Arisaig Partners Climate Change Management Approach (Investment side)

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1. What does climate change mean to us and why does it matter?

Arisaig Partners' Investment Philosophy is founded on the belief that Purposeful Growth - taking a multi-stakeholder view of the world - generates superior long-term investment returns in the emerging markets. Climate change and its most disruptive outcomes pose an existential threat to humanity itself and, therefore, all businesses.

Emerging markets are particularly vulnerable to these risks given their geographic positioning (many are located between the tropics, where many of the most extreme weather events are concentrated) and economic fragility (they tend to lack the infrastructure and fiscal resources to respond to and/or mitigate the effects of climate change).

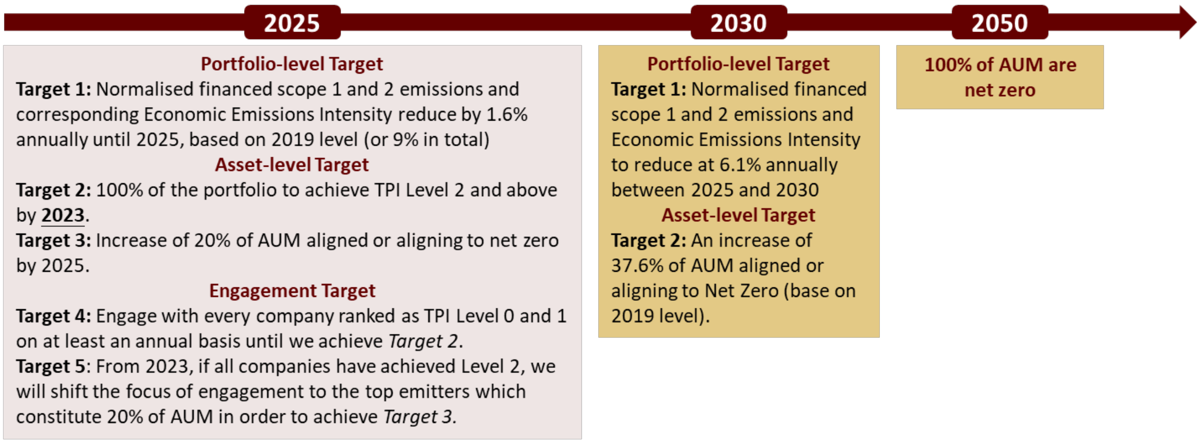
In response to this, there are growing policy actions led by governments to limit global emissions to manageable levels. Nearly 200 countries[1] have pledged to limit global temperature rises to 1.5°C above pre-industrial levels. In addition to policy pressure, consumers and broader investor communities also demand companies to respond to climate change. If companies fail to do so, their business performance, asset prices and access to financing may be severely impacted in the future.

We believe the trend towards a low carbon economy is now firmly entrenched. Given our multi-decadal investment outlook, it is imperative that we adequately manage climate change risks and opportunities over the coming years to preserve our clients' capital. To achieve this, we need to integrate climate risk management firmly within our processes and implement a targeted and proactive engagement approach, as set out in this document.

Targets and Objectives

Given the profound impact of climate change, we believe taking early actions to transition investments to 'Net Zero' is necessary to respond to climate risk. As one of 30 inaugural members of the Net Zero Asset Managers (NZAM) initiative in December 2020, we committed 100% of our assets under management to be managed in line with net-zero. We have set granular decarbonisation targets for the coming decades that will allow us to fulfil this commitment.

Figure 1: Targets supporting Arisaig's Net Zero Commitment[2]



Source: Arisaig Partners

Our targets are designed to be actionable, comparable, and suitable for emerging markets. The last point is particularly challenging in practice, with data gap being the first and foremost issue to resolve.

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[1] 197 countries agreed to sign the Glasgow Climate Pact at the UN Climate Change Conference in November 2021 (COP 26)

[2] Read more about our targets here: [Implementing Net Zero in emerging market public equities - Arisaig Partners]

To address this, we set the near-term target for 2023 based on the Transition Pathway Initiative(TPI) Climate Risk Management Quality framework[3]. The framework lays out a useful roadmap via five clearly defined 'levels' of climate change integration. By achieving 'level 2' in 2023, all companies will publish emission data, providing a sound foundation for assessing risks and monitoring progress.

