

Arisaig Partners ESG and Constructive Ownership Approach

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Why do we need an approach to ESG and constructive ownership?

Our Investment Philosophy is based around the core belief that the practice of ‘Purposeful Growth’ delivers superior operating performance for our holdings and supports long-duration compound earnings growth. We make long-term investments in a concentrated number of exceptional businesses which grow with purpose by taking a multi-stakeholder view of the world. This means they are motivated not by short-term profitability but rather the value they create for customers, employees, communities, the environment, and ultimately shareholders.

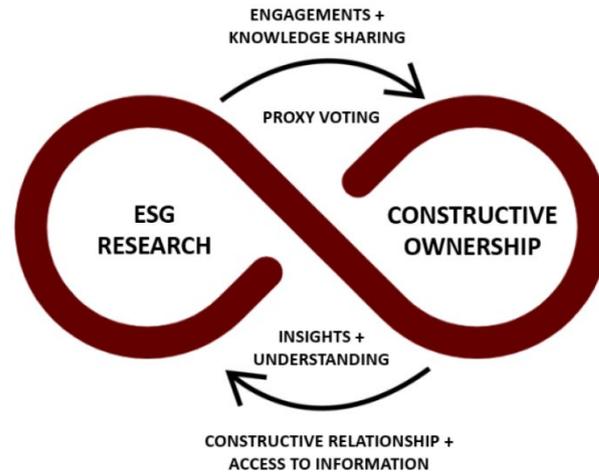
An understanding of how a company manages material environmental, social and governance (ESG) issues is fundamental to assessing whether it meets our criteria for ‘Purposeful Growth’. Ineffective management of such ESG issues could significantly impair long-term prospects of a business. On the flip side, capturing ESG opportunities can lead to significant long-term value creation. ESG research and assessment, leveraging both internal and external resources, are therefore integral to how we invest (our ‘Research Excellence Process’ – see separate document for more details on this).

Moreover, our concentrated¹ buy and hold approach² gives us sufficient time to: (i) build trusted relationships with our holdings; (ii) use these relationships to actively engage companies to make meaningful positive changes to their ESG practices; and (iii) reap the superior shareholder returns that we believe such change brings about in the long-term. We call this approach ‘constructive ownership’. This active engagement in turn provides insights for our ESG research and assessment, thereby creating a virtuous cycle.

¹ Our portfolios hold c. 25 stocks (as of January 2022)

² Our average holding period is 8.5 years based on last five years (source: Arisaig analysis, as of January 2022)

Figure 1: Virtuous cycle of Arisaig's approach to ESG research and constructive ownership



Source: Arisaig Partners

What are the underlying principles guiding our Approach?

Our approach to ESG and constructive ownership follows the same underlying principles as that of our overall approach to Research Excellence, namely: clear focus, systematic due diligence, thoughtful judgement, endurance investing, and continuous learning (see Research Excellence Process document for more information).

In addition to the above principles, we incorporate responsible investing best practice and guidance from leading organisations such as the UN Principles for Responsible Investment (PRI), the Institutional Investors Group on Climate Change (IIGCC), and the UN Global Compact (UNGC). We continuously try to improve our understanding of ESG issues through attending specialist conferences, talking to experts in the field, writing our own thematic research pieces, and commissioning third party research on important issues. These third-party resources are also useful allies in our engagement efforts with companies, providing a level of domain expertise and independence that is difficult for us to match internally. Alongside these partners, we also try to do our bit to promote more sustainable investment practices globally, including participating in working groups, sharing research, and speaking at events.

What is the process?

ESG and constructive ownership are considered alongside financial considerations throughout our 'Research Pathway'.

