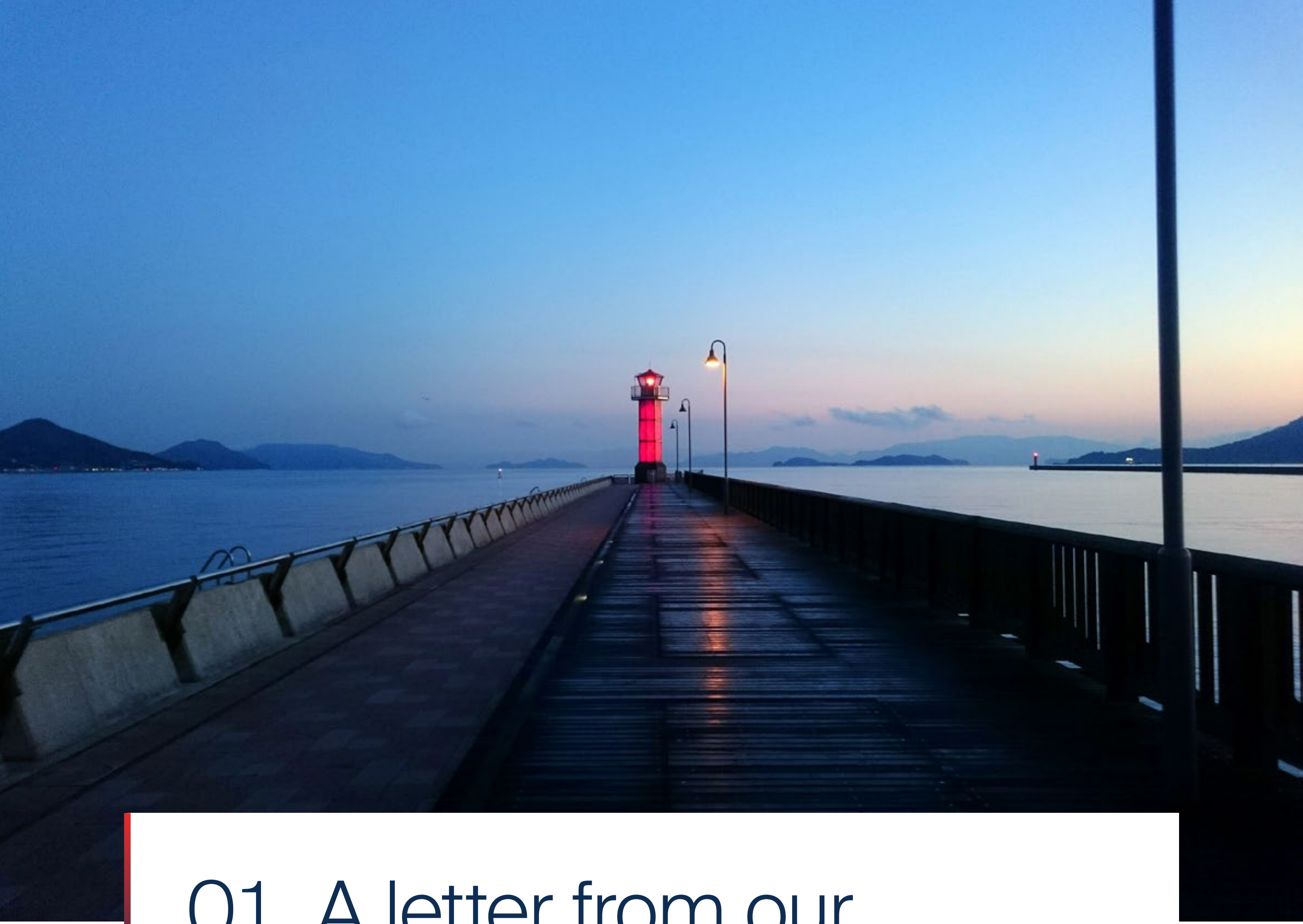
FSSA Investment Managers

Environmental, Social and Governance Report 2022

Moving forward

Contents



01. A letter from our managing partners

Dear stakeholders,

In our last report, we remarked that sustainable thinking and the consideration of environmental, social and governance (ESG) factors should always be incorporated into investment decisions. But, admittedly, we haven't always been clear in articulating what we do in a way that tallies with how the general market thinks about ESG. This has improved over time, through feedback from stakeholders.

We believe that ESG is synonymous with quality; and in our search for good companies we have always integrated ESG analysis into our investment process. However, we don't use ESG ratings or positive/negative screenings to decide whether or not to invest and we don't rate companies purely on ESG factors. Our approach does not fit naturally into the check-box nature of a typical ESG questionnaire.

In July 2022 a special report from *The Economist* suggested that "the ESG approach to investing is broken".[1] Much of the criticism stems from the idea that what can't be measured, can't be counted; and that when it is measured, "good" ESG does not seem to correlate with better financial performance.

Unfortunately, a plethora of ESG ratings, providers and terms have prevented the industry from agreeing on what "good" or "bad" ESG entails. How is an investor to decide on which factors are important, and how to measure them?[2]

Our view is that responsible investing cannot be based on ESG ratings alone. As part of our investment process, ESG factors are incorporated into an overall quality rating for each company. We look at its growth drivers, competitive moat and the sustainability of its business model. And we look at all of these things through the lens of a long-term and committed investor.

1. https://www.economist.com/special-report/2022/07/21/a-broken-system-needs-urgent-repairs
2. https://www.ft.com/content/e84a6f9a-7861-43e6-b0e8-773732772c3a

From this perspective, we think it is critical that management teams spend time thinking about the externalities affecting their businesses. This naturally includes ESG-related decisions. We believe this is simply good business sense and should help to ensure the long-term sustainability of a company's earnings and cash flows. To us, "ESG investing" is simply "investing".

This year, we met with a growing number of sustainability-minded management teams and leaders at our investee companies. They have brought a level of professionalism which has led to improved disclosures and communications with investors. We have been encouraged by the integral role they play in setting strategy and the high level of engagement from the teams they report to. This trend highlights the growing focus on sustainability throughout entire organisations, rather than being limited to certain silos or individuals.

Meanwhile, as demand for sustainable investments continues to grow, there are plenty of new funds touting their green credentials, though a large number of so-called sustainable funds have been accused of "greenwashing" – or misstating the extent that ESG considerations are factored into investment decisions.

There have been some high-profile cases and fines, resulting in a shake-out of the industry. A number of major asset managers proactively downgraded their funds from "dark green" to "light green" in readiness for phase two of the European Union's Sustainable Finance Disclosure Regulations (SFDR).

We have never sought to put a sustainable label on our funds and have not been impacted by the fall-out. Under the new regulations, FSSA's funds have been categorised as Article 8, or "light green" where appropriate, which means that they incorporate the promotion of environmental and/or social characteristics, while stopping short of having the objective of being a sustainable investment (which would make them Article 9).

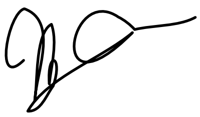
Over the years, we have taken steps to keep apprised of topical events and issues, including climate change and decarbonisation, natural capital and biodiversity and modern slavery risk in supply chains. This year, we have delved deeper into these topics to better understand the key sourcing risks in certain supply chains; the countries and sectors in which our holdings are most exposed to modern slavery; and the raw materials, electrical components and collaboration needed for the clean energy transition.

At the core of our investment approach, there is nothing new about what we are doing on ESG. As a team we have been evaluating companies and management teams for more than 30 years on the basis of their ability to deliver sustainable growth. ESG is a critical part of this and our awareness of the scale and urgency of challenges has grown.

On the other hand, the new regulations have highlighted the need for clearer articulation of our approach. That is what we have been striving towards this past year. In the pages that follow, we provide an overview of our approach to quality, case studies to highlight our company engagement and an update on our decarbonisation strategy.

We hope our stakeholders will enjoy reading the report. If there are any questions or feedback on our approach, we would welcome hearing from you.

Thank you for your support.



Martin Lau
Managing Partner

Michael Stapleton
Managing Partner

02. Introduction

About this report

This report covers our ESG activities over the 2022 calendar year. It reviews the team's investment philosophy and approach, and recent progress in key areas of ESG. Our extensive engagements with portfolio companies form the bulk of our activities and as such we aimed to illustrate the report with a series of case studies. These stories include engaging with China's top sportswear company on its management approach, viewing climate action through the perspective of scarce resources and applying the modern slavery toolkit with the largest canned foods company in the Philippines. The report concludes by laying out our priorities for 2023 and beyond.

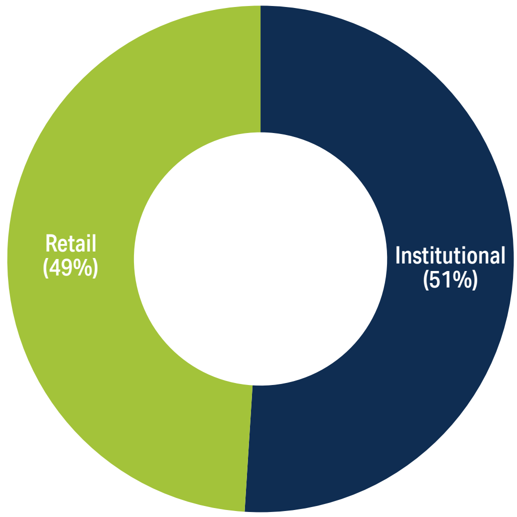
We recognise that ESG is an evolving landscape; therefore, we seek to continue to learn and improve. We intend to enhance the comprehensiveness of this report by providing more details and metrics in future editions, in line with the regulatory landscape and our commitments to stakeholders.

About the team

FSSA Investment Managers has been investing in Asia Pacific and Global Emerging Market (GEM) equities for more than 30 years and now manages USD 30bn[3] of assets. Our investment team is comprised of around 20 individuals who come from diverse backgrounds and are all generalists. We avoid creating siloes and encourage team members to research ideas from across our universe. This approach allows for broader coverage and ensures that the entire team develops in-depth knowledge of each company. Our culture is one of respectful debate, as we challenge each other's thinking and bring different perspectives to the table. This helps us to learn from each other's mistakes and, ultimately, become better investors.

