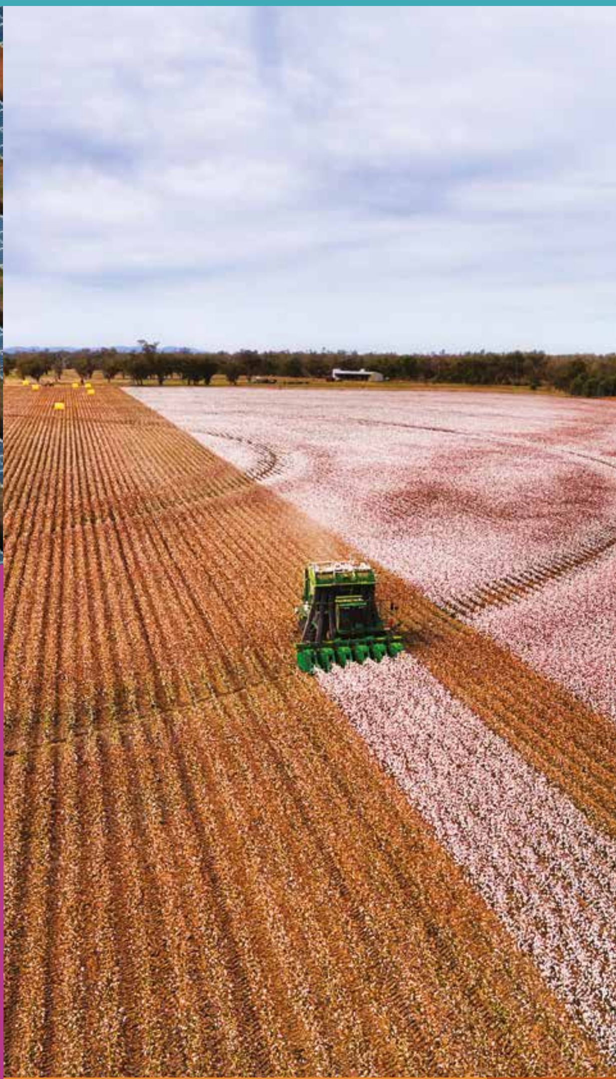
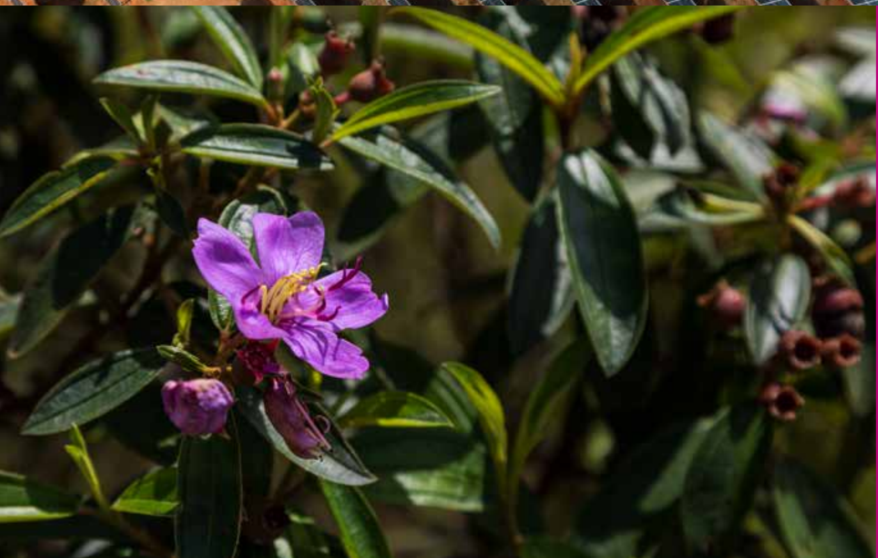
Q&A Interview

David Shelton, Global Head of Investments on taking New Forests' capability global





David Shelton, Global Head of Investments

Q What was the strategic reason that drove New Forests to launch this global natural capital strategy now?

A Historically, we've offered regional strategies across Australia, New Zealand, the United States, Asia and Africa. Our clients have typically been large global institutional and pension funds who have the inhouse capability to make their own global allocations to the regions they would like exposure to.

