new development approvals by the GIC. Where possible reducing and where appropriate, offsetting those emissions.

Source: Most recent company annual reports

WaveStone's View

We are by no means prescriptive in what we look for in REM structures. In our view, the inclusion of ESG metrics in REM should be nuanced, tailored to suit the positioning and desired strategic outcomes of the company in question. We believe best practice should be the provision of targets that are quantifiable, externally verifiable, transparent and sufficiently challenging so as to encourage a greater push for ESG integration as opposed to allowing a simple uplift in executive pay or any tick the box exercise. What is most suitable is likely to, and should, evolve over time to reflect the changing operating landscape. Much like the design of more traditional financial remuneration metrics, the ESG metrics applied should be tailored to align to desired stakeholder outcomes. At WaveStone, we strongly believe in Active Ownership and in 2025 will continue to engage with our investee companies for better governance, disclosure and alignment of executive remuneration.

1.2 REM strikes remain elevated 2024 AGM season

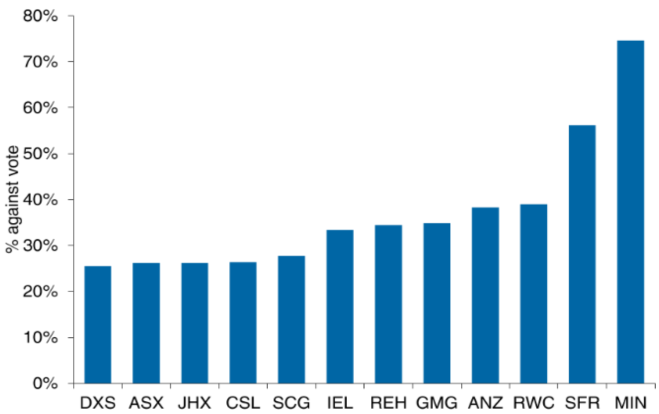
As can be seen in the table below, the 2024 AGM season continued to witness elevated levels of REM strikes against ASX remuneration reports.

Figure 1: S&P/ASX300 company remuneration reports - strikes (>25% votes against)

Source: CGI Glass Lewis, company AGM results, compiled by Jarden

ASX100 alone accounted for 12 REM strikes as shown in table below. Further, there were 3 companies in the ASX100 that technically didn't record a strike but could be considered near misses – IGO Limited (ASX:IGO), Worley Limited (ASX: WOR) and Xero Limited (ASX: XRO).

Figure 2 - ASX100 companies that received a strike in CY24



Source: Company data, Macquarie Research, December 2024

Based on Macquarie Research coverage

REM Strikes and Foreign CEOs

Notably, a quarter of REM strikes within the ASX100 during the most recent AGM season occurred at companies led by non-Australian domiciled CEOs. In light of this, we delve deeper into executive remuneration concerns raised by proxy advisors at these ASX-listed companies, examining their unconventional REM in the ASX context, as well as the outcomes of their REM related AGM resolutions.

ASX Company	Company CEO	Location of where CEO based	2024 AGM REM proposal Voting Outcome	
Xero Limited (ASX: XRO)	Sukhinder Singh Cassidy	USA	Close miss	Approx. 22% against REM report
CSL Limited (ASX: CSL)	Paul McKenzie	USA	REM Strike	Approx. 26% against REM report and 23% against CEO equity grant
James Hardie (ASX: JHX)	Aaron Erter	USA	REM Strike	Approx. 26% votes against REM report
Reliance Worldwide Corporation (ASX: RWC)	Heath Sharpe	USA	REM Strike	Approx. 39% against REM report and 37% CEO equity grant

Source: WaveStone's company research referencing AGM Results and ASX announcements

For the aforementioned companies, their core operations, revenue streams, and key talent are substantially tied to the US market, which significantly influences their approach to executive remuneration. Unlike their ASX peers, these companies often adopt compensation structures tailored to the competitive dynamics, pay and disclosure standards of the US market. This includes the prevalence of higher base and variable pay to attract and retain top-tier global talent and aligned to US-style incentives.

For instance, RWC notes below context in their 2024 Annual Report:

RWC's executive remuneration structure is *"referenced primarily against a USA peer group to recognise that:*

- *International expansion has resulted in RWC's operating activities being less Australian based;*
- *The majority of senior executives are US based with 75% of senior executive roles based there; and*
- *The Group currently generates around 70% of external revenue from its Americas business in addition to having major manufacturing and distribution facilities in North America. Approximately 12% of external revenue was generated in the APAC region in FY2024"*

Upon closer review of the remuneration reports and voting outcomes for the abovementioned companies, some recurring themes emerge as key concerns highlighted by proxy advisors (as may be considered influencing investor voting). These concerns include, but are not limited to, the following:

- **High quantum of executive pay:** The quantum of executive remuneration remains a significant point of contention.
- **Variable remuneration without performance hurdles:** For example, 40% of the XRO CEO's equity grant and 25% of the RWC CEO's equity grant are tied solely to continued service, rather than being subject to performance conditions.
- **Inadequate disclosure of performance hurdles and vesting schedules:** XRO, for instance, does not disclose vesting schedules for its LTI hurdles related to Relative Total Shareholder Return (RTSR), Free Cash Flow (FCF), and Operating Revenue Growth.
- **Use of the fair value approach in LTI calculations:** Both JHX and RWC adopt the fair value approach for determining LTI grants.
- **Absence of Short-Term Incentive (STI) deferral mechanisms:** lack of deferral (especially combined with excessive pay concerns) has been highlighted to undermine the alignment of incentives with long-term value creation.
- **Overemphasis on non-financial hurdles:** where there is significant weighting towards non-financial metrics, which are often perceived as part of the CEO's routine responsibilities. Additionally, these metrics frequently suffer from inadequate transparency regarding their specifics and vesting conditions.

The table below aims to summarise these common concerns flagged by proxy advisors during the recent AGMs of the four companies. We hope this analysis offers meaningful insights to our clients, as well in evaluating balance approach for such companies in delivering long-term value creation via talent attraction and retention within an international context.

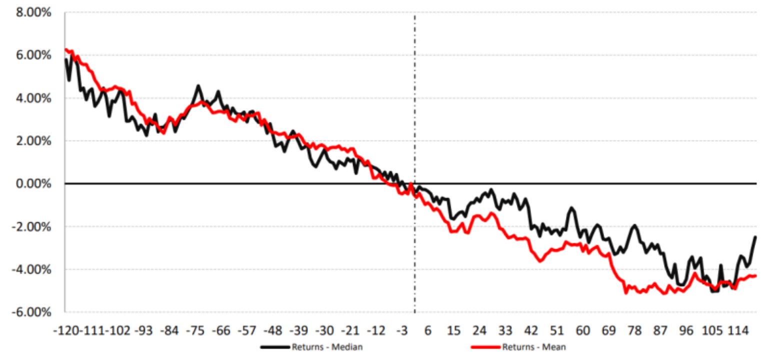
	JHX	CSL	RWC	XRO
Common concerns raised by Proxy Advisors at 2024 AGM				
High Quantum	Yes	Yes	Yes	Yes
Inadequate disclosure relating to hurdles/vesting conditions	Yes		Yes	Yes
No STI Deferral	Yes	Yes	Yes	
Components of variable pay not linked to any performance hurdles i.e. only continuity of service condition			Yes	Yes
Significant weighting (>25% within STI or LTI plan) to non financial hurdles where those hurdles are perceived as CEO's day job		Yes	Yes	Yes

Source: proxy advisor recent AGM reports

Does underperformance lead to a strike?

Macquarie's ESG team investigated 10 years of data on strikes with their analysis showing companies with strikes have on average underperformed the market before the event on average by ~6.2% relative to the ASX200 Index. Strikes likely point to broader issues confronting a company, which take time for resolution. For example, is the company rewarding executives for poor performance? Is there a perception that there is a misalignment between incentive structures and performance outcomes?

Figure 13 - Strikers often see underperformance leading into the AGM



Source: Macquarie Quant, December 2024

Carbon Emission and Intensity Tracker:

WaveStone – Australian Share Fund (WASF)	Carbon Emissions		
	Portfolio	**Benchmark**	**Difference**
Carbon Emissions Scope 1+2 (tonnes CO2e/USD M invested)	68.3	115.7	-41.0%
Carbon Intensity Scope 1+2 (tonnes CO2e/USD sales)	91.1	150.8	-39.6%

Source: MSCI ESG (as at 31/03/2025)
Benchmark is the S&P ASX 300 Accumulation Index

Engagement

ESG-related Engagements during the Quarter

Company	ESG Category	Topics
XRO	Governance	Executive remuneration
JHX	Governance	Capital allocation, remuneration, succession planning, board composition
RIO	Environment Governance	Climate Transition Action Plan
WDS	Environment Governance	Climate governance, strategy and disclosure
STO	Environment Governance	Climate transition action plan, executive remuneration, board composition and succession planning
WTC	Governance	Board renewal & CEO succession
TCL	Governance	Management and prioritisation of shareholder interests and social licence.
CAR	Governance	CEO taking on non-executive directorship role at another major ASX listed board, capital allocation, Chinese EVs
ALL	Governance	CEO succession, remuneration and regulation
CWY	Social Governance	Hurdles to the implementation of FOGO - timeline and council economics. Batteries and flammables in the waste stream - risks and economic impacts. Driver fatality.

Memberships and initiatives

- Principles of Responsible Investment (PRI)
- Climate Action 100+
- 40:40 Vision

Links to WaveStone Policies

- ESG Policy: **WaveStone ESG Policy**
- ESG Activity Report: **WaveStone ESG Activity Reports**
- Proxy Voting Policy: **WaveStone Proxy Voting Policy**
- Proxy Voting Records: **WaveStone Proxy Voting Records**
- Engagement Policy: **WaveStone Engagement Policy**
- **WaveStone PRI Assessment Report 2023**

Want more information?

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