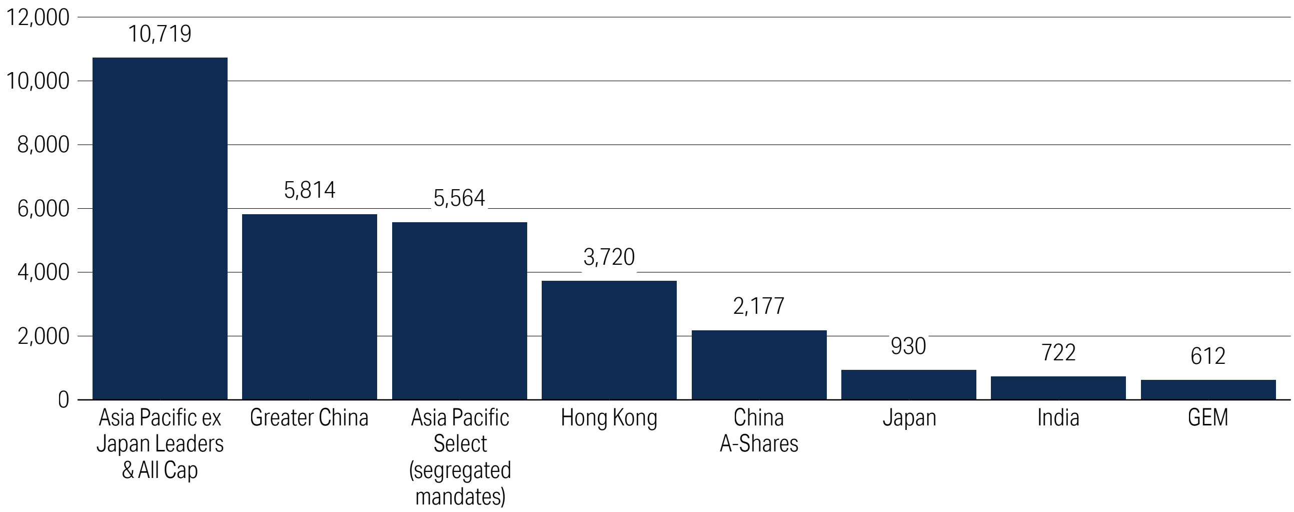
Our philanthropic giving is facilitated by Manan Trust, a charitable foundation that aims to drive long-term change in communities across Asia. Manan Trust provides multi-year unrestricted grants as well as strategic support to their portfolio of more than 30 non-profit organisations.[4]

Breakdown of AUM



Source: First Sentier Investors. Data as at 31 December 2022.

Total AUM USD 30.3 billion



Source: First Sentier Investors. Data as at 31 December 2022.

3. As at 31 December 2022
4. https://www.manantrust.org/who-we-fund

Our investment approach

Our philosophy is focused on identifying quality companies, buying them at a sensible price and holding for the long term, which we define as three to five years or longer. We analyse companies from the bottom up to build concentrated, high-conviction portfolios. We target absolute returns without regard for benchmark indices and aim to achieve long-term capital appreciation while preserving capital in down-markets.

Our process can be described as being more qualitative than quantitative. Rather than build complex financial models, we try to gain conviction around a company's competitive moat, the sustainability of its earnings growth and the integrity of its management. We prioritise meeting with companies, holding more than 1,500 meetings each year. We assess the quality of management and examine their track record of executing long-term strategies, how they have dealt with challenges and whether we believe they have earned their licence to operate in the community. In our meetings we also observe the nuances of their culture. Is there a domineering leader, or is the decision-making more egalitarian and inclusive? Do they treat their employees well?

While ESG analysis is integrated into our company research and engagements, we believe that there is no such thing as a perfect company. Instead, we focus on the direction of travel and partner with companies to help them improve. Given our reputation as long-term investors, we find that companies are often willing to work with us and accept our feedback.

Our core beliefs

1	We believe in quality.	6	We are pragmatic contrarians.
2	We are bottom-up stock pickers.	7	We invest in companies where we are an aligned partner.
3	We believe in the investment case for Asia and emerging markets.	8	Sustainability is a key part of our process and always has been.
4	We are long-term growth investors.	9	We believe in the team.
5	We define risk as the risk of capital loss, not under-performing an index.	10	We believe in our funds.

Our ESG partnerships

MANANTRUST

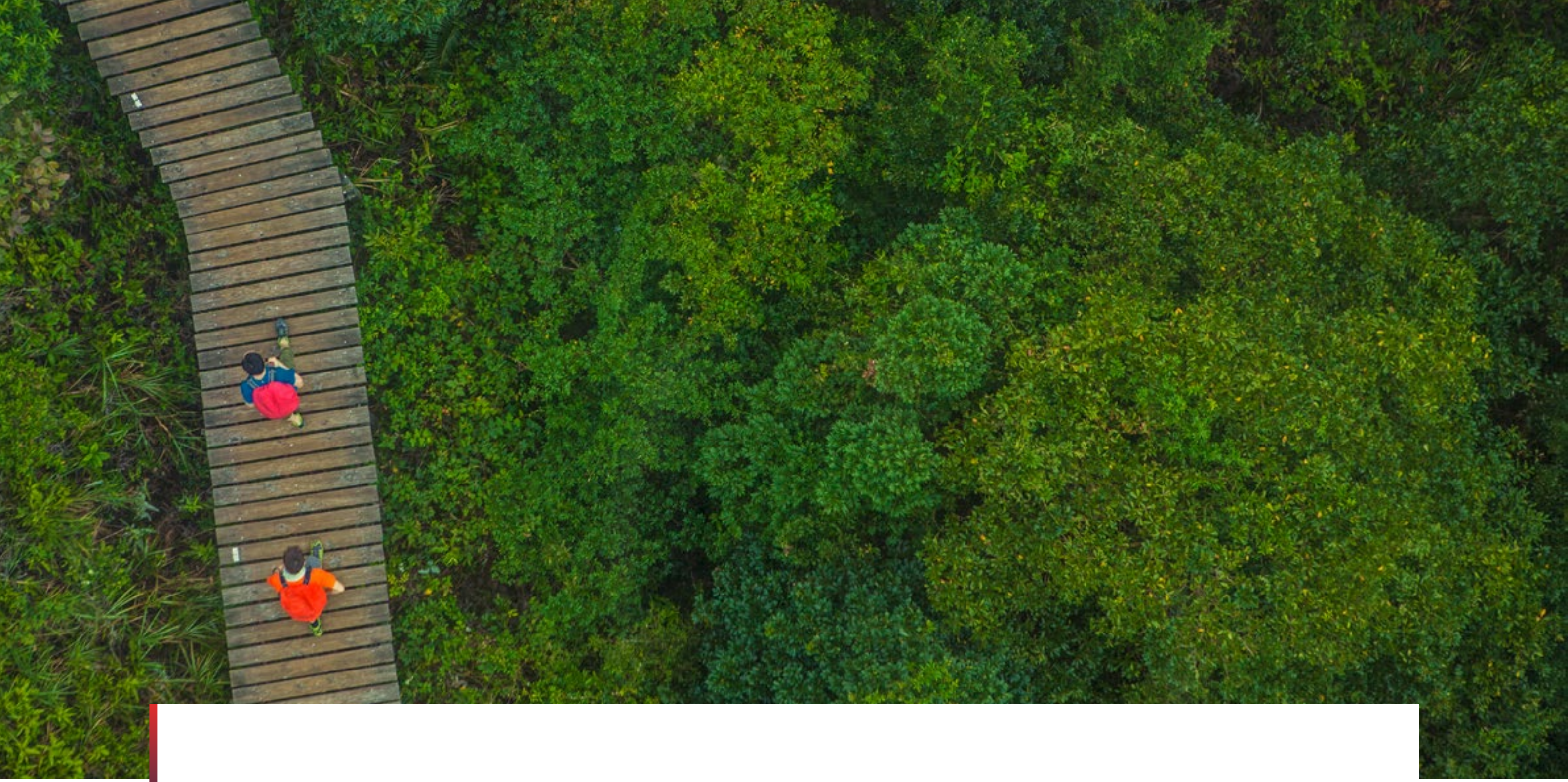
PRI Principles for Responsible Investment

TOBACCO-FREE FINANCE PLEDGE SIGNATORY

As an autonomous investment unit within First Sentier Investors (FSI), we share in the commitment to be a leading advocate and agent of responsible investing. We are a signatory of the Principles for Responsible Investment (PRI) and are committed to the same firm-wide initiatives such as eradicating modern slavery, taking climate action, and protecting biodiversity and human health.

FSI's Responsible Investment team provides specialist knowledge and support to the firm's global investment teams, including FSSA. At the firm level, we are signatories of the Finance for Biodiversity pledge, Tobacco Free Portfolios Pledge (recently stepping up our commitment by becoming a Pledge Stamp member), Net Zero Asset Managers Initiative and Climate Action 100+.

Furthering our involvement, two FSSA representatives participate in Investors Against Slavery and Trafficking Asia Pacific (IAST-APAC), a collaborative effort chaired by FSI. FSSA also contributes to FSI's recently established Natural Capital and Biodiversity Working Group.



03. Our approach to quality

Overview

1. Find a new idea + **2. Inclusion process** + **3. Decision-making** = **Portfolio**

1. Find a new idea

- Hard exclusion policies
- Management track record and reputation
- Corporate governance
- Past red flags

2. Inclusion process

- Fundamental company research
- Meetings with management, competitors and suppliers
- Identify material ESG factors
- Compare against peers

3. Decision-making

- Quality rating
- Team discussion
- Risks vs. opportunities
- Watch-list review

Portfolio

- Monitor and review
- Company engagement
- Encourage best practices

What we look for and what we avoid

With every potential investment, we assess its quality in terms of the management, business franchise and financials. The main characteristic we look for in management is a sense of stewardship and corporate responsibility. We want our investee companies to be run by people who think about long-term returns in the context of the broader consequences for society.

With our index-agnostic approach, there is nothing we must invest in and consequently there are some areas that we avoid completely. Please view our latest exclusion policy on our website. We also avoid companies with deep-rooted governance issues, excessive leverage, significant government interference and over-complicated ownership structures. Contrary to most with a valuation discipline, we do not believe there is a price for everything.

Our overall quality rating

We have always viewed ESG as being synonymous with quality. In our experience, the companies that make the best long-term investments are those led by management teams with integrity, have sustainable business models and generate durable returns on capital.

A significant proportion of our time is dedicated to analysing and interpreting unquantifiable qualities. With respect to ESG, this means finding companies run by people that apply management foresight, technology and new ideas to address changing societal and environmental expectations. The phrase, *not everything that can be counted counts, and not everything that counts can be counted*, might summarise it best.

Each company we encounter will be assigned an A–E quality rating, based on a holistic analysis of its quality. Our views on a company's ESG credentials are incorporated into this overall quality rating. Companies which we consider to be the highest quality form the core of our portfolios.

This quality rating is subjective, based on a combination of views and data points, and can differ from person to person. Ultimately the lead portfolio manager is responsible for stock selection and the portfolio construction of each fund – these ratings are simply a starting point for broader debates and discussion. As we believe there is no single or correct means of approaching ESG or engagement, we consider it important to acknowledge the varying opinions within the team.

Through active engagement with the companies we own, we are able to raise legitimate concerns and attempt to persuade them to address the issues at hand. We believe progress is best made not with lectures or demands, but through thoughtful discussions with trusted management teams over time.

As companies can be at varying stages of development when it comes to ESG awareness and disclosure, we have no fixed minimum threshold. It is the direction of travel that matters most to us. We are not interested in a static assessment of a company's performance; rather, we want to understand how a business is underwriting its long-term success. Finally, we aim for our portfolios to be well diversified with a select group of companies at different stages of development, such that there should always be something in bloom.

How we use external ESG ratings and data

One common criticism of ESG scores is that they are vastly different between providers, due to the various methodologies used. We believe that view has missed the wood for the trees. ESG, like quality, is subjective and we should expect and value differences in opinion.

