

When a supplier doesn't deliver: The sour taste behind melamine in milk

Sustainable Team visits Asian suppliers

Big news recently about the industrial chemical melamine contaminating milk supplies highlights the risks that business can inherit from its suppliers. While product quality has gone spectacularly wrong for milk and children's toys in the past 12 months, the risks run far deeper in the environment and workplace.

AMP Capital Investors Sustainable Funds Team (The Team) members Nick Edgerton and Ian Woods visited China and other Asian countries in May to observe environmental and social issues first hand. China is supplier of choice for many Australian businesses, but it also creates many environmental, social and governance challenges, influencing company value. While in China, Nick and Ian visited several manufacturers, energy providers, and water treatment sites to gain insights about business risks in the supply chain. While visiting workplaces in China, they observed:

- a wide range of working conditions, from the very poor to the very good,
- broad scale absence of safety equipment, safety systems or practices,
- and ongoing and significant environmental impact, especially air and water pollution.

Importantly, for business and investors seeking opportunity from environmental and social trends, Nick and Ian were shown first-hand:

- cases of government support for eco-efficiency, alternative energy and pollution treatment,
- evidence of government and buyer support for better working conditions,
- and indications of strong government enforcement of environmental breaches.

So why does this matter?

As profiled in our Autumn/Winter 2007 newsletter, The Team believe that intangibles make up approximately 75% of the value of companies on the ASX200. These intangibles are the relationships with stakeholders, including customers, employees, the environment, the community, and suppliers.

As supply chains extend throughout the world and become more visible to company stakeholders they increasingly offer risk and opportunity for intangible value. Significant risks exist when supplier working conditions for employees, or environmental or community impacts do not meet the cultural or legal licence to operate in either the supplier or buyer country.

As an example, 22% of 1,800 of the largest global companies say that labour conditions in their suppliers' factories present material risks to their businesses and their shareholders.

In the 1990s, Nike became synonymous with poor working conditions for women and children in the developing world, subsequently losing half of its capitalised value, before turning around its approach.

Recent problems?

Last year, a spectacular case in the children's toy market illustrated what can happen when things go wrong. Mattel suffered losses due to supplier behaviour when it found excessive lead levels in paint used by toy manufacturers in China. Mattel recalled over 20 million products and the financial impacts rapidly became material. Toy recalls, increased testing, lost sales and temporary import restrictions cost more than \$100 million.

Increasing consumer awareness, telecommunications and transport technology, is combining to shorten global supply chains, which can expose companies to supply chain related risk for goods as diverse as African chocolate and Uzbekistan cotton.

Nick and Ian visited China because of its considerable supplier role, and wide ranging risks at play. For example, China has the highest rate of death from work-related illnesses of any country, and the majority of its river sections, lakes and urban groundwater are heavily polluted, while it suffers from considerable air pollution.

What are wise investors looking for?

Business and human rights is a focus in 2008 as the 60th anniversary of the Universal Declaration of Human Rights (UDHR), along with the UN Human Rights Council examination of a company's sphere of influence and complicity in human rights issues, underlining the importance that companies not be implicated in poor business practices through relationships in the supply chain.