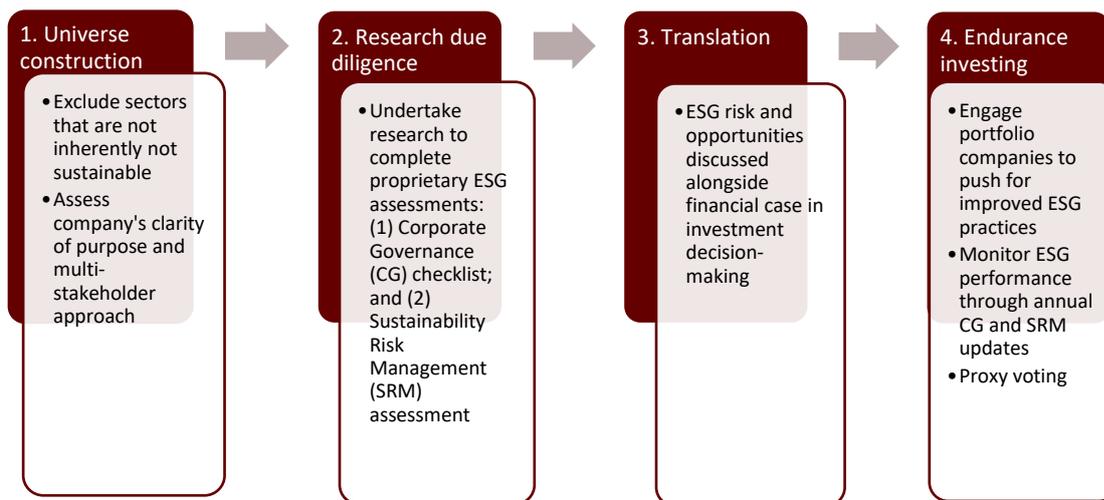


Figure 2: ESG and constructive ownership through our research pathway

1. Universe construction

Right at the start of the research process, we screen out sectors that we do not see complying with our investment philosophy of purposeful growth. This means excluding from our investable universe any companies generating 5% or more of its consolidated revenue from tobacco, fossil fuels, pornography, gambling³, or weapons⁴.

At this stage, we also seek to understand (at a high-level) whether the company is clear on its purpose, and whether its business is aligned to that purpose. This includes looking for evidence that the company takes a multi-stakeholder approach, for example by examining its corporate strategy and speaking to third parties such as ex-employees and industry experts. Our sense of the company's 'clarity of purpose' is further refined through the due diligence stage.

Finally, we conduct a search using a comprehensive international database as well as of general press to identify glaring ESG red flags (e.g., incidents of major corruption, sanctions) for a company before it enters our due diligence funnel.

2. Research due diligence

There are three stages at the 'due diligence' stage of our research funnel: 2-pager, Investment Case (IC) Draft, and IC Final. ESG research takes place in the first two of these.

2-pager stage: Corporate Governance checklist

The first stage of due diligence is for the research analyst to prepare a '2-pager', which includes the outputs of undertaking our proprietary Corporate Governance (CG) checklist. This consists of c. 70 questions covering shareholder rights, transparency and related parties, audit and accounting, board oversight and executive oversight and compensation. The checklist has been developed over 20+ years for investing in emerging markets and reflects the issues we believe to be the most pertinent. These

³ We apply the Cambridge Business English Dictionary definition of gambling as: "the activity of risking money on the result of something, such as a game or horse race, hoping to make money". This is commonly manifested in casino operations, betting agencies and lotteries.

⁴ The exception to this rule is with regards to retailers, where rather than applying an explicit threshold to revenues derived from products such as tobacco or pornography, we prefer to adopt an engagement-centric approach to understand what they are selling and how (i.e. whether they following responsible retailing policy or firmly committed to doing so). The rationale is that in emerging markets, such retailers are often providing a regulated, accountable alternative to informal channels for purchasing products such as tobacco.

tend to be in line with global best practices, which are often over and above what is mandated by local regulation in emerging markets.

Figure 3: Sample summary output of CG checklist

	Raw Score	Out of	%	Weighted Raw Score	Out of	Final Score (%)
Overall CG Score	51	70	73%	103	141	73%
Shareholder Rights	11	12	92%	25	26	96%
Transparency & Related Parties	9	13	69%	20	31	65%
Audit & Accounting	11	14	79%	22	26	85%
Board Oversight	10	15	67%	18	28	64%
Executive Oversight & Incentivisation	10	16	63%	18	30	60%

Source: Arisaig Partners

IC Draft: Sustainability Risk Management assessment

For companies that progress through the 2-pager, the covering analyst prepares a draft investment case. It is at this point that the analyst conducts a detailed assessment of environmental and social issues using our Sustainability Risk Management (SRM) assessment. The purpose of the SRM is to allow us to make a judgement on how well the company is managing material environmental or social issues. It is an internally developed framework that considers five to ten issues that are most likely to be material based on the company's sector. For example, for a food and beverage company, the health and nutrition profile of its products will likely be material, whereas this will not be the case for a financial services business.

Each material issue is assigned a weighting based on its relative importance. For each issue, we then rate the company's management on a scale of 0 to 3 in terms of three dimensions:

- **Strategy & Policy:** Does the company have a comprehensive and suitably ambitious strategy to manage this issue? Does it have corresponding policies and governance structure to implement the strategy?
- **Disclosure:** How thoroughly and consistently does a company disclose its performance on this issue?
- **Performance:** How is the company performing against its objectives, over time and relative to peers?