However, the usefulness of third-party ESG scores relies largely upon the standardisation and quality of data disclosed by companies – and this is still lacking, especially in emerging markets. The tendency, therefore, is for scoring to skew to the measurable, such as scope 1 and 2 greenhouse gas (GHG) emissions. This comes at the expense of a holistic assessment of sustainability, as environmental factors are decoupled from the value of the underlying business in terms of doing good.

We are optimistic that the ESG data industry will eventually converge towards standardisation and regulation, similar to the field of accounting. This will allow us to compare companies more effectively on a whole host of factors, which helps us to form a view on a company's growth potential. The key for us, however, will still be our ability to parse the information and use it to deepen our engagements with companies – we use ESG ratings as a prompt to discuss the issues among the team and if necessary to seek clarification directly from the company.

To extend the accounting analogy, when we assess a company's financials, it is what we read between the lines that interests us most. Is the company aggressive in its accounting practices? Is it misleading investors in any way? Have the management delivered on what they said five years ago? What explains the profitability and competitive advantages? These are the same questions we ask when we analyse a sustainability report or ESG disclosure. External ratings and data merely provide clues to which potential controversies or issues may be uncovered.

We fully expect third-party data providers to continue to adjust their offerings as companies improve their disclosure practices. This will help us be more efficient in our research, though it will not replace our bottom-up and differentiated investment analysis.

04. A year in review

In 2022 the gradual relaxation of travel restrictions allowed us to get back on track with in-person conversations – both with investee companies and across our own team – which reminded us of the positive impacts we generally have when meeting face to face.

From an ESG perspective, regulations have continued to accelerate with enhanced disclosure and reporting requirements against a regular cadence of greenwashing examples. Asset managers and companies alike have been back-pedalling from their commitments so as not to run afoul of the more stringent criteria imposed by these new principles and directives. We see this as a positive which should ensure more thought and care.

Throughout, we remained focused on assessing company quality rather than marketing ourselves as a particular shade of green. Nonetheless, we too are subject to these same regulatory developments and recognise we must continue to learn, evolve our work on ESG and improve our communications to stakeholders.

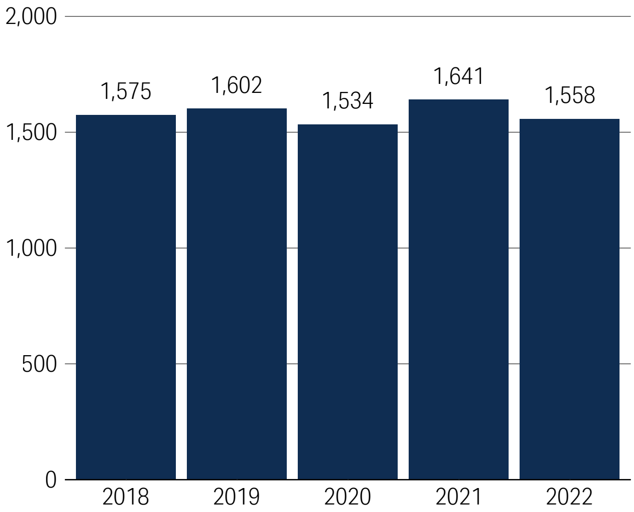
Building on last year's commitment to invest more resources into these areas, we have made important progress in 2022. For example, in September we updated our disclosure of climate-related risks and opportunities on our website. We also announced short-, medium- and long-term climate targets to reduce the absolute carbon exposure in our portfolio holdings, and have encouraged investee companies to make reductions in greenhouse gas emissions. This is in line with FSI's Net Zero Commitment and the publication of its Climate Action Plan to substantiate the commitment.

We broke ground on understanding what nature-based risks are and how to engage on the topic. We also hosted a roundtable event on tobacco-free financing in association with other asset managers, banks and related parties to pave the way for tobacco-free solutions to take hold in Asia.

Additionally, we began tracking and organising our engagements more closely and conducted a gap analysis on where our engagement risks and opportunities lay. We considered the implications of several grey areas, from seemingly "good" ESG players with exposure to what might be considered controversial industries to potential human rights violations in less engaged areas. We participated in more responsible investment conferences and built new relationships with various solutions providers to broaden our understanding of the issues.

It has been a fruitful year for the team, though there is still much to be done. We intend to build on this momentum in the years to come.

Total number of company meetings



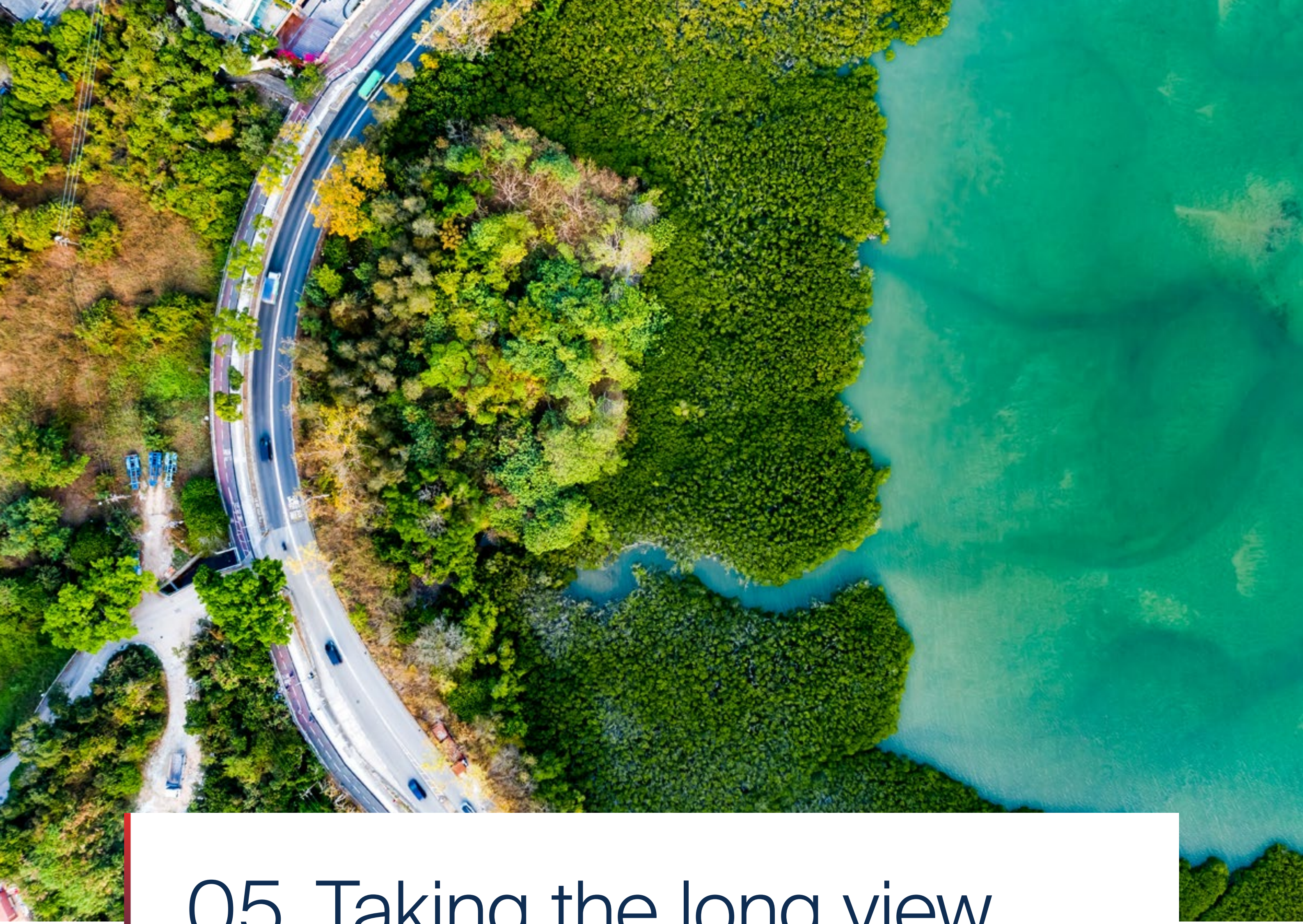
Source: FSSA Investment Managers, as at 31 December 2022.

Topics covered in ESG-specific meetings

Category	Topics
Governance	Taxes, capital allocation, governance structure
Environment	GHG emissions, net zero strategy, wastewater pollution
Social	Labour rights, human rights, modern slavery
General ESG	ESG strategy, disclosure quality

Engagement letters by topic

Category	# of letters	Topics
Governance	11	Director independence, board tenure, board diversity, management turnover, M&A, capital allocation
Environment	1	GHG emissions, waste management, water stewardship
Social	4	Labour rights, modern slavery, workplace culture, gender diversity
General ESG	1	ESG strategy, disclosure quality



05. Taking the long view... the Jardine Group

Much of what is so important about ESG (or investing sustainably, in our words), as well as why it really matters, is the indivisible positive impact it has on humanity and society broadly. That's a problem; because while it is undoubtedly good for all of us, when everyone is collectively responsible, often there is nobody to take the responsibility head on.

But, as ESG hurdles grow, whether it be access to (or the price of) capital, maintaining a good reputation with customers and clients, branding, stock-market ratings, or simply remaining an attractive and relevant employer, we have seen a marked shift in attitude. For us, it's usually about our alignment with companies, given their implicit mission is to maximise profits.

We previously considered Jardine Matheson (JM) to be an ESG-free zone. In our view, they used to be actively resistant and appeared to regard ESG as a challenge to their muscular corporate leadership and maverick culture. After years of engaging with them, we are happy to see the company making positive improvements and progress.

Today, with a growing alignment of interests, we see real changes underway. Jardine's 2021 annual report called out sustainability as being "core to creating long-term value". We have always thought so; but such has been their pivot.

These things matter. We see responsible investing as being synonymous with quality. To paraphrase: good people and companies don't typically do bad things and vice versa. Furthermore, we value open and engaged management teams who appreciate their stakeholders, whether that be their staff, society, government, or even shareholders.

JM was founded in 1832, which makes it older than some Asian countries. We consider it one of Asia's best examples of a family-owned company that is managed by professionals. However, it is only in the last three years that they have demonstrably moved from reluctance to sustained effort towards ESG, with a high degree of openness.

These efforts have been led by the group chairman, Ben Keswick. The turnabout started in early 2019 with his appointment to executive chairman and the subsequent announcement of a group-wide "momentum-shift" strategy. JM's Sustainability Leadership Council was formed in July 2019 and now comprises all of the group CEOs. There are three key pillars: leading climate action, driving responsible consumption (recycling) and the promotion of social inclusion.

JM hired its first sustainability head in December 2021 and released its first sustainability report in May 2022. The group aims to manage against the subsequent data, before ultimately defining a set of hard targets (including net zero). We are confident they will make further progress. As long-term shareholders there have been two main areas of contention (and engagement) for us in the past – and we can happily report positive actions from JM on both.