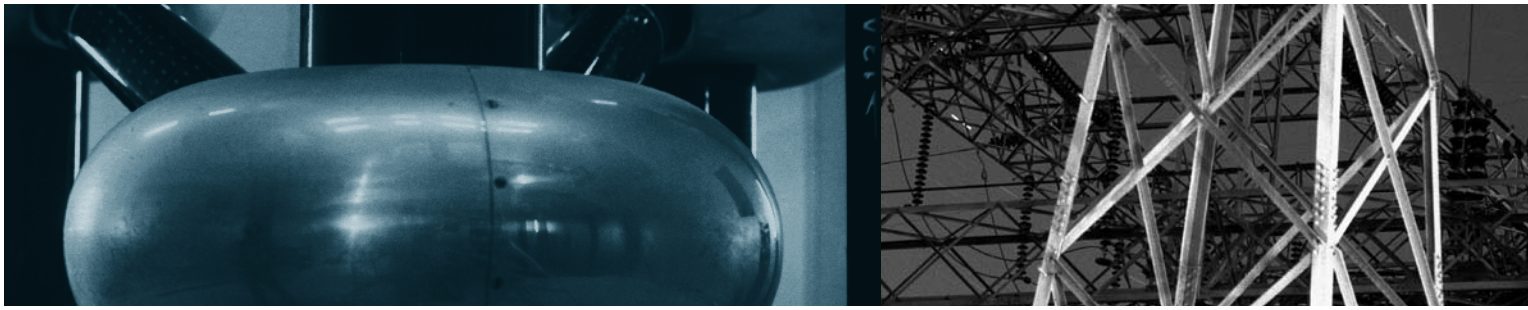
The Team are on the lookout for:

- **Company commitment:** strategy or code and endorsement of relevant principles, e.g. UN Global Compact and/or UDHR to provide a framework. The OECD Guidelines for Multinational Enterprises remains useful for overarching company practices.
- **Collaboration with other buyers or multi-stakeholder alliances:** the Ethical Trading Initiative is just one example of an opportunity for retailers to learn and collaborate with other stakeholders.
- **Closer relationships with suppliers:** in-country teams (direct sourcing rather than operating through agents) allow a company to learn about its supplier's track record, while sharing policies, systems and targets.
- **Transparency and disclosure:** Material, responsive and complete disclosure to stakeholders about risk management.

1 RiskMetrics 2008, cited in Bernstein, A. (2008) Incorporating Labor and Human Rights Risk into Investment Decisions, Harvard Law School, Occasional Paper Series No.2, September 2008

2 International Labour Organization: <http://www.ilo.org>

3 Dr Richard Hardiman, EU Commission, Challenges in Water Resource Management in China, Presentation in JP Morgan's Hands on China series 2008



AMP Capital corporate governance

UNPRI Progress

Karin Halliday, Corporate Governance Manager, AMP Capital Investors, recently participated at the International Corporate Governance Network (ICGN) conference and Conference of United Nations Principles of Responsible Investment (UNPRI) signatories, held in Seoul, Korea. AMP Capital Investors, as a signatory to the UNPRI, attended both meetings and provided an 'Implementation/Challenges Case Study' to UNPRI delegates.

It has been just over two years since the launch of the UNPRI and engagement in the initiative continues to build. Over the past 12 months, the number of signatories to the UNPRI has almost doubled. Approximately 360 institutions now subscribe to the principles, representing in excess of \$14 trillion in assets.

Despite serious upheaval in global credit and financial markets in the past year, interest in environmental, social and governance (ESG) issues, as they pertain to investing, shows no signs of slowing.

The UNPRI and ICGN conferences indicated evidence of increased recognition by asset managers and asset owners that ESG issues are material to company performance and

therefore must be factored into investment analysis and decision-making.

The 2008 UNPRI Progress Report states that:

"For investors, this is not an exercise in philanthropy but rather an effort to maximise long-range investment returns, while also contributing to societal goals.

It is this convergence – between the interests of business and finance, on the one hand, and those of the United Nations, on the other – that marks one of the most important developments of the 21st century. The process of globalisation continues to bind societies and economies closer and closer together. Solving problems as diverse as climate change, water scarcity, poor labour conditions, and corruption – to name just several priorities – must be a collective effort."

In essence, globalisation means that investors can take their money wherever they want. Therefore, the race is on for companies to retain investment. At the ICGN, Geoff Rothschild from the JSE Securities Exchange, South Africa noted that the challenges of environmental sustainability and social responsibility are no longer localised, but go beyond boundaries – in many cases touching on the future of the planet.