2. What are the underlying principles guiding our climate change management approach?

We have the following principles when designing the approach to managing climate change:

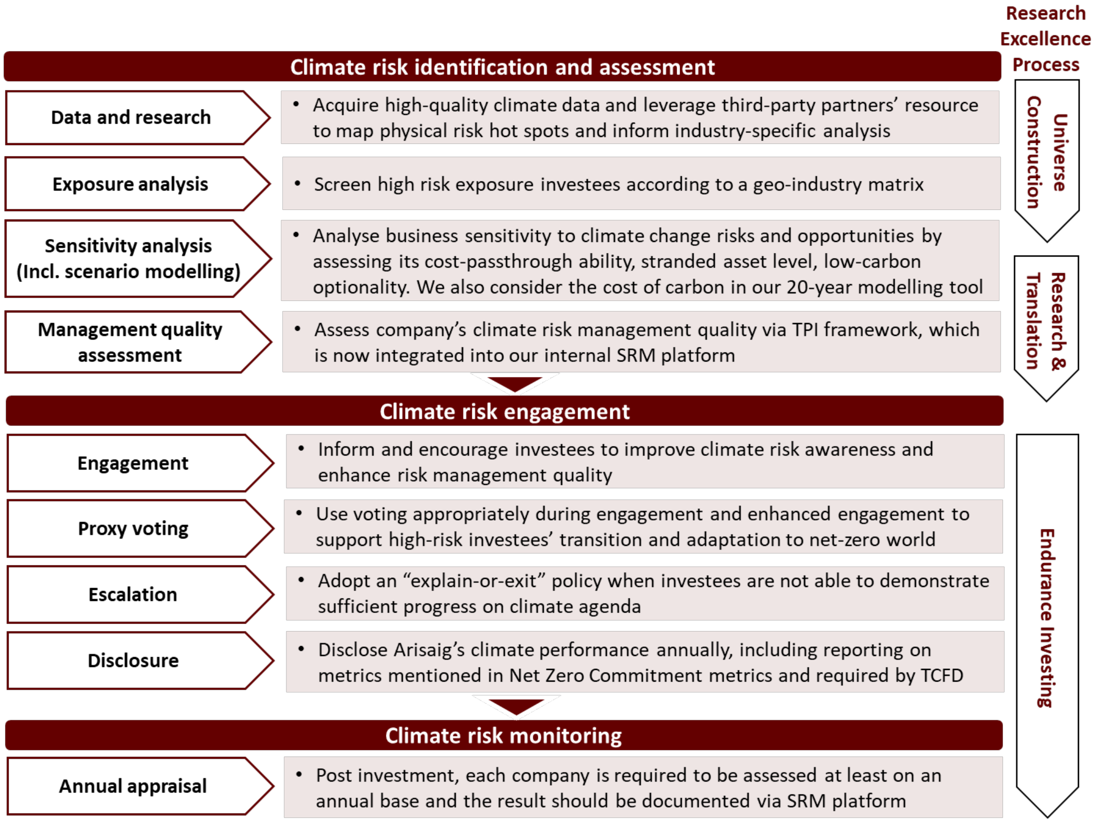
- Systematic due diligence: Climate risks and opportunities will be fully integrated into our investment analysis and decision-making processes. To support this, we will seek appropriate disclosure on climate issues from our holdings.
- Endurance investing: We are long-term, active stewards of capital. We will meet our climate change commitments by proactively engaging and supporting our holdings to achieve the emissions reductions and other measures necessary to limit global warming to 1.5°C above pre-industrial levels.
- Continuous learning: We will monitor evolving best practice and update our climate approach annually to reflect this.

3. What is the process?

Climate risk is embedded within every asset we hold. Only by decarbonising at the asset level can we enhance asset climate resilience, and therefore societal resilience and financial resilience. To achieve this, climate risk is considered within every step of our investment research pathway (see Research Excellence Process document for more information).