The issues relate to Indonesia's Astra, a subsidiary company, with the business involved in palm oil (80%-owned Astra Agro Lestari) and coal mining (60%-owned United Tractors). United Tractors holds the Komatsu machinery franchise for Indonesia, owns coal mines directly (15% of Astra's sales) and does coal contract mining for other companies (half of turnover). These have long been concerns for us from both environmental and social aspects and in recent years we have implemented stricter thresholds on coal activity in our portfolios.

Astra Agro Lestari (AAL) accounts for 4-5% of Astra's net profit (just 1-2% at the JM level), while United Tractors (UT) is more significant, accounting for 35–40% of Astra's profits (and 10–12% at JM). Directly-held coal mining accounts for 2% of Jardine profits, while overall coal mining exposure is 6% including contract mining.

To our questions about palm oil, JM said that AAL operates in line with European Palm Oil Alliance (EPOA) standards. That means no deforestation, no peat development and no exploitation. The EPOA has now been supplanted by Sustainable Palm Oil Choice, with similar compliance requirements.

Astra's plantations are certified by Indonesia Sustainable Palm Oil as compliant too, but not by the Roundtable on Sustainable Palm Oil (RSPO), an international organisation with Unilever and the World Wildlife Fund (WWF) as founding members. This is despite Astra's global client base. Jardine knows it can do better and is working to improve.

Though Astra (and Jardine Cycle & Carriage) have been producing sustainability reports since 2017, in line with JM they started including greenhouse gas (GHG) emissions data for the first time in 2021 (using 2019 figures). While the management have been discussing these issues privately with us and others for some time, there is now a series of commitments to 2030 in their latest reports.

Astra has stated that it will not acquire any more coal assets and highlighted 10 sustainability aspirations. These include hard targets, such as reducing scope 1 and 2 GHG emissions by 30%, at least 50% renewable energy use for its internal needs and a 15% reduction in water intensity.[5] Overall, Astra expects all coal-related revenues to account for less than 12% (from 22%) of overall sales by 2030, though we will continue to hold them to a threshold of no more than 10% revenue from coal mining and processing.

As always, there remains much to be done. It's a journey with every company, but with JM we have seen real progress. Today, ESG has arguably become a necessary investment condition. But the very best companies have embraced the issue, rather than just box-ticking their way to success, understanding that ultimately it makes them better businesses.

5. https:///sustainability.astra.co.id/

06. Corporate governance

In our search for quality, we value the governance of a company most highly and thus look for founders and management teams with high standards, whose interests are aligned with minority shareholders and where the execution track record is exemplary.

To us, it is a binary issue – either the corporate governance is good enough or it is not investable. In our experience, where the management team is weak or misaligned or if there is a dishonest controlling shareholder, this can destroy a company's investment case. As such, the most important trait that we look for in management teams is stewardship. Simply put, there can be no question around management integrity and alignment.

Our approach is broadly the same regardless of where we invest, with a similar governance framework and criteria. India is perhaps where we have found the most investment opportunities, as the quality of companies is high and there are many alternatives within a sector to choose from. In China, the market is large and deep and there are many companies with good long-term growth prospects. While investing in China is not without risk, we try to mitigate those concerns by investing only in companies with appropriate governance structures and strong management teams.

6. ASEAN stands for the Association of Southeast Asian Nations
7. https://www.topglove.com/storage/annualreports/December2021/TopGloveAR2021.pdf

Spotlight:
An evolving opportunity set in ASEAN[6]

We think ASEAN is exciting from an investment point of view, as we believe many high-quality companies with good growth potential are there hiding behind small market capitalisations. The region has largely been ignored by investors who have tended to favour North Asian markets – foreign ownership of public equity in ASEAN is the lowest it has been in a decade. While the region has improved over the years, corruption is still a major issue, though we tend to stay away from sectors like commodities and energy where this is more prevalent.

Family-owned companies are commonly found across the ASEAN markets and the strong alignment of interest this creates can make for an attractive investment case – particularly when outside managers are brought in to professionalise the business. In our experience, this combination of long-term family ownership and competent, professional management is often a positive sign of improvements to come.

There are still many complications for investors to contend with, such as related-party transactions and the corresponding profit leakage to privately-held companies. For this reason, we have steered clear of certain families in Indonesia or the Philippines with poor governance track records. As bottom-up investors, there is no company that we have to own and we are happy to say "no" when a company does not meet our investment criteria.

One example of this is Mayora Indah, a leading Indonesian food company focused on biscuits and coffee, with good management, signs of positive strategy execution and a strong financial track record. However, despite the founding family owning over 80% of the company, the alignment is not as strong as it could be. The brand, distribution and new businesses are held outside the listed company, which has made us stay on the sidelines for now. We will continue to monitor the company's progress and hope that the next generation of the family will improve things over time.

Monitoring the succession planning is particularly important for family-owned businesses in ASEAN. In this regard, we have started to see positive generational changes taking place at Universal Robina Corporation (URC), a leading food and beverage company based in the Philippines. The company was founded in 1954 by John Gokongwei Jr. and had been run by a series of family members, the most recent being Lance Gokongwei who was appointed CEO in 2013.

In the years following Lance's appointment, URC suffered from operational issues and a lack of new "hit" products. This was partly due to Lance being spread across too many parent group companies and partly complacency after a few successful years. To address these problems and to reposition URC for the future, Lance stepped down in 2018 and hired the company's first outsider CEO, Irwin Lee. Previously a long-serving veteran at Procter & Gamble, we believe Mr Lee has made good progress in professionalising the business and taking steps to fix URC's problems. We believe this is much needed for homegrown franchises like URC to become bigger businesses over time.

From a social and environmental perspective, ASEAN companies regularly comply with local standards, but in our view they can sometimes lag in the global arena. Entrepreneurs are more focused on running their businesses in a low-cost manner and remaining competitive. One example where we have seen notable improvement is at Top Glove, the world's largest maker of natural rubber and nitrile gloves.

In June 2020 an investigation carried out by UK media outlet Channel 4 exposed evidence of migrant worker exploitation, including excessive overtime scheduling, the confiscation of workers' passports, deductions from salaries and extortionate recruitment fees at the group's factories in Malaysia. The report was almost immediately followed by a US import ban. While these practices are somewhat acceptable in Malaysia, in developed markets (where the group's customers are based), it is not. We wrote a letter to the chairman to raise our concerns and have continued to maintain a dialogue with the management to reinforce our views.

While we sold out of Top Glove due to expensive valuations, we continued to follow its progress. Top Glove subsequently enforced zero recruitment fees for new workers and reimbursed those who joined in previous years. The company also strictly limited working hours, improved worker accommodations and set up a whistleblowing/grievance channel managed by third-party auditors and in the workers' local languages.

Top Glove aims to improve its social audit rating to "A+" by 2024[7] (from "C" in August 2020) and in September 2021 the US import ban was revoked. We have observed that the group also appears to be getting up to speed with environmental issues in terms of scope 1 and 2 emissions disclosure, and is in the process of setting up a net zero roadmap.

Case study:
Access to management is key to understanding a company's ESG practices

Anta Sports is the domestic market leader in Chinese sportswear, operating well-known sportswear brands like Anta, FILA and Descente in China, as well as Wilson, Salomon and Arc'teryx on a global basis. Having followed Anta Sports since its initial public offering (IPO) in 2007, we have spent the past 15 years visiting the company and engaging in frequent dialogue with management to deepen our understanding of its franchise and build conviction in the quality of its management.

We have been impressed by Chairman Ding Shizhong's long-term vision and the management team's execution. We believe this combination of long-term owners, with the Ding family holding over half the shares, and well-incentivised professional managers, including high-profile hires from Nike, Reebok and Lululemon, has been vital in driving Anta's success. Long-dated share options (10 years) and restricted shares (vesting over 5 years) were allocated to its top managers, which strongly aligns their interests with Anta's long-term success. We think it is a testament of the management's belief in Anta's long-term prospects that a large part of the options awarded back in 2010 were only exercised in 2020.

We became shareholders of Anta Sports in July 2020, marking the start of our official engagement. Through a series of meetings with Anta's management (including the chairman, CFO and sustainability team), and a letter written directly to the chairman, we engaged with the company on a range of issues. These included supply chain management, workplace diversity, internal processes to combat corruption, management compensation and auditor independence. Given the open and proactive response we received, we believe the company is genuinely interested in improving its ESG practices and becoming a leader in sustainability issues.

We believe Anta has made progress on a range of ESG topics over the years:

1. In December 2021 Anta established a sustainability committee to formulate and review its sustainability targets, and became the first Chinese sportswear company to pledge to carbon neutrality by 2050. It has also committed to a range of other sustainability goals, including the use of recyclable materials and biodiversity conservation, which have been incorporated into the management's Key Performance Indicators. Anta now monitors the sustainability of its suppliers, including water usage and emissions levels.
2. Anta has announced a target of at least 40% women among its executives at director grade and above by 2030. Following our engagements on the board's diversity and the independence of its directors, Anta announced the appointment of Ms Xia Lian to the board, being the second female director appointed by Anta in the last two years.
3. Anta was the only Chinese sportswear company to join the Better Cotton Initiative, and increased efforts around supplier transparency as a result. Although it has now exited the programme due to political pressures on sourcing areas, it swiftly pledged to look for alternatives. It joined the UN Global Compact initiative in November 2021 and has committed to reporting on its alignment to the ten principles. It has also joined the Sustainable Apparel Coalition and the Science Based Targets initiative.[8] Anta is also encouraging its suppliers to align to the Higg Index, a sustainability self-assessment tool to monitor environmental and social impact.

While Anta's progress is encouraging, we believe that no company is perfect. We appreciate the transparency of Anta's chairman, who openly admits to the company's steep learning curve and acknowledges that there is more to be done. This includes the publication of scope 3 emissions data and a comprehensive map of its supply chain.

We believe our access to Anta's top management enables us to better understand the company's ESG approach and monitor its progress, which is distinctively different to our experiences engaging with other sportswear companies in China. We look forward to continuing our dialogue with Anta's management in the upcoming months and years, as they continue to deepen their ESG focus.

8. https://manager.wisdomir.com/files/394/2023/0321/20230321143448_55714182_en.pdf

Case study: Engaging on management succession and capital allocation

Alsea S.A.B. de C.V. is Latin America's leading Quick Service Restaurant (QSR) operator with over 4,300 stores. It is responsible for managing brands like Starbucks, Domino's and Burger King in countries such as Mexico (its home market), Colombia, Chile and even Western European countries like Spain, the Netherlands and France.

We have known the company for many years (our first meeting with them was in 2007) and admired the way the founders, three brothers who initially started as franchisees for one Domino's store in the '90s, have built the business. Their track record of growing consistently and generating significant operating cash flows is commendable – over the past 10 years, the company has grown sales more than three-fold and earnings over six-fold in US dollar terms.

We have owned the business through some volatile periods, including the Covid-19 pandemic. Our engagement focus over this time was on succession planning and capital allocation. Since 2015 we noticed an increase in senior management churn, with four CEOs appointed in eight years, which raised concerns about the stability and direction of the company.

