

CEO Kilter Rural, Cullen Gunn recently spoke with ANZ's Managing Editor bluenotes, Andrew Cornell about sustainable investing of the future.

Andrew Cornell: Hello Cullen, thanks very much for taking the time to speak with us. It's a very interesting organisation, Kilter Rural. And I suppose I wonder if we could start by giving us just a sort of potted history of what Kilter Rural is and what its ambition is.

Cullen Gunn: Sure. Andrew, thanks for having us on. Greatly appreciated. Kilter was formed in 2004 really in response to a request from an institutional investor, and that institutional investor was seeking to invest into rural and regional Australia; to transform the way food was produced so produce more food and fibre using less land and water resources; to repair ecosystems that have been damaged and degraded, so within that, also protecting biodiversity and to deliver a solution, I guess, is the best way to put one part of the solution to climate change. So they were the sort of riding instructions. I mean, those that institutional investor obviously recognised these assets are almost totally uncorrelated with other traditional investment classes. So, you know, that was another plus. But that was in 2004, we established a regenerative agriculture model that serviced those four requirements, producing more food, using less land resources, redressing biodiversity loss and ecosystem degradation, and making agriculture a key part of the solution to climate change. So we've been working pretty hard at that for 16 years now, and we've had a good track record of delivering returns above target returns. So you know that farmland investment's done over nine, nine and a half per cent. We've got other investments that have delivered around well water investments delivered over 13 per cent. And we're just into our next phase of our farmland regenerative investment program through the Kilter Australian Farmland Fund. So we have five hundred million in assets under management at the moment. We'd like to get that up to, you know, over a billion by 2023 24 and really profitably improve as much of the Australian landscape as we can that's our goal.

Andrew Cornell: I mean, it strikes me and maybe this was not the case when you started, but in this day and age, with the awareness we have about climate change and the land degradation, particularly in parts of Australia, why wouldn't most agricultural investors be

set up this way? Because it sounds like A you're regenerating the land, but B, you're getting very solid, more sustainable returns.

Cullen Gunn: Why wouldn't they? That's a good question, I think increasingly they are. You know, it's probably in some respects, we were obviously very, very early adopters of this approach, and that was driven as much as anything by our history before starting Kilter Rural. So now I've got 30 years now working in rural and regional landscapes and across Landcare groups and catchment management authorities and trying to I guess balance production with environmental protection. I mean, that's all the founders of Kilter ever did before Kilter was established. So in that sense, we come from a different background I think. Many of our competitors, historic and recent have come from a financial management background we came from an asset management background and with sustainability, asset management background. So the organisation is always being driven by that outcome. I think increasingly Andrew in the last 18 months to two years, almost every one of our competitors is sort of pitching themselves, at least partly in this space, which is a great evolution from recent history. But it's probably the nature of things, really, isn't it? You know, people will respond when investors start asking. And that's the other key thing that's happened in the last two years is capital allocators are really asking much harder questions about where the money's going and the sustainability and community impacts.

Andrew Cornell: I mean, potentially there's two reasons why that might be the case. One is they're seeing better long term sustainable returns. But equally, there is there is pressure from lots of whether it's activist groups or just the community in general to do the right thing by the land. So is it the case that you are compromising returns, but you're doing it for sort of the greater good, or do you get both?

Cullen Gunn: It's a really interesting question. You know, nothing's easy in agriculture I'd make that point, whichever way you do it, nothing's easy. You know, there's always challenges, but I just can't see how you can sensibly suggest at all that any degradation of the environment that underpins your productive footprint is going to be good for the long term value of your asset. I just can't see how that makes sense. I mean, the two things are just so inextricably linked that if you're not working to improve the environmental or natural capital condition, you're basically degrading your long term agricultural output. And I think,

you know, any agricultural enterprise of any work that's been operating for a long time recognises that.

Andrew Cornell: And you talk about nothing in agriculture being easy. And clearly we see that just not through agricultural cycles alone, but what's happening with climate. So how do you balance those difficulties in terms of are there principles that you apply to how you manage the land and how you perhaps forgo a return in the short-term for a longer-term return?