A weighted average score across all dimensions/material issues is calculated and is translated into a consolidated 'SRM rating' for each company, ranging between 'A' and 'E'.

It is worth noting that our internal scoring guidelines use international best practice as reference points (i.e. a score of '3' reflects best-in-class by international standards). Therefore, a company that achieves an 'A' rating in our SRM is typically in line with global leaders and far outdoing typical domestic emerging market peers. We have set this high bar intentionally as we believe the highest quality emerging market companies have the potential to achieve this in time.

Figure 4: Example SRM snapshot

Social and Environmental Risk Management						
Summary Scores			Summary Comments			
Risk Management Score: 6.9			is one of the regional leaders from an ESG standpoint with a detailed strategic focus on broader business sustainability. The company produced a detailed sustainability report in 2018 with an effort to bring the business more in sync with the Sustainable Development Goals. While long term goals have been set, work needs to be done to develop short term targets.			
Risk Management Rating: B						
Key Issue	E or S	Weighting	Strategy	Policy/Disclosure	Performance	Final Score
Supply Chain Footprint	E	10.0%	3	2	2	●
Product Safety	S	35.0%	3	2	2	●
Health and Nutrition	S	15.0%	3	2	3	●
Water Management	E	15.0%	3	2	2	●
Energy Management	E	10.0%	3	3	3	●
Packaging Life cycle Management	E	15.0%	2	1	1	●
Grade			A	B	B	B
0	1	2			3	
○	●	●			●	

Source: Arisaig Partners

Data sources

Given the paucity of bulk reliable ESG data sets for emerging market companies, we rely primarily on our own proprietary research to complete our CG and SRM assessments. We scour published data from the company itself, namely annual reports, earnings releases, investor presentations, and CSR/sustainability reports. In certain cases, we will approach the company directly for more information if we cannot find the information we require (see ‘information exchange’ engagements below). This is very much a manual, time-consuming process: ESG assessment for one company can take two or three days for an analyst to complete, not including peer review time.

We do supplement our research using ESG data from carefully selected third-party providers where we cannot obtain it by other means. For example, emerging market companies’ disclosure of GHG emissions has been very sparse historically, although this is gradually improving. In these cases, we try to triangulate and sense-check the data based on our deep knowledge of our holdings. In the future, we may also need to rely on third-party ESG data to meet regulatory disclosure requirements (e.g., to report on Principal Adverse Impact indicators as part of the EU Sustainable Finance Disclosure Regulation).

Integration into due diligence

The outputs of both the CG Checklist and the SRM Framework are integrated, alongside commentary from the covering analyst, into the IC Report (ICR) for the company. ICRs are a structured research document that underpins the due diligence of every company on our watchlist.

ESG research, where relevant, are also factored into the Arisaig Crystal Ball (ACB), our long-term valuation tool. The ACB includes an ‘ESG scenario’ which allows the analyst to factor in the implications of an ESG risk or opportunity, for example by changing future costs or revenue growth. We have used the ESG scenario to introduce shadow carbon pricing into our ACB calculations. We apply a shadow

carbon price of USD 75/tCO₂e⁵ to the estimated future emissions of the company and calculate what impact this would have on the company's margins (and consequently our expected long-term returns) should it be required to absorb this cost. While simplistic, this gives a sense of the company's sensitivity to the introduction of carbon pricing.

3. Translation

The third step in our research pathway involves applying research backed judgement to portfolio decision making. Arisaig's Investment Committee is responsible for making investment decisions for our strategies. To decide what companies to invest in and what weighting they should have in portfolios, the Investment Committee considers how well a company is managing its ESG risks and opportunities, as documented within the ICR and our internal reporting systems.

4. Endurance investing

Engagement

We view our engagement style as being that of a 'Constructive Owner'. Over time, we hope to become trusted partners of our investee companies, helping them to become better versions of themselves. Our specialist focus – exclusively emerging markets, generally consumption-driven businesses – allows us to maintain detailed knowledge of global best practices, which (we hope) makes us a valuable partner to investee companies. Another benefit of being established emerging market investors is that we hold trusted relationships and are of sufficient scale, which gives us a greater positive influence on public companies than the average investor.