We were particularly surprised with the recent appointment of Armando Torrado as CEO (one of the three founder brothers). To us, this raised questions about whether the company's attempts at attracting talented professionals had failed. Further, we were uncomfortable with the board's strategy of using acquisitions to drive growth, potentially putting the company at risk. This was borne out by Alsea's experience during the global pandemic, when it had to approach its lenders to arrange a waiver on interest payments while its shops were shut. We had hoped that this would change the board's mind about using acquisitions and leverage to drive further growth. In this regard, we wrote a letter to the main founder, Alberto Torrado, in July 2022. He responded immediately, and asked us to meet with the new interim CEO (his brother) as well as a longstanding independent board member.

In October 2022 we visited Mexico and met with Armando Torrado, the new CEO, and Leon Eskenazi, an independent director who has been on the board for nearly a decade. The two provided us with an honest and detailed overview of the leadership changes. They assured us that the company is committed to maintaining strong corporate governance practices and has implemented measures to ensure more stability in the senior management. Armando's top priority, as per the board, is to groom a capable successor. They also provided us with an overview of the company's acquisition strategy and the steps they were taking to mitigate potential risks associated with leverage.

Overall, we were satisfied with the explanations. While we still have concerns, we have been encouraged by the steps they are taking to address these issues. We will continue to monitor the company's progress and engage with management and the board as appropriate.

Case study: **Pressure to perform – recognising that culture comes from the top**

In Japan, many small and medium-sized enterprises, some of which have been family-run for generations, face growing succession issues as the next generation of family members are unwilling to take over the business. This has generated strong tailwinds for the mergers and acquisitions (M&A) advisory industry, benefitting companies like Nihon M&A Center, Japan's largest M&A advisory services firm.

The company provides consulting and intermediation services to ageing business owners who wish to retire. While its execution seemed outstanding, its highly motivated and sales-driven culture resulted in an unusual booking of sales at a subsidiary company in December 2021, which raised red flags about the sales and profit attribution over the quarter.

Upon internal investigation the management discovered that several similar cases had occurred, involving more than 80 employees.[9] Brokers were being put under immense pressure by the top management to achieve sales targets, particularly around the 30th anniversary of the company's founding in April 2021. Despite the background of Covid-19, brokers did not want their departments to show poor results.

In June 2022 we met with the president at Nihon M&A's office in Japan to discuss the issue. The president acknowledged the problems and was deeply apologetic. He committed to improving the situation and outlined several preventative measures that the company planned to implement, such as stricter sales recognition criteria and changes to the employee incentive program. A new director with a legal background was appointed to the board.

In a follow-up to our meeting, we sent a letter to the president in September 2022 to highlight our concerns about whether its internal culture and governance could transform meaningfully without harming its business franchise. We also suggested additional actions to consider, such as a stronger internal audit and compliance division, open and transparent channels to check the internal systems, and the disclosure of historically-revised financials.

In our view, setting such high targets while ignoring the business environment could be a cultural issue and alleviating the pressure to perform may not come easily. On the other hand, the president has been clear that he does not condone these practices – we found his personal involvement in conducting face-to-face sessions with employees to address the issue to be a positive sign. We intend to monitor the situation to see whether the president's efforts to change the corporate culture succeeds.

9. https://www.nihon-ma.co.jp/ir/pdf/220214_information1_en.pdf

07. Climate change and the environment

We believe that identifying quality management teams is often the precursor for improvements on environmental and social factors to follow. In our experience, effective leaders understand that progression in these areas should also mean sustainable and successful outcomes for their business.

The climate action conversation over the past year has been dominated by the notion of "just transition", with mounting support for developing countries that are more susceptible to the effects of climate change. Policymakers globally have finally recognised that action towards a greener future must be as fair and inclusive as possible.

A significant portion of the assets we manage are in China and India, which both face significant cost pressure to prepare for the impacts of climate change policies and the transition to a greener future. Given our extended investment time horizon, we fully expect climate risks and opportunities to become more evident as extreme weather events occur with higher frequency and greater intensity and governments step up their commitments to the cause.

We believe every company and every investor must consider the impact of climate change. For our part, we have invested in and continue to seek out companies that are actively taking steps to solve the climate change problem. We expect that this will require firm commitments of capital towards decarbonisation initiatives and product innovation. Over time, we expect to see real reductions in greenhouse gas (GHG) emissions across our portfolios. Learn more about our methodology in the Decarbonisation commitment section.

Climate action must be extended to include other interrelated and complex environmental issues. Many investors, like us, are only beginning to comprehend the enormity of the risks. We are now starting to engage on natural capital and biodiversity loss, circularity and pollution, and other topic areas as defined by the material risks of our holdings.

Case study:
Understanding the role of natural resources in the transition economy

Our knowledge and understanding of what "net zero" entails has evolved through ongoing study, company discussions and internal reflections. Through this process we have grown to appreciate just how critical certain resources are to the transition economy. As a team, our research on China has helped us understand some of the technologies and cost reductions needed for decarbonisation to occur (China produces 60% of the world's wind turbines, 70% of its solar panels and 80% of lithium ion batteries). But, in addition to this, we have also sought to better understand the extensive dependence on natural resources which belies widespread adoption.

We have long viewed BHP Group as one of the highest quality mining companies globally and even owned it in our regional Asia Pacific strategies nearly ten years ago. While we no longer own it today, we recently conducted due diligence on BHP's business to understand the quality of the franchise, its sustainability challenges and opportunities, and its approach to capital allocation in this context.

What piqued our interest was the growing acknowledgement of the scope of the energy transition (the demand) combined with years of underinvestment by the mining sector (the supply), which has led to meaningful supply tightness and commodity price appreciation in recent years. Research suggests that in 2021 the world paid more for extractive resources as a percentage of Gross Domestic Product (GDP) than at any other point in the last 50 years.[10]

The mining industry's margins bottomed in 2014 and its constituents have been on an investment strike ever since – expansionary spending has come to a complete halt. To put the scale of this capital expenditure (capex) strike into perspective, between 2014 and 2022 the FAANG[11] companies invested a combined total of over USD 600bn into capital projects. The world's top miners BHP, Rio Tinto, Antofagasta, Anglo American, Fortescue and Vale spent just USD 200bn over the same period. Given it takes most mines around seven to ten years between breaking ground and extraction, an immediate increase in supply seems unlikely.

Whilst one might argue that the supposed asset-light business models of technology companies make them strong environmental contributors from an ESG perspective, we would suggest that a good mining company with high-quality and future-facing assets, like BHP, will do far more to support the necessary transition – even despite its energy-intensive business practices.

In the last five years BHP has moved from being one of the worst emitters in the world, as measured by scope 1 and 2 emissions intensity, to one of the best. Generally, its mining portfolio is being repositioned away from legacy assets and towards "future-facing commodities" which support the transition.

BHP has targeted a 30% reduction in scope 1 and 2 GHG emissions by 2030 (from FY2020 levels) and to achieve net zero by 2050, with short- and medium-term targets linked to management compensation. It will invest USD 400m over the next five years to achieve this, increasing to USD 4bn by the end of the decade. The company has also pledged 30% of its land to conservation practices, restoration or regeneration – roughly half the size of Switzerland.

Although we cannot predict the demand for commodities over any given timeframe, it seems clear that we will need more of certain metals, ores and minerals than we currently produce and use today. The supply and demand imbalance for these resources could be cause for grave concern, given the world has underspent on decarbonisation efforts thus far and the journey has only just begun.

For example, copper is a critical ingredient in the energy transition – but the purchase of just one new dishwasher would consume an individual's entire copper budget for the whole year.[12] When taking other household electronic devices into consideration, the scale of the impact on copper demand and prices is inconceivable. As investors in home appliance companies across emerging markets, this type of analysis has highlighted the profound implications on affordability our investee companies might soon face.

10. BP Statistics, Bloomberg, IM, Bernstein estimates (2021) and analysis.
11. FAANG refers to Facebook (now Meta), Amazon, Apple, Netflix and Google (now Alphabet), commonly grouped together as the technology companies that dominate people's day-to-day lives.
12. Defined as being the current total annual copper production divided by the world's population to arrive at an individual's "copper budget" for the year.

This is compounded by the increasing demand from electric vehicle (EV) adoption and renewable energy investment, which will only accentuate existing pressures. As it stands, a single EV consumes 30 years' worth of copper budget, almost twice the useful life of the vehicle itself.[13] Renewable energy generation, whether wind or solar, requires 3x the copper content of an equivalent conventional power unit. BHP's own forecast says that if we are to meet the 1.5°C global warming limit relative to pre-industrial levels, as outlined by the Intergovernmental Panel on Climate Change (IPCC), then demand for copper will double over the next 30 years, while nickel will quadruple.

Our analysis has deepened our understanding of some of the risks, opportunities, constraints and possibilities involved in the decarbonisation process. But the investment industry has, perhaps until very recently, missed much of this nuance. Hard-coding ESG to differentiate the good risks from the bad potentially blinds investors to the complexity of the challenges we face. While clients have commended us for the low carbon intensity of our portfolios (and not owning BHP might have contributed to that), it has largely been an outcome of our process rather than something we strategically sought to do.

In our view, there is too much focus on a static assessment of the here and now. We believe it is much more constructive to focus on the companies that are contributing to the transition, rather than invest solely in those that have a low carbon footprint today. We cannot afford to deprive the former of capital.

13. Bernstein Research - Jan 2021

Case study:
Encouraging positive climate action with banks and financials

Climate action is a complex topic and we recognise our responsibility to positively influence other allocators of capital, such as the banks and financial institutions we hold in our portfolios. ICICI Bank, having been highlighted as a laggard in our initial decarbonisation assessment, is one such example. We raised the topic with its CEO, Sandeep Bakhshi, as part of our engagement process.

ICICI Bank (previously known as the Industrial Credit and Investment Corporation of India) is a leading private sector bank in India which offers a large variety of loans, savings and investment products for retail and institutional customers. For over 20 years since it was separately listed in 1999 we have been concerned about its culture and governance standards[14], which meant that we were not shareholders until fairly recently.

In 2018 the former CEO, Ms Chanda Kochchar, was found guilty of fraud and fired along with most of the directors on the board. An entirely new board was constituted and Mr Bakhshi, who had been the CEO of ICICI Group subsidiaries such as ICICI Lombard and ICICI Prudential, was appointed CEO in her place.

Over the past four years, we have had several meetings with Mr Bakhshi and most of the bank's senior managers. It is clear to us that there has been a comprehensive overhaul of the culture and we would now regard ICICI Bank as one of the best-run banks in Asia. We have built a close relationship with the senior management team and have engaged with them on a range of topics, including the bank's ESG strategy.

After our initial assessment on ICICI's net zero maturity plans, we engaged with it on what we considered poor disclosure (only scope 1 and 2 greenhouse gas emissions have been disclosed since 2019 with few other metrics) and the lack of a tangible decarbonisation strategy. We found their responses underwhelming, given that banks have an indirect but major role in decarbonising economies.