But there's a large pool of capital amongst those that don't necessarily have dedicated teams to assess the fundamentals of the regions and geographies. In these instances, it's easier for these investors to allocate into a global fund where we make the allocation decisions based on our knowledge to where the underlying investments should go, and how to create an optimal portfolio.

Q Who is the target audience for this new global strategy?

A The target audience is institutional investors including pension funds, insurance companies, family offices and endowments or foundations that are interested in an exposure to natural capital, but don't necessarily have the capability to make a regional or geographic judgement decision themselves.

Q What will the portfolio construction look like? What will be the split between developed and emerging markets?

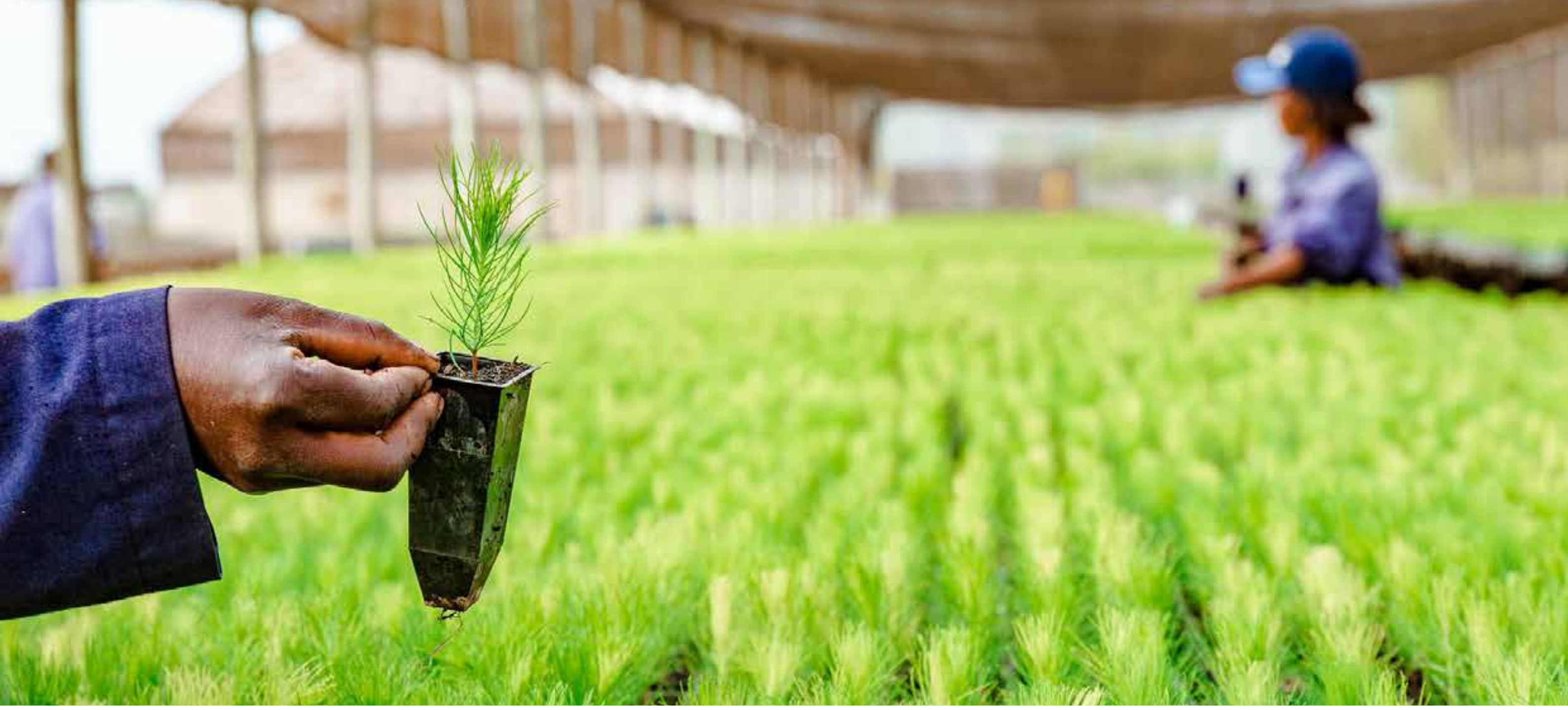
A The strategy will have global exposure, with a majority allocation to mature and developed markets:

- United States, Canada, Europe, UK, Australia, and New Zealand – 60% to 80%
- Developed Latin America (Brazil, Uruguay and Chile) – up to 30%
- With a smaller allocation to emerging markets: Southeast Asia, Other Latin America and Africa – up to 20%

Q New Forests has been doing this for a long time, but how would you define natural capital within this strategy?

