Socially Responsible Investment Policy

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Focus AM
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Introduction

Since the creation of European Compounders in June 2005, Focus AM has focused on the investment in high quality global companies, named “Compounders”, which meet demanding profitability criteria and are capable of producing long-term earnings growth by reinvesting their cash flows at high rates of return.

Through our investment approach, which relies on a long-term understanding of businesses, as well as independent and exhaustive research, we have always considered various extra-financial data in our analysis. In particular, it has always been essential to us that the companies in which we invest observe ESG criteria (Environment, Social, Governance) that we consider indispensable for the creation of long-term value for their shareholders.

Focus AM’s investment strategy and culture – which can be best described as long-term shareholders with a business owner mindset – is a natural fit with responsible investing. Just like our investment universe, essentially formed by companies that have developed ESG standards accepted as best practices in their sectors (based on Sustainalytics data).

To better reinforce our commitment to these principles, after becoming a signatory to the United Nations Principles for Responsible Investment (UN PRI) Focus AM has taken the decision to formally integrate responsible investing in its investment process starting in September 2018.

By conviction, we manage our funds essentially according to a Best-in-Class approach while excluding investments in companies whose activities are related to the controversial arms sectors, pornography, gambling, and fur.

Our definition of responsible investment

There are many ways to be a responsible investor, and even more so to present oneself as such. While our primary goal is to deliver attractive absolute and relative performance for our clients, our belief is that the social and environmental impact of the companies we invest in are essential components of sustainable growth and long-term value creation.

Although our investment process is based first and foremost on the detection and support of companies that meet a set of very specific qualitative and quantitative characteristics, we complement our fundamental research and our selection process through the consideration of different ESG criteria. This extra-financial analysis allows us to highlight the environmental, social and governance issues that could affect positively or negatively the fundamentals of a company as well as its sector’s. And, ultimately, to better understand its long-term strategic issues.

On the other hand, we do not adhere to the overly simplistic approach of excluding certain sectors as a matter of principle. Taking the example of Environmental criteria, we consider that strategies that exclude companies with high scope 1 and 2 carbon footprints ignore several important principles and, as a result, distort reality. There are two essential reasons for this (list is not exhaustive):

- the absence of reliable and abundant scope 3 carbon emission data makes the calculation of the real carbon footprint of companies more often than not random: for example, the very high environmental cost associated with the extraction of rare metals used in the manufacture of batteries or solar panels is rarely considered in the calculation of carbon emissions (and overall environmental impact) of companies identified as “positive” contributors to energy transition and global warming;
b) many companies that belong to sectors known as high generators of greenhouse gases are often essential to the existence and operations of companies belonging to sectors depicted as “green”: for example, oil companies or cement manufacturers remain indispensable to the construction of premises, factories or data centers of companies belonging to less polluting sectors, such IT, media or business services.

With the exception of the 4 excluded sectors listed above, we have chosen to follow a Best-in-Class approach, directing our investments in companies that adopt best ESG practices within their sectors – rather than being rejecting companies belonging to structurally less well-rated sectors in ESG terms. We also believe that, through our investments, we have a role to play in encouraging companies to adopt measures that improve best ESG practices within their sectors.

**Why an SRI approach?**

We believe that the integration of ESG criteria into our investment strategy and process allows us to better direct our investment decisions in quality companies that are best able to create long-term value.

We also consider that the integration of ESG factors into the strategy of companies will play an increasingly important role in determining their long-term competitiveness and in the durability of their financial performance. The integration of these factors into our fundamental analysis and valuation models allows us to better quantify the extra-financial risks and opportunities faced by companies entering our portfolios. We also consider that the integration of ESG criteria is part of our fiduciary duties.

Focus AM’s culture and investment philosophy are also a natural fit with a responsible and sustainable investment policy. The type of global, high-quality companies entering our restricted investment universe is generally consistent with high ESG scores, as explained below. Similarly, we believe that asset managers that do not integrate ESG parameters in their analysis miss increasingly important, non-financial issues.

Our responsible investment policy addresses four pillars that we consider essential:

1. Integration of ESG analysis and criteria into our investment process
2. Voting and engagement policy
3. Transparency for our investors
4. Involvement in the world of SRI, with a particular emphasis on one of our convictions: energy transition as a key factor behind issues related to global warming.

This responsible investment policy was developed with the help of external experts.