Figure 2: Arisaig Climate Risk Management Process

[3] The Transition Pathway Initiative (TPI) Management Quality Questionnaire is a set of 19 questions to assess companies' preparedness for low carbon transition. Supported by investors representing over USD 40 trillion assets, TPI was initially developed by an international group of asset owners initiated by Church of England, in partnership with the Grantham Research Institute on Climate Change and the Environment at the London School of Economics (LSE) in 2017.



Source: Arisaig Partners

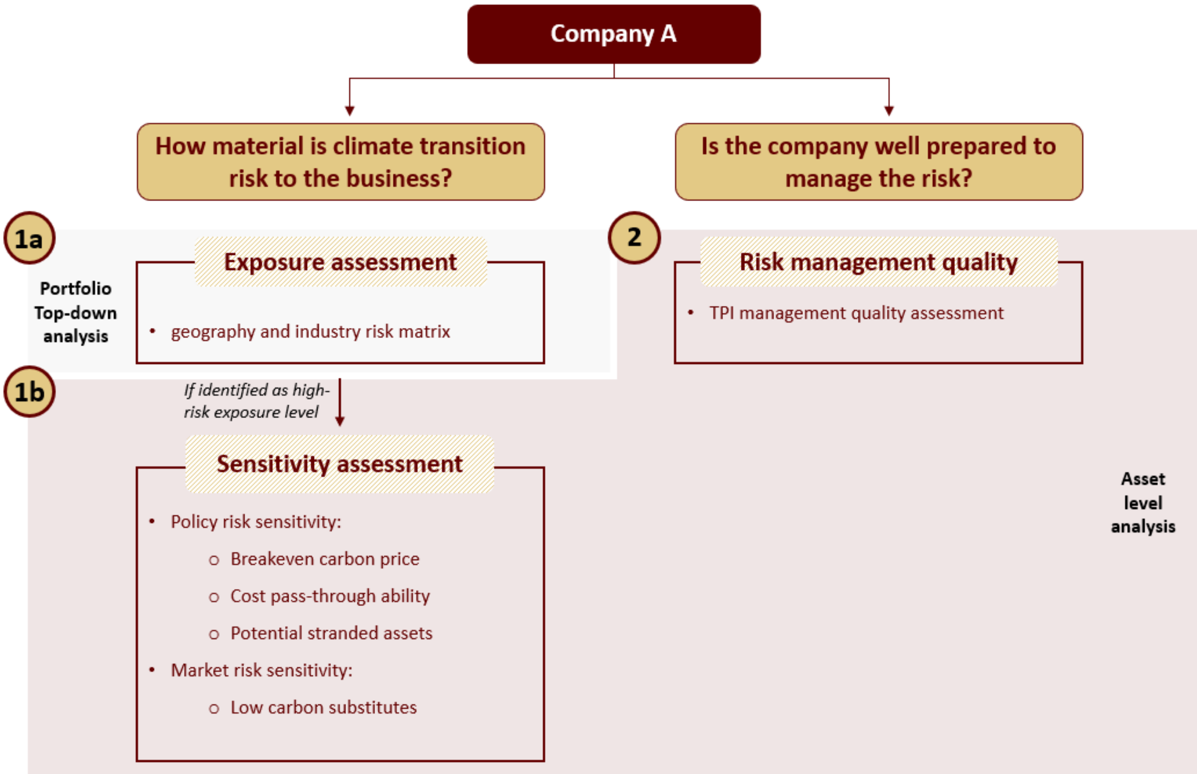
3.1 Climate risk research and assessment

The effect of climate change can broadly be categorised into transition risk and physical risk[4]. In short, transition risk is the risk involved with a transition to a low-carbon economy, which is typically brought by policy, technology, and consumer behaviour. Physical risk refers to impacts from physical climate events, such as severe climate catastrophe or sea-level rise.

3.1.1 Transition risk

To translate research into practice, we developed a climate risk assessment framework to apply during *Investment Case (IC) Draft* stage.