A Natural capital can cover everything from conventional forestry and agriculture, to carbon, wind, solar developments, biodiversity credits, and emerging ecosystem markets. For investors, they are starting to define what they include as natural capital, which is typically forestry, agriculture, carbon, biodiversity and nature – and how they define the potential asset pool.

The key for investors is the balance between conventional assets that rely on natural processes and provide core returns, and evolving markets like carbon credits, that rely on regulatory and market interventions and provide upside to the core returns.



Q Where would natural capital likely sit as part of investors' allocation?

A From an asset allocation perspective, we're seeing investors allocate to this area as part of alternatives, such as infrastructure, or as real estate. The most sophisticated investors are starting to define what natural capital is to them, what their risk return profile expectations are, what they include and exclude, and how they will make a dedicated allocation to natural capital. Many investors are also realising what assets they already have, which include an element of natural capital, and also where approaches to natural capital investing can enhance existing assets.

Q Why would New Forests' global natural capital strategy appeal to investors?

A It's appealing on a couple of fronts; firstly, we're offering a compelling return profile for investors – with a proven track record.

Over our 20-year history, we've had multiple funds, multiple exits and delivered compelling returns at or above benchmark for investors. We have a track record, with people on the ground, and have demonstrated an ability to deliver returns and sustainability outcomes to our investors.

Second are the attributes of investing in natural capital assets such as inflation hedging characteristics, low correlation to other asset classes and long dated return profiles with relatively low volatility. Many investors will look at the efficient frontier; incorporating these types of assets shifts that efficient frontier further out, which changes the risk return dynamics at the portfolio level.

And finally, investors are starting to recognise in addition to delivering compelling investment returns, investing in this asset class has a positive impact on the environment. We need to clear up misconceptions that investing in an impactful or environmentally sustainable way, comes at the cost of returns – we've proven this is not the case.

Q Investors have a fiduciary responsibility to look at risks around climate, nature, regulatory. How does this strategy help investors define and manage these risks?

A There are very large areas of existing institutional investment portfolios that have direct or indirect exposures to climate, nature and regulatory risk.

In many countries around the world, we now have compliance-based obligations for climate and biodiversity impact reporting coming for many assets of different scales and sizes. And that's starting to drive behaviours. Once people are having to publicly report their position it will then influence their potential future investments and decision making around those.

Having an exposure to the underlying natural capital assets will help investors at their portfolio level either mitigate the risks from what they're now sharpening their focus on through that reporting, or indeed create opportunities for investments in spaces that they haven't typically been in previously.

Q How will the new global strategy report on impact?

A Reporting on impact is an area where the science and reporting metrics are still evolving, depending on the asset type. Some measures are advanced, such as quantifying and measuring carbon. For example, in most developed countries, there are established market metrics, and schemes for participation in those markets. Measuring impact in areas like biodiversity is somewhat nascent, but markets for biodiversity are still emerging and at varying levels of sophistication. For example, mandatory reporting drives changes as noted earlier, with concepts of no net loss to net gain, or "nature positive" being used in many approaches to reporting.

From our point of view, in terms of the practicalities within our funds, we set a series of metrics that we monitor and report on regularly. Our fund vehicle will also focus on accepted measures, using third party verification and standards, where that is available.

Q The new global strategy has allocations to different markets. What are the different characteristics of these markets?

A **US, Australia, New Zealand** – If we focus on the US where forestry was pioneered, and Australia & New Zealand, these regions are considered low risk, long dated, stable and established timberland markets.