While funding carbon-intensive industries is not the main profit generator for ICICI Bank (estimated at roughly 5% of its loan book), the capital it provides as, for example, project loans to coal-based power plants, could have a material impact as financing for renewable power and other related sectors gain momentum. The company has been noticeably quiet on the topic.

As at the date of our discussion, an ESG lending framework did not exist, but the team is exploring the many facets this involves (it is also being pushed by the Indian government). ICICI Bank has also expanded its ESG team with a revised governance structure to support it, and recognised the need to improve its communications with stakeholders. We will continue to engage on these matters until its goals and progress are evident.

An important factor in our engagement was having the support of Mr Bakhshi, who believes that ESG is central to the success of the business. His views have been pragmatic and he has reminded us to keep in mind India's emerging economy status, mired as it is with many energy challenges. Progress often goes hand in hand with commitment at the state level; and with India pledging to become carbon neutral by 2070 followed by its decarbonisation strategy announced at COP27,[15] we thought this presented a prime opportunity to continue engaging on the topic.

We shared with several of our holdings the WWF Sustainable Banking Assessment (SUSBA) 2021 report, which summarises the environmental and social progress (and/or regression) of 36 ASEAN banks. At times, it was to show how the report reflected on the company in question and to press for improvement in the lagging areas. For banks not included in the report, it was to encourage them with best-in-class examples to follow suit.

We shared the report with Mr Bakhshi, hoping that ICICI Bank could be one of the leaders in India. This was followed by a meeting with the responsible team. We were encouraged by their openness to share, as they provided an overview of their activities, challenges and projects in motion. For example, they have significantly increased solar production onsite (by 70% from fiscal year 2020 to 2021 alone), are trying to keep emissions intensity flat and have begun a lending checklist for environmental and social risks in 14 key sectors.

14. https://economictimes.indiatimes.com/news/company/corporate-trends/why-icici-bank-wants-to-turn-a-new-leaf-a-peep-inside-the-banks-new-work-culture/articleshow/26758801.cms
15. COP27 is short-hand for the 27th Conference of the Parties to the United Nations Framework on Climate Change

08. Decarbonisation commitment

The underlying purpose of our team is to protect and grow our clients' capital over time in a responsible manner. To effectively deliver on this we must critically analyse long-term risks and opportunities in order to deliver durable returns and avoid a misallocation of capital. Climate change is one of the risks and opportunities we consider in detail.

In many ways this is nothing new. A company's reliance and impact on the natural world has always mattered to us as long-term investors. A recent revisit to the first chapter of one of our favourite text books, *Valuation*[16], first published in 1990, served as a useful reminder: "For their part, longer-term investors, themselves concerned with environmental issues such as carbon emissions, water scarcity, and land degradation, are connecting value and long-term sustainability."

What has changed, however, is the urgency, scale and our understanding of the challenges faced. We view ourselves as owners of businesses rather than tenants of the stock, meaning that we fully expect our investee companies will have to financially internalise these effects over the course of our ownership. We find ourselves, more than ever, questioning the contingent liability related to climate impacts that is not being adequately reflected in the accounting. What are the rising costs of compliance going to be? Who is borrowing from future earnings? Where is the likelihood of disruption to the underlying business model? We believe careful thought around this can mitigate considerable risk. Additionally, for companies that address climate challenges head on and where the transition provides a powerful potential tailwind, we are confident therein lies an intangible asset or competitive advantage waiting to be unleashed.

Our efforts to decarbonise our portfolios are focused on reducing the absolute carbon exposure of our investee companies. Rather than selling carbon-intensive assets or buying companies already meeting net zero claims through an abundance of offsets, we seek real-world reductions and abatement through a company's underlying business practices. To do so we place less emphasis on the grand gestures and more on the integrity, action and evidence of a plan. This approach also aligns to FSI's climate expectations of investee companies.

16. Valuation: Measuring and Managing the Value of Companies, 7th Edition, Chapter 1, by John Wiley & Sons, Tim Koller, Marc Goedhart, David Wessels. McKinsey & Company.

Our decarbonisation process

We launched our decarbonisation process in 2021 with an assessment of how our holdings were positioned, how they performed at that point in time and their plans for the future. While climate is a regular topic of discussion for all of our companies, we have undertaken a formal assessment with our largest portfolio holdings and have now covered 75% of the team's total AUM.

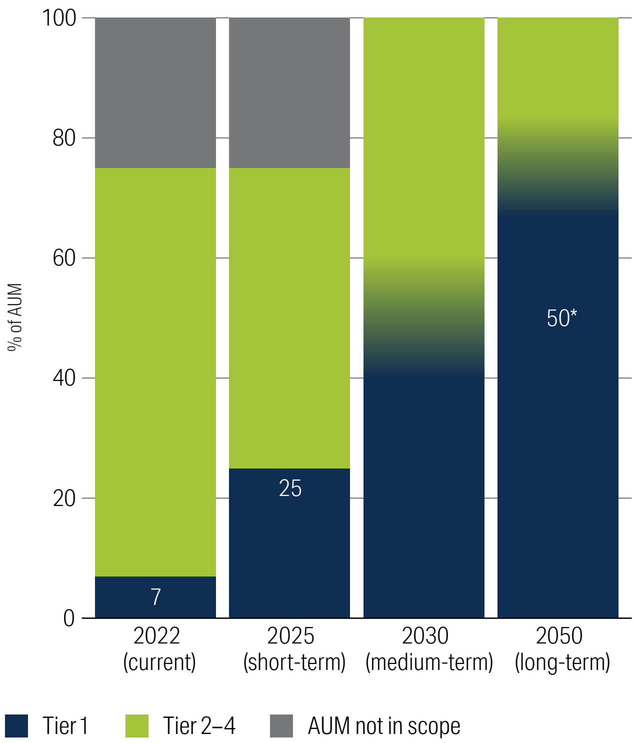
Our assessment is based heavily on the "net zero alignment maturity scale" from the Net Zero Investment Framework Implementation Guide (NZIFIG). Each portfolio company has been assigned to one of four tiers ranging from leader to laggard. The nuance in our tiers provides flexibility around a company's direction of travel, resource constraints and purposefulness, which we think is essential in an emerging market context.

FSSA tier	FSSA definition	NZIFIG maturity scale	Differences
Tier 0	Not applicable	**Achieving net zero**	FSSA does not define this tier level. Companies achieving net zero are included in the Tier 1 definition.
Tier 1	"Leader" is defined as either achieving net zero with current emissions intensity performance at, or close to, net zero emissions; or those aligned to net zero with adequate emissions reduction performance over three or more years	**Aligned to a net zero pathway**	FSSA includes both those that are achieving net zero or those aligned to net zero in this category. NZIFIG only considers those with current intensity emissions at or close to net zero to be achieving net zero or aligned. NZIFIG recommends checking the proportion of green revenue and if there are relevant increases over time as part of the company's decarbonisation plan. FSSA does not include this criteria. FSSA specifically checks for SBTi alignment, defines adequate performance over three or more years, and how the business model may contribute to decarbonisation or how it may be structurally challenged. NZIFIG does not include this criteria.
Tier 2	"Committed" is defined as aligning with short-, medium- or long-term goals (but not all), and disclosure of scope 1 and 2 emissions data for two or more years (with an option to include material scope 3 emissions data)	**Aligning towards a net zero pathway**	NZIFIG recommends checking the proportion of green revenue and if there are relevant increases over time as part of the company's decarbonisation plan. FSSA does not include this criteria. FSSA checks for any combination of scope 1, 2 or material scope 3 emissions reduction targets, defines adequate progress over two or more years, and how the business model may contribute to decarbonisation or how it may be structurally challenged. NZIFIG does not state progress over a specific timeframe.
Tier 3	"Laggard, Planning" is defined as committed to aligning towards a net zero pathway with the intention to set clear targets, and disclosure of scope 1 and 2 emissions data for at least one year, but with little to no progress over time	**Committed to aligning**	NZIFIG specifies having a long-term goal to achieve net zero by 2050. FSSA checks for a clear foundation to set a target and will engage on this. FSSA checks for disclosure of scope 1 and 2 emissions for at least one year and any progress over that period, as well as how the business model may contribute to decarbonisation or how it may be structurally challenged. NZIFIG recommends transition plan methodologies with a progress timeframe defined according to the target(s) set.
Tier 4	"Laggard, Needs Support" is defined as not aligned and may have the intention to set targets but with no time frames or metrics defined. These companies have poor disclosures leading to the inability to measure progress and their business models may be structurally challenged due to a reliance on carbon intensive resources.	**Not aligned**	NZIFIG designates this scale for all other companies. FSSA checks for level of disclosure, the intention to set a target, history of environmental malpractice, and how the business model may contribute to decarbonisation or how it may be structurally challenged. NZIFIG does not include this criteria.

FSSA's climate targets

We have set targets to achieve by 2025, 2030 and 2050. Year-on-year we aim to increase the number of assessed companies graduating into Tier 1. We will report on the progress annually, then provide a detailed report in 2025 and every five years thereafter. To achieve these goals, we have made formal commitments around company engagement with assessed companies.

The targets are represented in the graphic below.



*This is subject to increase as economies decarbonise over time.
Source: FSSA Investment Managers

By 2025, we aim for 25% of assessed AUM to be assigned to Tier 1, aligned to net zero by 2050.

We will engage with all companies under assessment to meet 100% disclosure of scope 1 and scope 2 emissions by 2025, and encourage the alignment of targets to the Science Based Targets initiative (SBTi). As at 31 January 2023, companies comprising 75% of our AUM have been assessed.

For companies to be considered aligned to net zero, they must disclose their emissions performance and have short-, medium- and long-term targets. We recognise that companies in our portfolio are subject to different timeframes (i.e., carbon neutrality by 2060 for China and by 2070 for India). We expect our holdings to align with the IPCC's recommendation of limiting global warming to below 1.5° Celsius and to reach net zero emissions by 2050.

By 2030, we aim to increase the percentage of AUM assigned to Tier 1, aligned to net zero by 2050, from the initial 25%.

Rather than penalise companies that are less advanced towards their net zero goals, we aim to make and measure progress. We will achieve this through frequent engagement with company management to move towards genuine reductions and meaningful targets.

We are initially committing 50% of our AUM to be aligned to achieving net zero in 2050 (assigned to Tier 1), with an aim to increase the portion of AUM towards 100% as economies gradually decarbonise.

In considering these targets it is important to remember that they are based on:

- information provided by, and representations made by investee companies to us, which may ultimately prove to be inaccurate; and
- reasonable assumptions in relation to future matters such as government policy implementation in ESG and other climate-related areas, enhanced future technology and the future actions of investee companies, all of which are subject to change over time and are not guaranteed to occur.

As a result, achievement of these targets will depend on the ongoing accuracy of such information and representation as well as the realisation of such future matters.

Progress and priorities

We continued with the decarbonisation process we began in late 2021. We have divided our portfolio holdings into three priority groups for the decarbonisation assessment: A, B and C. Companies were selected based on its position size across our strategies, association to high-emitting sectors, and geographical representation, among other factors.