[4] See the detailed definition of the two types of climate risks in annex.



Source: Arisaig Partners

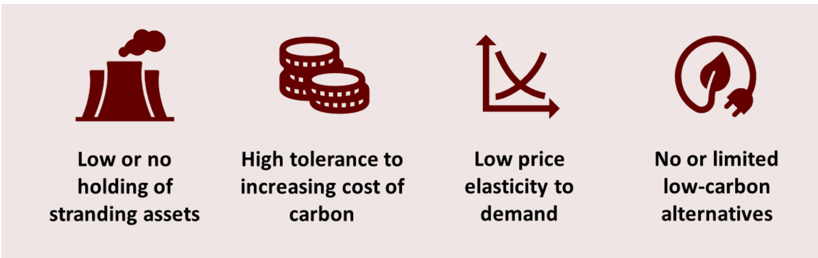
Step 1a. Exposure assessment

Risk exposure level is determined by the industry of the business and where it operates. We developed an industry-geography risk matrix to identify companies that are high risk. Industry is relevant as emission sources are similar within a sector. Geography is relevant because climate policy risk and market appetite are highly localised. For companies that operate across multiple markets and several business-lines, our analysis focuses on where most of the revenue is generated.

Step 1b. Sensitivity assessment

For companies identified as highly exposed to climate transition risk, we conduct 'sensitivity assessments' to investigate how financially sensitive these businesses are. Even where a company is highly exposed to transition risk, we believe having certain qualities make a company less financially sensitive, effectively mitigating the risk (see below).

Figure 4: Key indicators of low sensitivity companies



Source: Arisaig Partners

Step 2. Climate Risk Management Ability

All companies, regardless of risk exposure, need adequate climate change management abilities. Therefore, we applied the TPI framework[5] to measure the quality of companies' management of their GHG emissions and of risks and opportunities related to the low-carbon transition.

The Questionnaire is part of the Sustainability Risk Management (SRM) assessment, a proprietary web-based tool used to assess each company's management of material sustainability issues[6].

3.1.3 Integration

We incorporate climate change research and assessment into the Investment Case reports we write, using a 'traffic light' risk tracking system (see below).

Figure 5: Transition Risk 'Traffic Light' Alert

Source: Arisaig Partners

We also price carbon in our 20-year discount cash flow model Arisaig Crystal Ball (ACB)[7] for every holding and prospective holding. Our approach focusses on the impact on margins. We firstly calculate the cost of carbon by taking (estimated) scope 1+2 emissions and multiply by a carbon price[8]. The cost of carbon will then be applied to operating costs, assuming a direct transfer over time. While the estimation of margin compression could be conservative, this straight-forward approach helps us easily understand and communicate the impact on return on investment.

Figure 6: Long-term valuation under the ESG scenario (Illustration)

		+ 5 Years	+ 20 Years	
PnL Returns as % Sales	**2021**	**2026**	**2041**	
			Base	**ESG**
EBITDA	**6.6%**	**18.4%**	**25.3%**	24.9%
(Depreciation and Amortisation of PP&E and Intangibles)	2.7%	2.5%	2.0%	2.0%
(Depreciation and Amortisation of ROU Assets)	7.2%	4.5%	5.0%	5.0%
EBIT	**-3.3%**	**11.4%**	**18.3%**	**17.9%**
(Interest on Lease Liabilities)	-7.9%	-6.3%	-6.0%	-6.0%

Source: Arisaig Partners

3.1.2 Physical risk

Knowing our investments focus on asset-light consumer businesses and limited expansion plans beyond existing markets, we decided to lean our resources to assess and manage transition risks, which we believe will mitigate most physical risks if managed well.

[5] See *Footnote 3*

[6] See more details about SRM in the Constructive Ownership Approach.

[7] See more explanation about ACB in the Constructive Ownership Approach.

[8] Our model assumes emerging markets' carbon tax to reach USD 75 per ton in 20 years. This is adapted from the IMF's estimation of a global tax of USD 75 per ton by 2030 to effectively limit global warming to 2°C. With rising actions in emerging markets, we will increase modelled carbon price over time.