There's capability, track record, growth records, sophisticated management, established and deep downstream markets. From a pure investment point of view, they present attractive elements with conventional and predictable outcomes.

They will always form a core part of any forestry exposure because all the aspects that you would expect from the forestry sector have largely been addressed.

Europe is an interesting one in that it's a very large asset base, but it's often not been considered as widely from an institutional point of view. It's somewhat more difficult to engage with because you either have a small number of large owners controlling large areas of forestry, or and at the other end of the spectrum, a very fragmented small ownership structure.

The opportunity for institutional capital has needed to either displace the large corporates or participate in those very large assets, or pursue something of an aggregation strategy to put together those more fragmented assets. Through time, there have been actors operating across Europe putting together assets of institutional scale through aggregation.

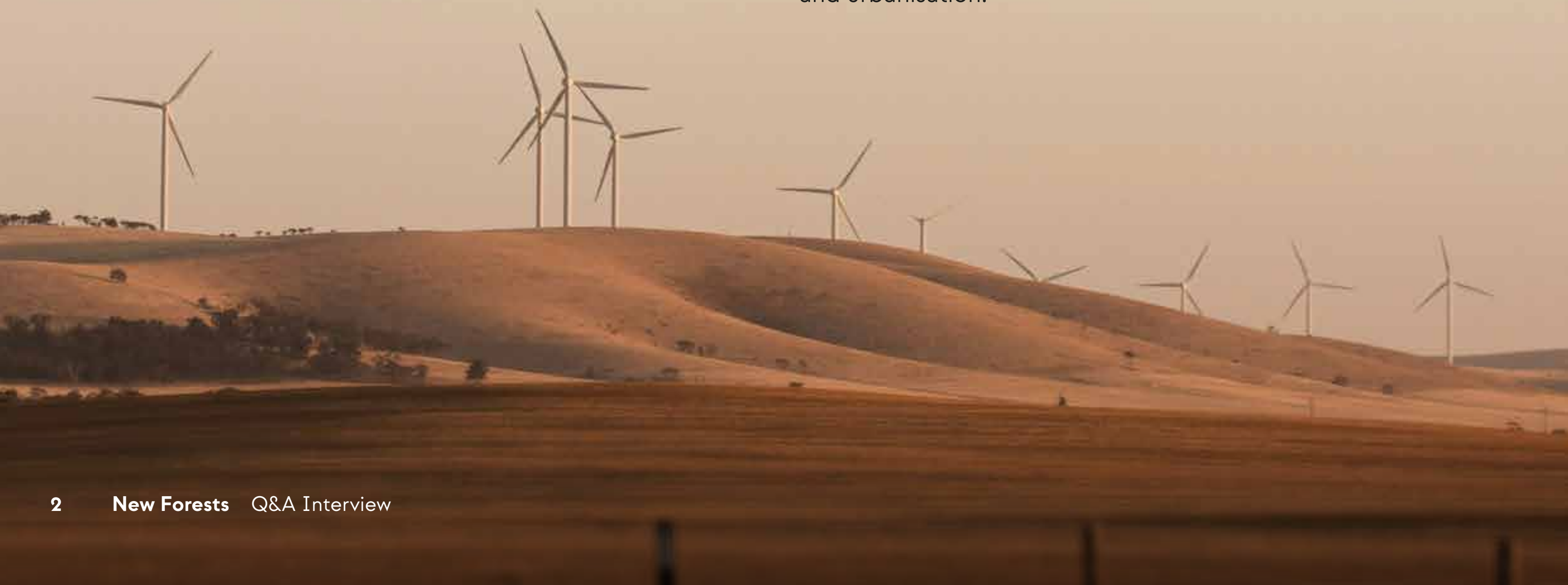
If we think **about Latin America**, it is what we'd consider a more recently established forestry investment destination for institutional capital. The location presents attractive growth rates and domestic processing in the form of an active pulp and paper sector, with export capabilities.

However, there are some challenges from an institutional investment point of view, given what many investors perceive as less well established regulatory environments, compared to those noted above. For example, forestry, land use, and environmental regulations have tended to change more regularly with election cycles, in some target investment countries.