We prioritised engagement on climate action with the lowest performing companies in our initial review, being careful not to dismiss interrelated factors such as green revenue investments, land use, water stewardship and product mix. We engaged with all Group A companies in our initial assessment in 2021, with varying levels of receptiveness and progress. We will continue to push for greater disclosure and performance from these companies.

In 2022 we expanded our assessment from 25% to 75% of AUM and covered companies in Groups B and C on our prioritisation list. As this was the first full assessment we will provide an update on our progress annually, with a detailed report in 2025 and every five years thereafter.

Some engagements have been very fruitful. For example, Taiwan Semiconductor Manufacturing Company's (TSMC) emissions have continued to rise in recent years as the company has grown significantly. The management stated that this trend will continue until 2025, after which they aim to return to 2020 levels by 2030. Importantly, they pointed out that every 1kWh of energy used in TSMC's production has enabled customers to abate 4kWh of energy globally through the use of its energy-saving semiconductor dependent technology. This was assigned as Tier 1 per our definition.

On the other hand, JD.com, which has been very receptive to feedback, is clearly very early stage in reducing emissions and will require some support around target setting given the evolving nature of the business. This was assigned as Tier 3.

Tier levels	Percentage of assessed companies[17]
Tier 1	7%
Tier 2	33%
Tier 3	44%
Tier 4	16%
Grand Total	**100%**

A common theme amongst the more receptive companies has been, not unexpectedly, the presence of a long-term-minded management team who are committed to doing the right thing. These leaders are attuned to their long-term challenges and are actively seeking to adjust their strategies over 5-, 10- and even 15- year timeframes to reduce the risk of stranded assets and extend their competitive advantages.

Our priority for 2023 will be to expand the coverage further and continue to engage with assessed companies. There will be a specific focus on the higher emitters and laggards, as they will require significantly more time and effort to record progress in their decarbonisation journeys.

We have found that for Tier 3 companies, target setting has been a particular challenge, while Tier 4 companies are struggling even to begin. We aim to support these companies with examples of best practices, helpful resources and introductions to our network of third parties.

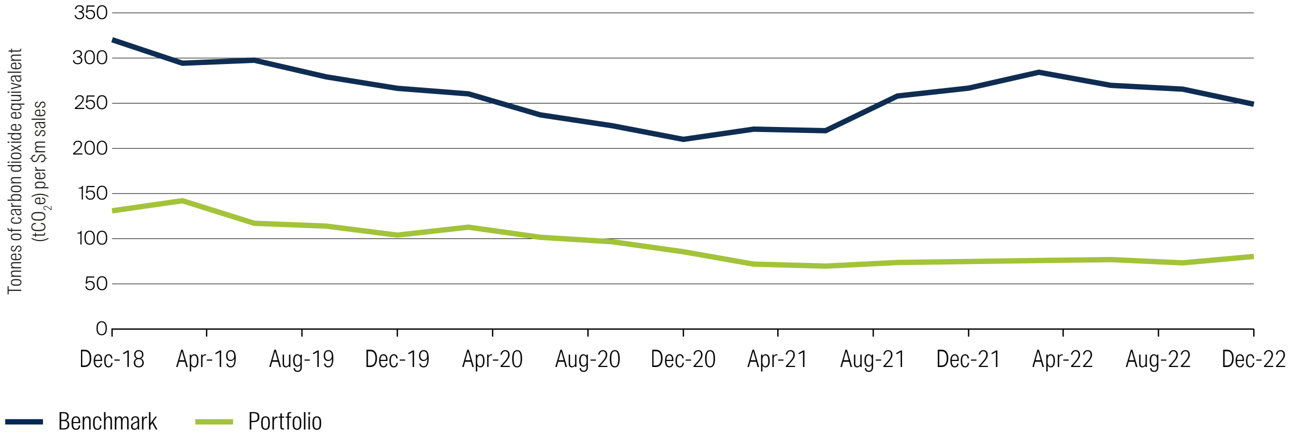
17. Based on approximately 75% of AUM calculated as at 1 December 2022

Portfolio carbon metrics

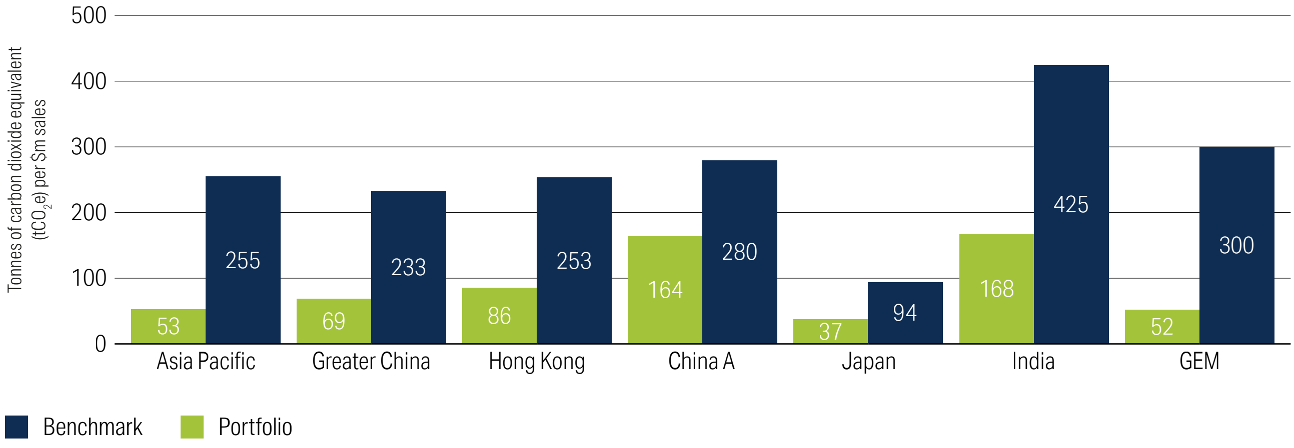
Our portfolios tend to have significantly lower emissions intensity than their respective benchmarks. We recognise this is a complex topic and we cannot draw conclusions from these results alone. We believe the data is best viewed as an output of our investment philosophy rather than an intentional screen for low GHG-emitting companies. We seek first to invest in high-quality companies and then focus on their emissions impact through the engagement process. We expect to see a convergence between our portfolio and the index over time, as they both decline.

Average emissions intensity of FSSA's strategies, 2018–2022

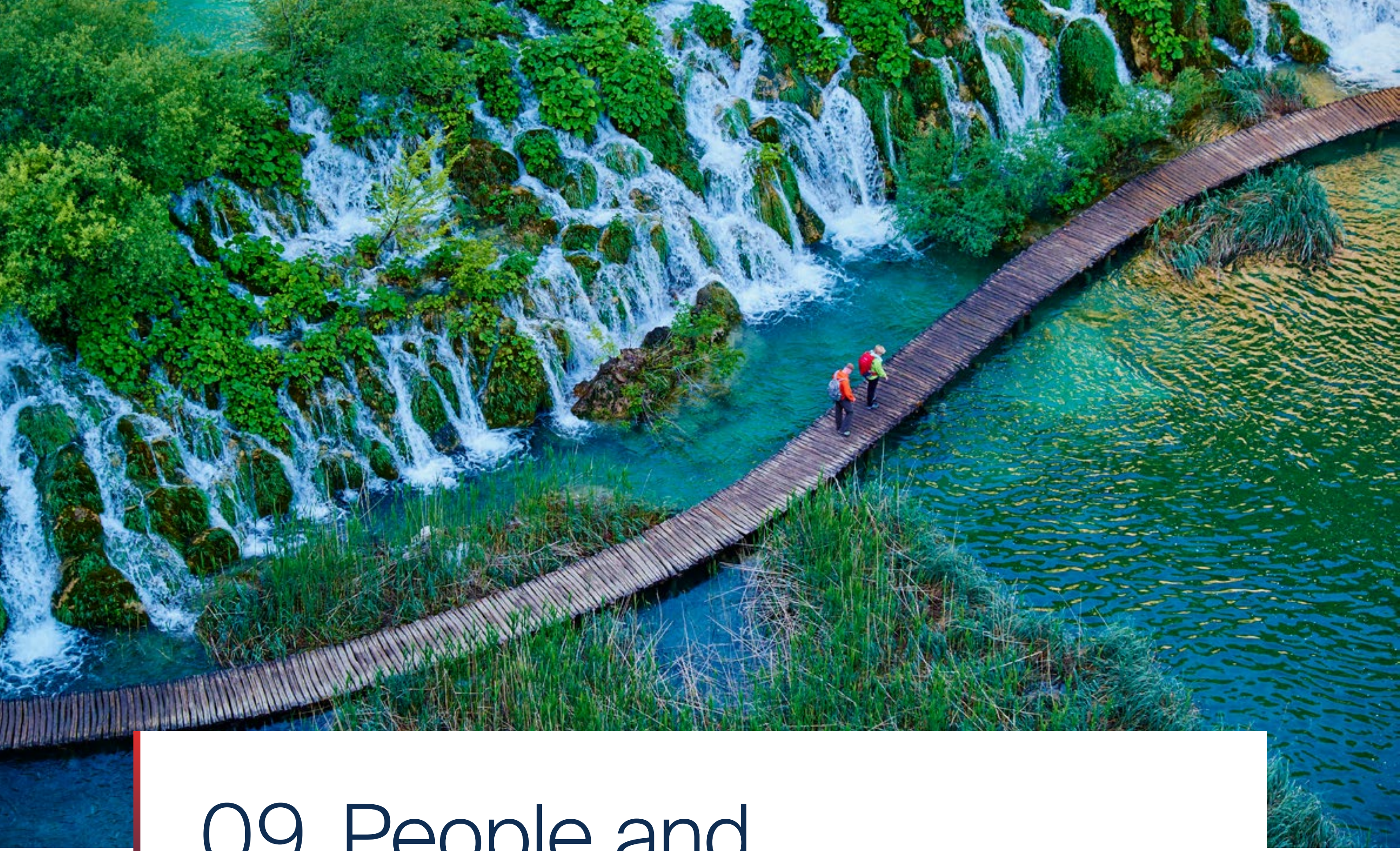
The line chart below shows the weighted average emissions intensity (scope 1 + 2) for FSSA's combined portfolios (green line) compared to the benchmark (blue line).



FSSA emissions intensity by strategy, 2022



Source: ©2022 MSCI ESG Research (UK) Limited Reproduced by permission. Although First Sentier Investors' information providers, including without limitation, MSCI ESG Research (UK) Limited and its affiliates (the "ESG Parties"), obtain information from sources they consider reliable, none of the ESG Parties warrants or guarantees the originality, accuracy and/or completeness of any data herein. None of the ESG Parties makes any express or implied warranties of any kind, and the ESG Parties hereby expressly disclaim all warranties of merchantability and fitness for a particular purpose, with respect to any data herein. None of the ESG Parties shall have any liability for any errors or omissions in connection with any data herein. Further, without limiting any of the foregoing, in no event shall any of the ESG Parties have any liabilities for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibilities of such damages.