100% of assets under management takes into account ESG criteria.
1. Integration of ESG criteria into our investment process

Our ESG approach involves 3 distinct phases in the construction of our portfolio:

1.1. Exclusions Policy

By conviction, Focus AM formally excludes any investment in companies whose activities are related to controversial weapons (anti-personnel mines and cluster ammunitions), pornography, gambling, and fur. These are areas in which we do not identify opportunities for improvement on ESG matters.

In addition, as stated above, our investment strategy seeks high-quality companies, or "Compounders", that meet demanding profitability criteria (attractive and resilient margins, high FCF conversion, ROIC> WACC, etc.) and are able to generate long-term earnings growth by reinvesting their cash flows at high rates of return. As a reminder, companies entering our investment universe must have a minimum market capitalization of 1 billion Euro.

This approach has two key consequences:

- As these business characteristics are rare, our funds' investment universes are limited: around 150 companies for European Compounders, and 350 for Global Sustainable Compounders;

- These companies are predominantly in business sectors - notably consumer products, manufacturing and services - which support structurally high ESG ratings and controlled carbon footprints. For example, 50% of European Compounders' investment universe is made up of "Leaders" or "Outperformers" according to Sustainalytics (95% of the universe is composed of "average-performers" or above).

Broadly speaking, the combination of the exclusion of these 4 sectors with Focus AM's traditional investment universe makes our selection process naturally compatible with high ESG quality requirements.
1.2. Screening of our investment universe according to ESG criteria

Within our investment universe, we review the ESG ratings of selected companies relying on data provided by Sustainalytics.

1.2.1. Why Sustainalytics

We particularly value Sustainalytics' methodology and quality of analysis for the following reasons:

i. Their ESG analysis methodology follows the weighting of the three pillars E, S and G, and extra-financial criteria are analyzed according to the materiality of the issues of each sector. In addition, ratings are reviewed annually.

ii. Sustainalytics' rating system is constructed in such a way that it is easy to identify the performance of each company for each type of parameter (E, S, and G), and follow its evolution over time. The agency ranks companies in ten deciles relative to each sector, and distinguishes 5 categories of companies by sector:

   - **Leaders**: These companies are ranked in deciles 10 and 9 and have an overall score generally above 80
   - **Out-performers**: These companies have overall scores that vary between 72 and 80. Leaders and out-performers generally obtain an ESG score at least twice the standard deviation of the average of other companies in their sector
   - **Average-performers**: these companies have overall scores between 72 and 51
   - **Under-performers**: these companies have overall scores between 51 and 45
   - **Laggards**: These companies have overall scores below 45.

These relative ratings allow us to build our portfolio using a Best-in-Class approach.
iii. The universe covered by Sustainalytics is among the broadest in the market: To the extent that our objective is to continually enrich our understanding of ESG issues of companies entering or likely to enter our investment universe, the depth of Sustainalytics’ database makes it a very useful tool for our investment process.

iv. Sustainalytics also uses a specific methodology to monitor controversies, which they rate from 1 to 5 according to their severity. Each controversy is accompanied by an explanatory note, which allows us to integrate them into the periodic reviews of our portfolios, and react accordingly.

1.2.2. ESG filters: our approach

For both funds, based on Sustainalytics data, we apply the following ESG filters to our investment universe:

- 80% of the stocks in the portfolios must at least belong to the 6th decile or above;
- A pocket representing a maximum of 20% of the portfolios can be invested in companies belonging to deciles 5 to 2. This pocket is reserved for companies in which we have a conviction and that we wish to support in improving their ESG practices.
- 1st decile companies are strictly excluded from the portfolios.

This approach ensures that at least 80% of our portfolios is invested in leading companies, out-performers or average-performers.
1.3. **Integration of ESG criteria into our proprietary analysis**

Thirdly, we integrate all the ESG data collected into our fundamental analysis of the companies in our portfolio. With this in mind, we focus on material ESG criteria that we consider the most important, such as:

**Environment:**
- Carbon footprint and greenhouse gas emissions, share of renewable energies in both the company energy mix and growth strategy
- Environmental impact (pollution, water and waste management, etc.)
- The development of circular economy within the scope of companies
- Raw materials consumption
- The company's environmental programs: the existence of quantitative targets and a timetable to achieve them at the group level

**Note on greenhouse gas emissions and the calculation of the carbon footprint of our portfolios:**
- The lack of data relative to greenhouse gas (GHG) emissions across the entire value chain of corporations makes the use of "scope 3" indicators (indirect emissions that are not directly controlled by a company, but are nevertheless related to stages of the product or service lifecycle including supply chain, transportation, or recycling) for the calculation of the actual carbon impact of companies almost impossible to date;
- Although we are convinced of the need to take into account the entire value chain in the calculation of companies' real carbon impact, we are currently focused on the available data of "scope 1 and 2" indicators provided by companies and/or collected by Sustainalytics (i.e., direct emissions directly related to the production of goods or services, and indirect emissions related to secondary energy sources and/or consumption necessary for the production of goods or services).