Therefore, investing in Latin America would be slightly further up the risk curve when compared to investing in the US or Australia, New Zealand in terms of an investment destination. But the growth rates and returns tend to offset these challenges.

Southeast Asia and Africa have long histories of forestry, largely from the harvesting of natural tropical hardwoods. Substantial portions of the natural forest timber resources have been depleted, and there is a need for capital investment to establish and expand the sustainable timber plantations and associated wood processing industries.

While these regions have higher investment risk characteristics including the leasing of land from governments, less well-developed infrastructure and less access to proven technical know-how, they also have rising demand for all types of wood products from growing populations, expanding economies and urbanisation.



Q What are your thoughts on valuations? Are these asset classes overvalued?

A Valuation risk is the same in most asset classes, and valuations are sometimes driven by popular trends and or near-term shocks. One of the attractive elements of forestry and agriculture is the valuation tends to take a long-term horizon, because you're dealing with a long-term asset – that is underpinned by stable demand characteristics around the need for food and fibre.

However, there are impacts in the short term, particularly for certain types of assets. For example, if your forestry asset is heavily export exposed, then it will be more exposed to short term shocks in say energy costs. Equally, if your asset is the other end of the spectrum, which is heavily exposed to a particular domestic geography, if that country's economy slows, then forestry will experience some level of slowing as a result, particularly if it's providing building products into a domestic industry.

On the agriculture front, we see this sector being a bit more prone to preference trends, whether that's shifting tastes and demand from say blueberries to avocados. However, a substantial portion of the investment is always in land, which is versatile and can produce many products. Investors need to look through those short-term populist trends to underlying commodity growth. These attributes mean this asset class is relatively subdued in terms of valuation volatility, compared to many other asset classes.

Q How do geopolitical risks impact investment in natural capital?

A We're experiencing a level of instability in the world driven by the back end of COVID disruptions, and then in what feels like a relatively short period of time, moving into a period of very strong geopolitical instability, driven by conflict in various parts of the world. In these scenarios, investors will tend to retreat to conservative postures, retaining cash, investing in fixed income and more defensive assets.

But it's exactly in this environment where investors should also be thinking about the products that we rely on in terms of food, fibre and materials for construction and packaging – these are fundamental needs of the human population. These core global commodities that are needed for sustaining human life globally, will always be a compelling area for investment.

What we tend to see during periods of conflict is that investors who already have exposure to forestry and agriculture—and understand the fundamentals—often increase their exposure because these markets are seen as "safe" asset classes.

Q Natural Capital is gaining momentum and if you look ahead to the next 5 to 10 years, how do you see this evolving as an asset class?

A We often hear managers in this space talk about global investors making a 1% allocation of their portfolio to the asset class. This is similar to how the infrastructure asset class grew about 20–30 years ago.

How you define what that allocation should be is up to individual investor's strategies, risk return profiles. But in my opinion if you haven't got an allocation to natural capital in some capacity, your portfolio is not performing at an optimum level from a risk/return point of view.

Q Can you explain how carbon and biodiversity contribute to returns?

A We don't build future revenues from carbon and biodiversity markets into our base case underwriting. Investors are always comforted by the fact that these assets are driven by the core fundamentals of the exposures that they have, whether that's forestry for pulp, paper, building materials, or agriculture for food production.

While we don't build these upsides into the base case, we certainly analyse and advocate for them, working closely with regulators and coalition groups to proactively deliver these to their maximum effect. This helps to drive a significant portion of the alpha that we deliver in asset performance, which is an area that helps set us apart.

Q How does New Forests align with its investors by making a financial commitment to its own strategies?

A Across New Forests' investment strategies, our focus is on ensuring close alignment between our investors and shareholders.

Q How do you balance your fiduciary responsibility with achieving environmental outcomes?

A Our fiduciary duty is to deliver strong long term returns, and that requires protecting the underlying productivity and resilience of our assets. Environmental factors such as climate risk, soil health, water security and biodiversity are financially material and directly affect performance and value. We therefore integrate them into due diligence, investment decisions and asset management, rather than treating them as trade offs or add ons.

Q What will success look like for this global strategy?