As environmental issues become better understood, the challenges they present are becoming increasingly compelling. The focus now is on how the global investment community will respond to these imperatives.

AMP Capital Investors considers responsible stewardship critical to protecting our future. We believe that by adopting high standards of corporate governance and social responsibility (environmental, employment and community relationships), companies can avoid potential damage to their trade and reputation. In this way, companies can enhance and protect the long-term wealth creation prospects of their shareholders.

AMP Capital Investors is pleased to be able to report a significant increase in our communication with Australian companies on environmental, social and governance issues. We agree with a conclusion drawn from the ICGN that increased dialogue will greatly assist the common goal of wealth creation.

The August 2008 AMP Capital Investors Corporate Governance Report, provides more detail on the widening governance agenda and AMP Capital Investors proxy voting report. (<http://www.ampcapital.com.au/institutions/governance.asp>).

profile



Ian Woods,

MEL, MBA, PhD (Chemical Engineering)

Ian has been the Senior Research Analyst of the AMP Capital Investors Sustainable Funds Team (The Team) since its inception in 2000. Through joining the Team, Ian sees the opportunity to make "more of a difference" in improving company performance through encouraging development of wise financial, environmental and social practices.

Ian's prime role is to undertake the environmental, social, workplace and governance research of Australian listed companies and investigate the relationship between sustainability and environmental, social and governance (ESG) issues and financial performance. In his role, Ian has engaged with numerous companies on their ESG performance, prepared a number of "position papers" for the fund and undertaken a number of research studies looking at Australian corporate governance, and climate change related issues. He has also been involved in numerous finance and sustainability initiatives, such as Deputy Chair of the Investor Group on Climate Change.

Ian joined the Team after 10 years in environmental consulting, working with a wide range of companies throughout Asia and Europe as a consultant in order to help make their business more economically, environmentally and socially sustainable. During this time he was involved in some ground breaking analysis into environmental impact assessment, environmental risk assessment, climate change analysis and cleaner production.



stock story

Sunshine Gas Limited

Research and Engagement

Our Sustainable Alpha Process requires an understanding of both sustainability growth drivers at an industry level, and environmental, social and governance risks at the company level. The value proposition of the AMP Capital Investors Sustainable Funds Team (The Team) derives from a fuller understanding of company value through our process which integrates tangible financial analysis with the more intangible extra-financial research. In delivering this value proposition, during the past 6 months the Team has completed industry specific research on the food products (including agriculture), medical devices, and coal seam methane sectors.

The Team has continued its constructive engagement as part of the investment process and as part of our value proposition to investors. Some engagement highlights with companies and industry were on the following topics:

Climate Change: Ian Woods in his role as Deputy Chair, Investor Group on Climate Change, wrote a submission in response to the Australian Government Carbon Pollution Reduction Scheme Green Paper. Ian attended the Department of Climate Change Industry Roundtable in Canberra. Ian presented on climate change and investment at the Australian Super Investment conference. Ian presented on the challenges of ESG integration, and on the social impacts of climate change, at the 6th International Responsible Investment Conference. Nick Edgerton presented on Climate Change and Investment at the Australian Investors Association Conference, and at the Triple Bottom Line Investment Asia Conference.

Sustainability: Ian Woods and Nick Edgerton attended the Triple Bottom Line Investment Asia Conference in Bangkok. Nick attended the Responsible Investment Academy Stakeholder Consultation Forum. Ian, Will Riggall, David Boyle, and Angus Dennis attended the 6th International Responsible Investment Conference in Melbourne. Ian and Nick participated in the 7th National Business Leaders Forum on Sustainable Development at Parliament House in Canberra. Nick participated in the Property Council of Australia 2020 Sustainability Visioning Workshop.