Cullen Gunn: Look, I do think the operating sort of outlook has changed. There's no doubt about that. And some of them you can control and some of them you can't. Obviously, the key amongst them, in a risk sense, really is climate change. If you look at the areas that we work in the southern Murray-Darling Basin, there's been a 26 per cent drop in winter rainfall. Now, that's significant because we rely on irrigation water. So a drop in winter rainfall means a drop in stream flow and a drop in storages. And with that long term decline has also come these just massive events. We've just seen some extraordinary rainfall events. So from day dot from 2004 we have taken the most cautious approach to laying out our landscapes that we could, with the impacts of climate change in mind, so planning properties to flood. Planning to deal with big rain events so we can move rainwater off really high value crops and into environmental areas. Planning for extreme drought scenarios, we've been through a series of events where you've had heat waves at 46 degrees, I don't know, six, seven days in a row and planning water systems to cope with that sort of stress. So I guess it's like anything I don't think agriculture is any more difficult or easy than anything else, you know. And I think if you think hard enough about where you invest your money, you'll see risks and different risk now than they were two years ago. So in that sense, it's really about being prepared and considering the landscape, you know, as an envelope that delivers a whole range of outcomes, not just agricultural output.

Andrew Cornell: And you're not I'm assuming with this philosophy, you're not specialist producers, you're not wedded to a particular commodity or whether it's meat or wool or something else. You need to look at a whole balance of production coming off your land?

Cullen Gunn: Yeah, we do tend to like a diversity of things. I guess to this point, our major focus based around the areas in which we operate and we operate in the southern Murray-Darling Basin, as I said. And you consider that area, it's about the size of Germany. So you get a terrific geographic and climatic variation across that area. So in that sense, it's good. And it lends and the soils and climate lend themselves to a range of potential sort of outcomes in an agricultural sense. We had to this point though really looked at annual crops and high value annual crops in our irrigation systems for the sole purpose that we expect, climate change driven water availability and scarcity to be an issue. So when we've got annual crops, it gives us options. We can decide whether we want to plant a crop and use the water to grow that crop or whether it's more... Better in a risk mitigation sense and a return sense to actually trade that water on in a given year. So, you know, that's the first part of my response to what sort of activities we're doing in our landscapes. The second thing I'd say is where we do have crops, we try to commodify them. So we try and have in almost every instance long-term offtake agreement and they're best endeavoured contracts. So they recognise that, you know, climate variability and water availability means some years you may not be able to do everything you plan to, but we don't put a thing in the ground unless a crop in the ground, unless we know we've got somebody on the other side to buy it and we know the price we're going to get and that price stacks up in our model of water use and water optionality.

Andrew Cornell: And one element of your mission is obviously to revitalise degraded land. How do you choose that? Presumably there's some land that's just too degraded and some that you wouldn't get enough return from improving it. How do you make that choice over the land you're going to use?

Cullen Gunn: Well, I'd like to stress we don't target degraded land. I think undercapitalised and under-utilised is probably a better way to present it. I mean, in some instances, some of it is degraded, you know, there's no doubt about that. Irrigation zones have been highly and intensively irrigated for a long time now. And in some areas that's had pretty deleterious impacts on the environment, whether that's the soils or water quality and or both. So, you know, we don't we don't seek out degraded land. But what we do seek are those sorts of landscapes that have been highly modified, that allow themselves to a regenerative

transformation and value uplift, so from a country that might have great soils, actually, but has just been under-utilised, is undercapitalised, you know, may be an industry that's in transition for whatever reason, you know, economics, demographics, whatever it might be, and an area where we know when we bring capital, we can transform the underlying value of that asset in a capital growth sense, but also in a yield sense so we can transform what happened and how we efficiently deliver to get increased yield and long-term sustainability out of a landscape.

Andrew Cornell: And you've talked about the broadening investor base coming into not just your own project, but similar projects. Now, ultimately, that investment dollar is looking for a return and perhaps there's some ESG components or something. But what is it in particular these emerging investors like to see and like to be to see measured perhaps?

Cullen Gunn: Look, increasingly, you know, we've found ourselves being asked, I guess, how we report on the natural capital or the environmental condition of our assets. And it's not so much necessarily even about the immediate impact, but it's more reporting on the long-term trends and conditions over time. So, you know, when we walk into a landscape, we might say 'alright there are some degradation issues, but, you know, dear investor over time we'll transform that landscape, we'll improve those degradation issues'. And what they ask us is well alright how are you measuring that? How are you going to report that to us? Yep we'll take the returns, you know, financial returns as a given, whatever your targets are, we like what you've put there and we like the experience you've got delivering against that sort of target. But how are you actually going to measure the change in the underlying condition and trend of the asset that underpins everything you're doing and the value of your investment? And so we've really applied our mind to that for a long time. I had a history before Kilter reporting on the condition of natural assets in Victoria, particularly. And we've come on to now an accounting for nature framework, really, which looks at measuring, physically measuring your key asset bases so soils, water, vegetation, flora and fauna and measuring that over time against a baseline condition and benchmarks for targeted improvement. So it's a pretty robust framework we use, it's called the accounting for nature framework. And we've been employing that now for probably close to four years. And it is the key thing always investors ask us about how are you measuring, monitoring and