A We are a global investment house. We're not just a forestry investor in Australia. We're very much focused on our financial performance, which is what investors expect from us.

Our aim is to deliver the financial results exceeding the benchmark that we've predicted, and deploying the capital quickly into those asset types. Then, it's about managing those assets and the transition of those assets in a timely fashion. That approach applies to every single investment fund,.

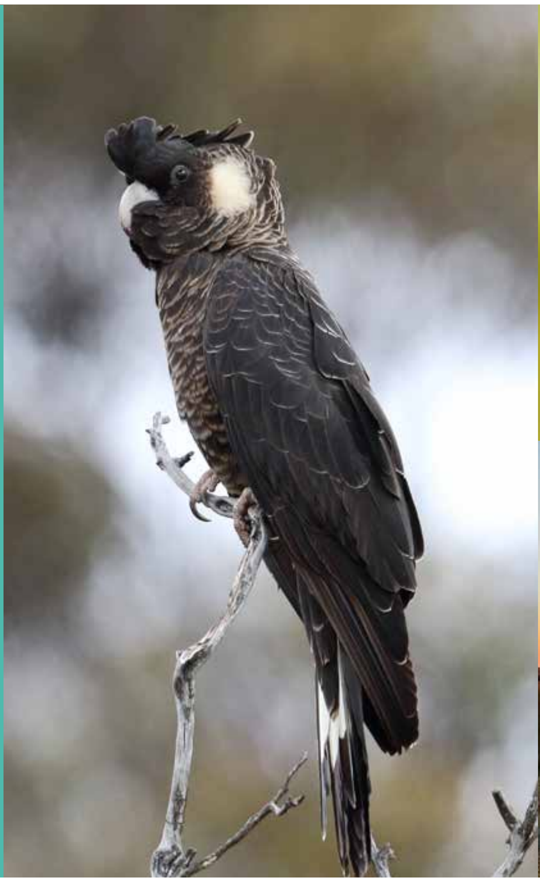
Success also looks like genuinely having an impact on the environmental and social issues that are of concern to the assets that we manage, whether that's climate risk through carbon contributions, food security through agricultural investments, positive partnerships with indigenous and local communities, alpha generated through downstream processing or infrastructure, as part of the overall allocation.

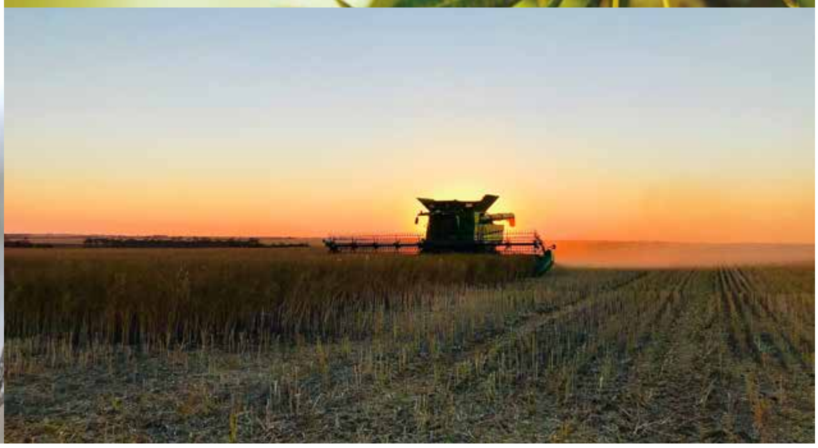
Q You've been in the industry for a long time. Is now the right time for New Forests to scale globally?