That said, it is important to distinguish physical risk from transition risk as individual company exposure to them can be quite different. For example, a renewable hydroelectric plant in India will have little-to-no transition risk but significant physical risk as water shortages threaten future output.

With this in mind, in 2020, we employed a climate consultancy to conduct a portfolio-wide assessment that involved geo-tagging physical facilities and using catastrophe models to estimate specific risk exposure and potential loss. We used this to engage the companies identified to be at the highest risk to assess whether they have adequate mitigation measures in place. Our internal research also pulls out the most vulnerable markets to extreme events, which could indicate physical risk exposure of new investments. As we advance, we will repeat the portfolio level analysis at least every five years, or sooner if our holdings' footprints expand significantly.

3.2 *Climate risk engagement*

We believe active engagement and the ability to build long-term, constructive partnerships with our holdings are essential. It is particularly crucial on climate issues – our goal is to encourage emissions reduction in the real economy while divestment will not necessarily lead to so. Since climate awareness in emerging markets is still lagging, early engagement and capacity building will unlock huge decarbonisation potential. We have therefore set engagement targets within our Net Zero Commitment (see above).

We will measure the success of our engagement strategies against the engagement targets set. Specifically, it will include:

- A company's climate risk management quality level assessed via TPI framework; and
- A company's decarbonisation performance against its climate target and net-zero pathway.

Proxy voting: We actively participate in proxy voting on all issues, including climate risks. Although climate-change-related shareholder resolutions are still rare in emerging markets, we will vote for supporting resolutions that will enhance investees' climate resilience and decrease climate risks. We also see proxy voting as a valuable tool for "enhanced engagement" (see Escalation section for more details). For example, we may vote against director appointments when a company has not made sufficient progress on climate-related issues in a reasonable timeline.

Escalation: Where we identify that a holding is not going to meet one or more of our asset-level Net Zero targets, we will launch an enhanced engagement. This includes but is not limited to voting against management. If the company still does not demonstrate sufficient progress after one year of enhanced engagement, we apply a 'divest or explain' approach where the relevant Strategy Research Head will need to recommend to the Investment Committee to divest from the company, or give sufficient justification for not doing so.

Disclosure: We are a formal supporter of the TCFD[9] and disclose according to its recommendations. We disclose on the governance and strategy, targets and risk management processes in this document. We disclose our carbon performance in our annual ESG Review. In addition, as a member of Principle for Responsible Investors (PRI), we also publish our climate transparency report on PRI's website, which is available to the public.

3.3 Climate risk monitoring

[9] Please see the annex for more about the TCFD.

Consistent with the Constructive Ownership Approach, climate risk factor will be re-appraised annually with all other material ESG risk factors registered on SRM.

4 Governance and learning

Climate risk is an agenda item within our Arisaig Partners Holdings Board meetings. The CEO is responsible for representing the firm's approach to climate risk. The CEO will report on annual basis on the climate risk of the business and how we are trending towards our targets on investment portfolios.

The Risk Management Committee, made up of our Co-CEOs, managing director of AP (Asia) and 2 non-executive directors, has a mandate from the Board to ensure climate change issues are integrated into our Risk Management Framework and that policies and practices adapt to reflect this evolving issue. The Committee meets at least every six months with these items on each agenda.

The Research Director (Impact and Engagement) is responsible for overseeing the risk identification process and reports to the Investment Risk Committee on this and other sustainability risks within the funds.

It is down to every member of the research team to carry out climate risk assessment and engagement in day-to-day work. Meeting our Net Zero Commitments is part of every analysts' formal objectives and their contribution to this is assessed in annual performance reviews.

5 **Annex**

A. External reference materials

- Recommendations from the Task Force on Climate Related Financial Disclosures[10]
- EU Sustainable Finance Disclosure Regulation[11]

[10] Source: [Recommendations | Task Force on Climate-Related Financial Disclosures (fsb-tcfd.org)]
[11] Source: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R2088&from=EN

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