Corporate Responsibility: Nick Edgerton and Ian Woods visited Super Cheap Auto Group in Hangzhou, China, to raise corporate responsibility challenges arising from operating in China. Nick and Ian visited the ILO Better Factories Cambodia program in Phnom Penh. Nick raised supply chain issues with Pacific Brands Group and its signing of the Ethical Trading Initiative. Nick discussed operating in water-stressed regions with Coca-Cola Amatil. Michael Murray raised quality assurance in the supply chain in China with GUD Holdings.

Sustainability Reporting: Nick Edgerton attended the Stockland Corporate Responsibility and Sustainability Report Stakeholder Feedback forum. Ian Woods was a reviewer for and presented at the ACCA Sustainable Reporting awards. Ian provided feedback to Boral on its sustainability report.

Social Capital: Michael Anderson raised human capital management with QBE and Transfield Services. Nick Edgerton discussed OH&S improvements with Healthscope.

The Fund invests in shares in Sunshine Gas Limited (SHG), a petroleum exploration company focused on the development of Australian and UK gas reserves, primarily coal seam gas (CSG) reserves. Its CSG projects include the Lacerta Project which is located 25km North of Roma. The project has a proven, probable and possible reserve of 1,097 PJ, enough gas to operate a 450MW power station for 30 years. The company continues to explore for further reserves in areas such as Atira.

SHG has also entered an agreement with Sojitz Corporation, a Japanese trading company, to complete a pre-feasibility study for a proposed Gladstone export Liquefied Natural Gas (LNG) project utilising gas from the Lacerta CSG Project as feedstock. The company aims to finish a bankable feasibility study in 2008 and start production in 2012.

Investor interest in coal seam space was recently evidenced by the proposed takeover of Sunshine Gas by Australian listed Queensland Gas.

With the need to move to lower carbon intensive fuels, Sunshine Gas, with its focus on coal seam methane and potential export of LNG, offers the potential to make a significant contribution to the transition to a more sustainable economy. Sunshine Gas addresses the significant environmental, safety and social issues in the exploration and production of CSG through formalised environmental and safety management systems.

performance

The AMP Capital Sustainable Share Fund (the "Fund") has outperformed its benchmark of the S&P/ASX200 Accumulation Index by an annualised rate of 1.67% since its inception in February 2001 to 31 August 2008. Over this period, the Fund has returned 12.07% pa compared to its benchmark return of 10.41% pa.

Top contributors for the Fund in the past six months included companies with coal seam gas assets. Fund overweight positions in Santos Ltd, Sunshine Gas Ltd and Arrow Energy Ltd all benefited from a repricing of assets in the sector, which was brought about by merger and acquisition activity, setting a new benchmark for the gas reserves.

Positive performance also came from the Fund's nil holdings in the gaming sector – consistent with the Fund's investment proposition around sustainable growth constraints in this industry. Tabcorp Holdings Ltd and Tatts Group Ltd suffered significant share price declines after the Victorian Government announced that the lucrative poker machine duopoly would not be maintained after 2012.

Detractors from performance included companies with high debt levels such as Transpacific Ltd and Macquarie Communications Infrastructure Group. In addition, stocks with exposure to consumer spending such as Flight Centre Ltd and News Corp were also weaker, as the economic environment in Australia and the rest of the developed world continued to show signs of slowing.

Looking ahead, the Fund will continue to apply the Sustainable Alpha Process to search for investments that are offering superior return and risk characteristics that provide a sustainable growth outlook consistent with the Fund's style.

(Wholesale Units) AMP Capital Sustainable Share Fund, before tax and after fees as at 31 Aug 2008

| | 3 mnths | 1 year | 2 years | 3 years | 4 years | 5 years | Inception |
|------------|---------|---------|---------|---------|---------|---------|-----------|
| Fund | -7.18% | -15.61% | 3.78% | 10.80% | 14.71% | 15.56% | 11.28% |
| Benchmark | -8.07% | -14.24% | 4.40% | 9.43% | 14.36% | 14.69% | 10.41% |
| Difference | 0.89% | -1.37% | -0.61% | 1.37% | 0.35% | 0.86% | 0.87% |

*Important Note: AMP Capital Investors Limited (ABN 59 001 777 591, AFSL 232 497) ("AMP Capital"). The above returns were available only to wholesale investors from the Fund inception on 20 March 2001 to 31 August 2008 and are before tax, after fees and costs and assume income is reinvested. Past performance is not a reliable indicator of future performance. A new class of retail units was issued in the Fund on 30 March 2007 pursuant to Product Disclosure Statement ("PDS") with higher fees and charges than those attached to the wholesale units.