Given the importance we place on engagement, we have set a target to engage directly with at least 60% of holdings every year, which we monitor on a quarterly basis. For this target, we define engagement as purpose-driven communication with our holdings with a deliberate objective to influence corporate behaviours or practices. It is distinct from dialogue as part of the normal course investment analysis and monitoring.

Stimulus for proactive engagement can come from the weaknesses identified in the CG and SRM assessments, occurrence of unexpected ESG incidents, and/or through our thematic research on topical ESG issues (which currently includes carbon emissions, gender equality, and data security).

We undertake two types of engagement:

- (1) Information exchange: Purpose of these is to better understand a company's strategy or practices e.g., around employee rights or supply chain management. In some cases, the information provides sufficient comfort that the company is suitably managing the issue. In other cases, we may decide that we should push for behavioural change.
- (2) Behavioural change: These engagements have an objective to change the behaviour of the company. It involves setting clear expectations with management about what we believe should be done differently and why.

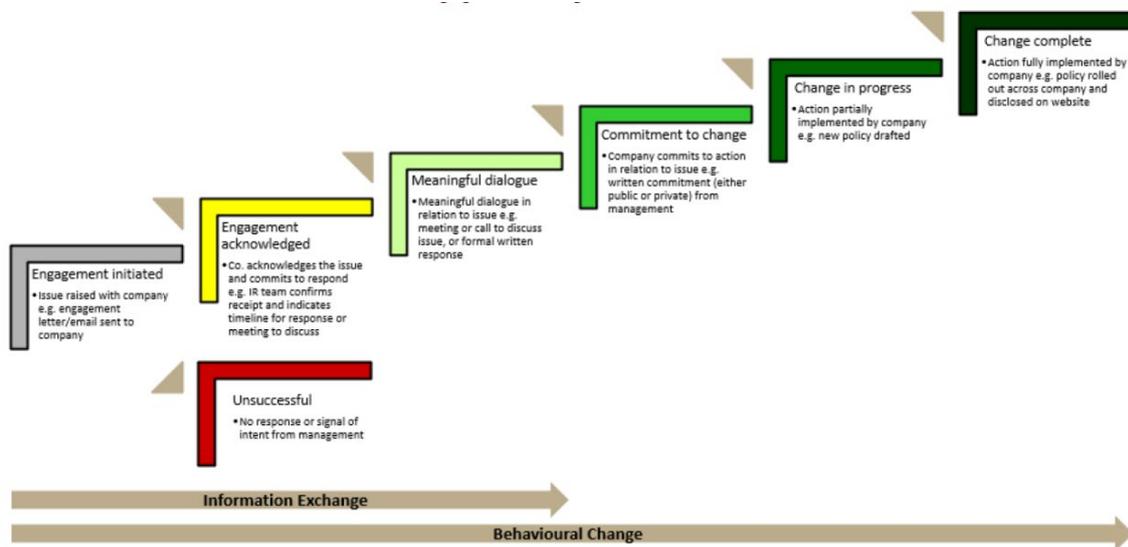
Successful engagements can take years. One study found on average it takes 35 months for an ESG engagement to be successfully completed⁶. Fortunately, as buy and hold investors we can not only see these engagements through, but also reap the resulting benefits to shareholder returns. To keep track of progress, we have an internal engagement tracking module. Each 'interaction' with the

⁵Consistent with the IMF's estimate of the carbon price needed by 2030 to meet carbon targets <https://blogs.imf.org/2019/10/10/fiscal-policies-to-curb-climate-change/>

⁶Hoepner et al. (2018) ESG Shareholder Engagement and Downside Risk https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2874252

company (e.g. a meeting, significant written correspondence, proxy vote) is recorded in the system alongside progress against our milestones system.

Figure 5: Engagement progress milestones



Source: Arisaig Partners

Where an engagement appears to have stalled (a sign of which could be no milestone progress for over 12 months), we consider the individual circumstances of each case rather than apply a blanket approach to escalation.

- In certain cases, we can afford to be patient – for example where management have expressed that change is in progress and provided a clear timeline.
- If we believe the issue is urgent or that more concerted effort is needed to create change, we will look for potential collaboration opportunities with fellow shareholders to improve the negotiating position. This can include a discourse with other stakeholders such as the stock exchanges.
- Finally, if we feel the company is still unwilling to respond on what we feel is a material business risk that will affect its long-term growth prospects, we will look to sell out of the position.

We strive to avoid any hostile or public exchanges as this rarely results in good outcomes from our experience.