**Social:**
- Social impact of companies throughout their entire value chain, including: working conditions, health and safety, etc.
- Relationships with stakeholders (unions, communities, NGOs, etc.), suppliers and employees (including the presence of collective bargaining agreements)
- Data protection and security
- Human rights, non-discrimination policies

**Governance:**
- Shareholders rights
- Audit and accounting
- Corruption and bribery
- Voting policy
- Executive compensation
- Board member experience and expertise
- Board independence
ESG analysis helps us identify the opportunities and threats affecting or likely to affect both specific companies or industrial sectors.

Our financial models take into account ESG criteria that we have identified as material. Our systematic meetings with the companies in our portfolio are also opportunities for us to question management on specific ESG issues.

Our work is completed with the integration into our proprietary analysis of the material ESG factors we have identified. In this phase, we pay particular attention to the following points:

1) the quality of the company’s business model and its sustainability (we value the presence of sustainable innovation factors likely to strengthen the competitive advantage of the company in the long term);
2) the evolution of the industrial sector in which the company operates, identifying possible sources of opportunities and / or threats related to ESG factors;
3) the quality of governance, compensation and alignment with shareholders' interests, and its transparency;
4) the existence of best Social practices not only within the company but also throughout its supply chain;
5) a controlled carbon footprint varying according to the company’s sector.

ESG integration into Focus AM’s investment process: Overview
1.4. **Team and control systems**

We believe that ESG data is a key source of information to support our analysis and overall risk management at the corporate and portfolio levels. As a result, all of our financial and extra-financial analysis is carried out by the same team.

Likewise, our portfolio management team permanently follows potential controversies, and the remedies taken by companies to address them. In the case of Level 4 or 5 controversies, we commit ourselves to make a complete review of the company and make a decision to remain invested or sell our position within 3 months of the report of the controversy.

Compliance with our SRI policy is ensured in two ways:

1. We review the ESG quality of our portfolios on a quarterly basis
2. Controversies are analyzed as soon as they are notified.

2. **Voting policy and engagement**

We use ISS-Ethix to support our voting policy. Through ISS, we are able to combine our proprietary data and the ease of using an integrated platform for proxy research, voting and reporting.

As part of our partnership with ISS-Ethix, we have chosen to adopt an SRI voting policy which we can update each year in light of new ESG parameters we deem essential and/or potential new regulation. This approach is in line with the UNPRI principles and focuses on the following three elements:

1. **Board**: Special attention is paid to the competence and performance of the members of the Board of the company, including topics related to ESG issues, diversity and independence.
2. **Compensation**: ISS pays particular attention to the alignment of salary and performance, including performance on ESG topics.
3. **Social and Governance**: The SRI voting policy supports shareholder proposals that address social and environmental issues, human rights and labor rights.

As business owners and long-term investors, we engage in collaborative engagement initiatives that drive companies to improve their ESG practices, including the quality of the ESG data they produce.

To help us in this process, we support and benefit from information from organizations such as the Institutional Investors Group on Climate Change / IIGC (whose main purpose is to work with investors to help them improve their understanding of risks and opportunities related to climate change) and the Carbon Disclosure Project / CDP (an independent, non-profit organization that encourages companies to be more transparent about their environmental and carbon impacts, focusing on scope 3 carbon emission data).
3. **Transparency**

Each year, Focus AM provides its investors with a report of its responsible investment approach.

Our SRI policy and voting policy are available online on our website.

4. **Conviction**

The Principles for Responsible Investment (PRI) is a UN initiative that has defined a set of investment principles that lists actions for incorporating ESG issues into investment practices.

The aim of the PRI is to achieve a sustainable global financial system by promoting the adoption of the Principles and cooperation for their implementation, good governance, integrity and accountability.

In 2016, we signed the UN PRI and have since moved forward in our ESG approach by following five principles:

1. We integrate ESG issues into our decision-making and investment analysis processes
2. We are active shareholders and integrate ESG issues into our share ownership policies and procedures
3. We ask the entities in which we invest to be transparent about ESG issues
4. We encourage the adoption and implementation of the Principles in the investment sector
5. Based on this commitment and convinced of the interest of working together in the investment sector, we attend conferences and events that allow us to follow the progress of SRI in our sector.
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