To invest in the AMP Capital Sustainable Share Fund ("Fund") investors need to obtain the Fund's current PDS from AMP Capital. The PDS contains important information about investing in the Fund and it is important investors read the PDS before making any decision whether to acquire, or continue to hold, units in the Fund. AMP Capital is the responsible entity of the Fund.

Neither AMP Capital, nor any other company in the AMP Group guarantees the repayment of capital or the performance of any product or any particular rate of return referred to in this newsletter.

news

The Australian, NSW and Victorian governments are supporting the development of a **Responsible Investment Academy**, to be chaired by Steve Gibbs. The Academy will aim to address the skills shortage in understanding responsible investing. The Academy's Stakeholder Consultation Forum was introduced by the Hon Peter Garrett AM MP.

In June, the **UN Principles for Responsible Investment** released a Progress report. The Report stated that the number of signatories more than doubled in 2008 to 381, representing USD 14 trillion in assets under management. It reveals a 31% increase this year in the number of asset owners (such as pension funds and insurance companies) who have signed up to the initiative and now publish specific reference to how they integrate responsible investment or environmental, social and governance issues within their investment or ownership practices.

In August, Mary Robinson, former United Nations High Commissioner for Human Rights, released a letter to mark the 60th anniversary of the **Universal Declaration of Human Rights**, highlighting the opportunity for companies to express their support for human rights. Over half the UK's FTSE 100 firms have adopted human rights policy statements in recognition of increasing expectations from investors, consumers and other stakeholders on issues such as how companies treat their workers and interact with local communities.

In September, **Prof Ross Garnaut** released his draft final report with his recommended scenario for a 2020 emissions target 10% below 2000 levels, as part of a global agreement, to meet atmospheric greenhouse concentrations of 550 ppm (higher than 450 ppm and the corresponding predicted 20 temperature rise). In the absence of an international agreement involving China, Prof Garnaut proposes a 5% reduction target. Carbon prices would start at a fixed \$20/t.

The Responsible Investment Association's **International Responsible Investment Conference** was held in Melbourne on 24 and 25 September. The Carbon Disclosure Project 2008 Report Launch was held in Sydney, Melbourne and Auckland on 7 October.

AMP Capital Sustainable Share Fund

The AMP Capital Sustainable Share Fund is available to Australian investors. The overall objective of the Fund is to deliver superior returns to our clients by investing in companies that contribute to, benefit from and best adapt to the shift to an environmentally sustainable and socially responsible global economy.

Further information can be found on our website:

www.ampcapital.com.au/sustainable

Important note: Investors should consider the product disclosure statement available from AMP Capital Investors Limited (ABN 59 001 777 591) for the Sustainable Share Fund before making any decision regarding the Fund. Neither AMP Capital Investors, nor any other company in the AMP Group guarantees the repayment of capital or the performance of any product or any particular rate of return referred to in this document. Past performance is not a reliable indicator of future performance. While every care has been taken in the preparation of this document, AMP Capital Investors makes no representation or warranty as to the accuracy or completeness of any statement in it including, without limitation, any forecasts. This document has been prepared for the purpose of providing general information, without taking account of any particular investor's objectives, financial situation or needs. An investor should, before making any investment decisions, consider the appropriateness of the information in this document, and seek professional advice, having regard to the investor's objectives, financial situation and needs. This document is solely for the use of the party to whom it is provided.