reporting what you do? So that's been really important for us. And one of the key elements I like about the accounting for nature framework and our prospective and current investors seem to like it is that it is independently audited and independently certified. And any method you employ to measure the condition of assets is independently, scientifically approved before you get out and do it, it's not just like making up your own framework. You know, it's a really pretty scientifically robust system so but we've found that has appealed to lots of investors.

Andrew Cornell: Is that an international framework, the accounting for nature framework?

Cullen Gunn: It's an Australian-based framework, but certainly applicable internationally and we're using it locally and I know the accounting for nature framework is speaking at a national level, it's used in Queensland it's used across areas of New South Wales. And there are other corporates like us in our space that are using it too, it certainly fits within an international framework in that it fits into the UN system of environmental accounts. It can feed up into a system like that. So it's certainly got lots of applications at a range of scale.

Andrew Cornell: And when we look at again, at the investor side, for example, even with ANZ, there is a now sizeable and growing investor base that is looking at ESG elements, environmental, social and governance elements as a proxy for the sort of sustainability of earnings. So those that sort of ESG sensitivity, presumably, that's applicable to Kilter as well, that are they the kinds of investors that are coming in?

Cullen Gunn: Yeah increasingly they are that's right. We're getting lots of interest from ANZ private wealth and, you know, their sort of list of investors and high net worth investors that, you know, as I said earlier, it's the capital allocators that are going to decide how far this sort of trend goes. And I can't see it waning at any time. I can only see it getting stronger. And, you know, they're the ones driving the questions along with groups playing a leadership role like ANZ, you know, who have made some pretty fundamental statements about, what you want to support and where you want to be in a sustainability sense. While we've been leading for 16 years, we are seeing it's reflected in a lot of investor interest.

Andrew Cornell: And we clearly have just come through of extraordinary challenge and difficulty. And Covid-19 is ongoing and there has been implications there for the sustainability of food supplies globally. How big an impact on that on that global situation can impact investing like this have? Is it always going to be a good but marginal good, or is it potentially a much bigger player in the global supply chain?

Cullen Gunn: I think increasingly it will be a much bigger player. You know, touching back on what I said earlier about the environment and agricultural produce and being inextricably linked. And I do believe that is a factual sort of proven fact that we've been delivering for over 16 years. And I really think if you look around right now what's happening in policy settings, so you know in Europe and the UK and the US and Canada and significant parts of Asia, there are very serious discussions about things like climate and climate related risk, the risk of nature and biodiversity loss, and how investors manage that through their investments. And we've just noticed in recent times just escalation around the task force for climate related disclosures. So we employ those sorts of frameworks in our investments because investors expect it. But, you know, we've been doing it sort of in a funny way for 5-10 years anyway. You know, we get the CSIRO in and they tell us what their climate modelling is telling them. They tell us how far in front reality is from the modelling. And that's been the case every time. I'd like to stress, you know, it's pretty scary stuff. So I do believe that, you know, that impetus won't go away. The policy settings are changing fundamentally. There's a whole new lexicon being developed in the EU for investing. And what that means for nature, I mean, it's pretty it's fundamental change. And if you look at farmland and what it can do, yep we can produce food and fibre and yep we know we can do it sustainably but in the context of climate change, there's not that many things Andrew that we can instantly right now do that physically draw CO₂ out of the air or out of the atmosphere and, you know, one of those is land based sequestration. We know when we plant trees and woody vegetation that it sequesters carbon. So in that sense, it's one of the immediate levers that policy and regulatory policy developers and regulators can pull to start addressing climate change. Obviously, that doesn't get around the fact that you have to reduce emissions that's first principle, but land based sequestration is one positive option we know we can do now. We know it works and we know it's a lot cheaper than the other

comparable methods at the moment, like carbon capture and storage. So in that sense, I think the outlook for farming and farm based emissions control is really very positive.

Andrew Cornell: Well, as you say, the expectations that the CSIRO and others are putting forward to continually being surpassed on the down side, so hopefully you can continue to see investor interest in this and continue to make an impact. But thanks very much for taking the time for speaking with us, Cullen.

Cullen Gunn: No problems at all. Andrew, thank you very much for the opportunity.