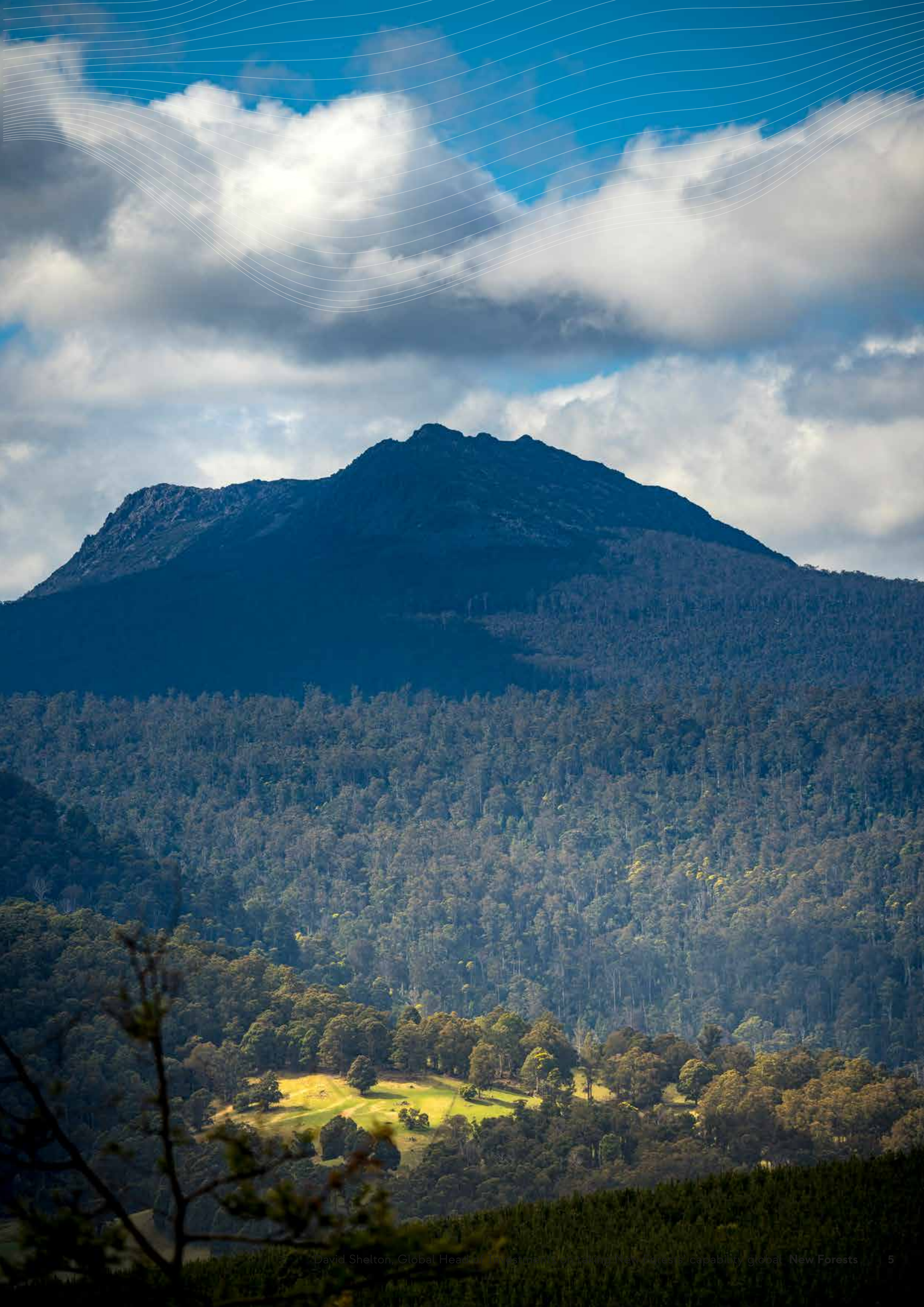
A I'm an environmental scientist by original training, and before joining New Forests 20 years ago, I was an economics researcher at Australia's premier research agency around environmental economics and policy. At the time, I was trying to grapple with how to convince the private sector to allocate capital to improve environmental outcomes.

Whereas today, if you go into any significant investment decision making body in the world, you'll find that consideration of the environmental impacts of the investment decision, will almost always form part of the decision making. There are those that are more sophisticated that aren't simply considering it from an impact and regulatory point of view, but are seeing it as an opportunity, as a point of differentiation, as a point of outperformance – this is where we operate.

There is now a weight of expectation from the general populace that have been feeling the impacts of climate change, feeling the impacts of commodity trade, food security, feeling the impacts of how we live in a society and the impacts we have on the environment. All these factors, combined with the need to deliver investment returns and improved environmental outcomes, means now is the right time to bring long term, institutional capital into such a strategy.







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