Monitoring

On annual basis we update the CG checklist and SRM assessment of every holding. Through our engagement efforts, we hope to see gradual improvements in these scores over time. Significant improvements can, and have, resulted in increased conviction in, and position sizing of, a holding. In other cases, these re-evaluations have led to disposals.

We also continuously monitor our holdings for significant negative ESG events. Examples include lawsuits or regulatory fines, allegations of human rights abuse, or natural disaster-related supply chain disruption. All such incidents are reviewed to determine the scope of the issue and determine whether it is systemic. We then run through the below process to determine the subsequent investment decision or engagement activity.

Figure 6: ESG incident escalation approach

Trigger	Question	A: Yes?	A: No?	Timeline
ESG Incident	Is this issue systemic?	Sell out as alignment of interests is broken	Understand sources of issue and engage the company on how it should respond	3 Months
Company mitigative action	Is the company responding to this issue?	Track activities and verify if suitable to remedy the issue	Escalate with company before deciding whether to sell out	6 months
Verification of change	Is there meaningful evidence of change?	Consider topping up position with added conviction in management quality	Escalate with company before deciding whether to sell out	12-18 months

Source: Arisaig Partners

Proxy voting

We see a proactive approach to voting on our shares as an important engagement mechanism through which we can encourage improved corporate governance practices. We vote on all available shareholder resolutions, whether through physical attendance at shareholder meetings or via proxy. We strive to vote decisively on all items and will typically only abstain if the necessary evidence to make an informed decision is not made available on time. Each vote is cast in line with the ‘best practice’ criteria set out in our Corporate Governance Checklist. This includes the following principles:

- Oversight of a suitably skilled, diverse, and independent Board of Directors
- Sensible, long-term orientated remuneration policies
- Disciplined, value accretive capital allocation
- Respect for minority shareholder interests (e.g., use of related-party transactions, royalties and voting rights)
- A strong corporate culture and citizenship, reflecting the interests of wider stakeholders.

More information is available in our Proxy Voting Policy.

Governance and Learning

Our **Research Team** is responsible for the day-to-day implementation of our ESG research and constructive ownership approach. We believe this is the most effective way of ensuring that ESG is fully integrated. It also ensures that those that have the closest relationships with the companies are also informed on the key ESG issues and empowered to engage with company leadership to understand how these issues are being managed and, if necessary, to push for change.

All analysts are required to go through external ESG training (CFA and/or PRI) to provide them with the foundational knowledge to carry out their ESG responsibilities. Analysts refine their knowledge and optimise their use of Arisaig’s proprietary ESG tools through regular internal training sessions led by the Research Director (Impact and Engagement), who sits within the Research Team. How well an analyst has integrated ESG and engaged with companies is a key component of their annual performance review.

The **Research Director (Impact and Engagement)** is responsible for updating this Approach and for overseeing engagement activities of the Research Team, including sharing learnings across offices. They are also responsible for preparing and reporting the ESG-related management information (see below). The **Research Analyst (Climate Change)**, with oversight from the Research Director (Impact and Engagement), is responsible for maintaining our Climate Change Approach and providing technical expertise to support the Research Team with respect to climate change engagements. See ‘Climate Change Approach’ document for more information.

Arisaig's **Investment Committee** is responsible for ensuring our Strategies are invested in purposeful growth companies. The Research Team provides the Investment Committee with relevant insights to allow the Committee to assess this. The Investment Committee also reviews ESG management information (see below) on a quarterly basis and engages with the Research Team if there are any concerns.

The Fund Boards are responsible for ensuring that the Strategy meets its mandate of generating sustainable long-term returns. It reviews selected management information on Arisaig's ESG objectives at board meetings and raises any concerns with the management entity.

The Boards of the management entities (AP Asia and APRS UK) are responsible for ensuring that the firm meets its mandate of generating sustainable long-term returns across its strategies. The Research Department and Investment Committee are responsible for updating the Board on progress against ESG objectives and justifying any deviations from its policy.

Management information

To monitor whether the Research Team is meeting Arisaig's ESG objectives, relevant management information is tracked every quarter such as:

- The percentage of holdings engaged in the last 12 months (target is >60%)
- Any holdings for which the CG checklist or SRM assessment is > 12 months old
- The average CG and SRM scores for each portfolio.

The management information is reviewed by the Research Excellence Forum (which consists of our Global Head of Research and all Research Directors) on a quarterly basis. A selection of the management information is also shared every quarter with the Boards of Directors of each strategy.

Updates

One of Arisaig's core principles is continuous development. We update this Approach document on an annual basis to reflect improvements to our framework and processes.

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