09. People and communities

The decisions companies make can potentially affect the lives of numerous people across different communities. As quality-focused and long-term investors, we believe corporate culture is a key signifier of whether a company is likely to do the right thing in taking care of its people and surroundings.

In our assessment of a company's culture, we ask qualitative questions and listen carefully to the management's underlying message. We seek to understand the company's treatment of its staff and customers; the health, safety and mental wellbeing of its workforce; and how diverse and representative the company is relative to its community and customer base.

We use third-party providers such as RepRisk and Sustainalytics to alert us to controversies, and take time to understand the various sides of an issue rather than draw quick conclusions. We do not apply a one-size-fits-all approach, and our level of tolerance varies depending on the severity of the issue. When things have gone wrong, we look at how management teams reacted and try to understand the reasons as well as lessons learned and/or changes made. We believe this provides us with deeper insight on how the management may handle future challenges.

In our work, we analyse market trends and talk to internal specialists and non-government organisations (NGOs). This has made us aware of our exposure to certain social issues, such as modern slavery and supply chain risks. For these, we continue to utilise the Modern Slavery Toolkit launched in June 2020 to help us identify and address modern slavery risks.[18] In Asia and emerging markets, labour practices and lean operations often provide scope for the exploitation of workers, for example. We have also seen a rise in the number of gig workers in recent years. These are temporary or part-time workers hired on an informal or on-demand basis, typically with less rights and lower employment security. Potential human rights violations as a result of the ongoing conflict in Eastern Europe are another area of concern, which prompted us to examine the issue more closely and engage where necessary.

18. Modern Slavery Toolkit was launched under the banner of First Sentier Investors ("FSI"). FSSA Investment Managers is an autonomous investment team and part of the investment management business of FSI, which is ultimately owned by Mitsubishi UFJ Financial Group, Inc. ("MUFG"), a global financial group.

Spotlight:
Moving Tobacco Free Portfolios forward

It is a sad reality that approximately 1.3 million children are engaged in tobacco farming worldwide,[19] with children as young as seven documented as working in tobacco fields.[20] Out of 130+ countries that produce tobacco, just four countries in Asia make up 50% of the world's total production in tons.[21] The supply chain is just one part of the conversation – the consumption of tobacco and its related health impacts are also acute. For example, the smoking rates for children aged 13 to 15 across Indonesia, Thailand and the Philippines range in the low to high teens.[22]

Given our strong presence and history in Asia, we felt compelled to act. Both FSSA and the broader firm, First Sentier Investors, have been signatories of the Tobacco Free Portfolios (TFP) pledge since July 2021. We increased our commitment to the cause in 2022 by becoming Pledge Stamp members, helping to push the agenda forward. While certain tobacco companies are captured in our exclusions policy, we may still be exposed through our investments in banks and consumer staples companies and have chosen to engage with them to highlight the issue.

In November 2022 we held a roundtable event featuring Dr Bronwyn King, founder and CEO of Tobacco Free Portfolios (TFP), a non-profit organisation focused on driving global change towards tobacco-free financing. We hosted a sophisticated mix of representatives from banks, asset managers and related parties in Singapore, and provided an overview of the issues (financial risks), challenges and solutions around tobacco financing. The audience, many of whom are in positions of influence at their organisations, were encouraged to add their pledge to the tobacco-free movement. The event also provided suggestions on how to influence the conversation, including engagement with exposed companies, impact or thematic investing and the adoption of tobacco exclusion policies.

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19. The WHO Framework Convention on Tobacco Control and Tobacco Farming, Frequently Asked Questions (2014, August), Framework Convention Alliance. https://www.fctc.org/wp-content/uploads/2014/08/WHOFCTC_FAQ.pdf
20. Tobacco's Hidden Children (2014, May), Human Rights Watch, https://www.hrw.org/report/2014/05/13/tobaccos-hidden-children/hazardous-child-labor-united-states-tobacco-farming#_ftn2
21. World Tobacco Production by Country, AtlasBig, https://www.atlasbig.com/en-gb/countries-by-tobacco-production
22. The Global Youth Tobacco Survey (GYTS), Indonesia (2019), Thailand (2015), Philippines (2019). World Health Organisation, https://www.who.int/teams/noncommunicable-diseases/surveillance/systems-tools/global-youth-tobacco-survey

Case study:
Protecting minority interests and assessing modern slavery risks

Century Pacific Food operates market-leading canned food and dairy product brands in the Philippines. Since its listing in 2014 we observed that its majority shareholders, the Po family, were managing the business with high governance standards and had hired experienced professional managers from PepsiCo, Unilever and Procter & Gamble to run the company's operations. Our conviction in the chairman's efforts to build a stronger and more sustainable franchise has grown over time.

In recent years the company formalised its sustainability strategy focused on "Protein, Planet and People". Its new products included affordable milk products fortified with immunity boosters and plant-based meat alternatives, which have helped the company gain market share in these categories. Additionally, Century Pacific was among the first corporates in the Philippines to achieve plastic neutrality and has consistently increased its use of renewable energy sources.[23]

In 2021 the company's management contacted us for feedback after it acquired a refrigerated food products business previously owned privately by the Po family. Being a related-party transaction, our engagement focused on the deal's strategic merit and valuation, and its impact on our alignment with the majority shareholders.

After several discussions with the management, we were reassured that the acquisition would be beneficial to the group. The acquired company provided entry into the under-penetrated and fast-growing refrigerated food category and its product portfolio was expected to improve Century Pacific's profitability significantly. We thought the valuation of 1x price-to-book represented an attractive price for the business.

Throughout the process, it was clear that the interests of minority shareholders were being protected and we appreciated the management's proactive engagement with stakeholders. The experience was encouraging and led us to believe that the management would be constructive towards other areas of engagement.

As such, when recent conversations with NGOs and experts on modern slavery risks in Asia revealed the magnitude of the issue in the fisheries industry, to which Century Pacific is heavily exposed, we felt able to voice our concerns. Specifically, its reliance on migrant workers and contractual labour, short lead times and low wages could provide scope for worker exploitation.

We wrote a letter to the chairman and made recommendations related to global best practices, such as establishing a grievance mechanism to improve working conditions, and training its supply chain members to prevent malpractices. We were again encouraged by the company's receptive feedback to our letter and willingness to learn about potential solutions.

We plan to reengage with the procurement director and investor relations team on developments from these topic-expert introductions, in particular to check its progress on developing internal grievance mechanisms and its plans for additional auditing and disclosure.

Our discussions with Century Pacific's management have consistently shown their intent to uphold high standards of governance as well as their efforts to improve the company's environmental and social footprint. In turn, this has increased our conviction in the management's ability to address the challenges and opportunities the company will likely face over the long term.

23. https://centurypacific.com.ph/century-pacific-brands-now-certified-plastic-neutral/

Case study:
Investigating the fair treatment of workers in China

As investors in developing markets, the countries we visit are often blessed with large and/or young and growing populations. While this supports companies in their growth, it also creates room for bad actors to take advantage of eager workers. This is especially true in places like China given the breakneck speed of growth and innovation there. Unfortunately, rules to protect workers have failed to keep up.

For example, the Chinese internet giants hired large swathes of workers to fulfil roles as food delivery riders and private-hire drivers in order to meet growing demand for their services. However, these "gig economy" workers, being neither full-time nor part-time, fell through the cracks of labour laws and were being paid low wages alongside long working hours and limited benefits. They were also typically employed via agencies – one step removed from the technology giants they worked for – making it harder to supervise and enforce rules.

In 2021 food delivery riders for Meituan and Ele.me started protesting heavily about their working conditions. Consumers were also upset to see these large companies taking advantage of workers, many of whom come from lower socioeconomic backgrounds. The government soon intervened, recognising "gig workers" as a new class of employees and mandating minimum levels of benefits and wages.

At FSSA, we were not widely invested in companies like Meituan due in part to concerns over worker treatment (and Ele.me is unlisted). However, since 2018 we have been shareholders of Yum China, the largest quick-service restaurant (QSR) business in China with over 12,000 stores and 440,000 front-line employees which are mostly part-timers. During the Covid-19 period, delivery accounted for a meaningful 30-35% of sales.

As one of the largest employers in the country, it was crucial that we understood Yum China's attitude towards the treatment of workers. We wrote a letter to engage on this topic while also sharing best practices from global company examples. The response was encouraging. For example, the management confirmed that delivery riders are employed full-time and receive all relevant benefits, while part-timers are paid competitively and have liability insurance and wellness benefits.

Yum China also hires its workers directly rather than through employment agencies and performs frequent store surveys and surprise inspections to monitor employee welfare. Restaurant managers are employed full-time and receive a host of benefits such as scholarships, family insurance, interest-free housing loans and share incentives.

While there is always more that can be done, the company's implementation of several best practices and its openness to engage with us is commendable – for example, our last meeting involved 12 representatives across the organisation including several senior executives. We will continue to monitor the direction of travel and attempt to nudge the company in the right direction where needed.

10. Priorities for 2023

As long-term investors, we seek incremental progress measured over years rather than months and quarters. We aim to invest in companies for at least three to five years, if not longer, which is reflected in our patient approach to ESG and engagement.

We recognise that we are by no means experts in the field of ESG, which is highly complex and constantly evolving as new ideas and information come to light. Just like our investee companies, we too are learning and gaining new perspectives about what is important and where to direct our efforts. In doing so, we have continued to refine our long-established investment approach to reflect the changing world.

For 2023, we aim to improve our process in five key areas.

1. Refining ESG research integration

While the new and upcoming ESG regulations often require more reporting, they also provide an opportunity for us to consider metrics we may have previously overlooked. We have begun a mapping exercise to understand where we may need to expand our process to incorporate these additional reporting metrics. While the decision to integrate any particular ESG metric will always depend on the relevance to the company in question, our two primary considerations in this exercise are: 1) risk mitigation for key stakeholder groups and 2) whether our engagement can improve the trajectory of the portfolio company.

2. Determining key priorities

Determining which environmental, social and governance matters to prioritise is an ongoing challenge. However, we recognise that we can have a greater impact by focusing on the areas where we are most exposed and experienced. We are working to introduce a set of engagement themes which would benefit from broader assessment. We will base this on the composition of our holdings and the companies' most material risks and opportunities. This list of engagement areas will be revisited annually.

3. Collaboration and connections

Expanding our expert network will help extend the engagement capabilities of our team. We are identifying sustainability and social impact specialists who can address the gaps in our understanding of certain topics such as water stewardship, circularity and supply chain transparency.

4. Deeper engagement

As active investors we aim to help our portfolio holdings grow and meet the long-term objectives of key stakeholders. To support this, we plan to improve our engagement on select topics by including additional best practices, best-in-class company or industry examples, specific recommendations and third-party resources.

5. Tracking and reporting

Tracking and reporting our activities has become ever more important to evidence our approach. We will continue to enhance our systems and processes to include more details, automatic feeds and reminders. Improvements in this area will also make our engagement with companies more streamlined and systematic, resulting in better engagement focus, greater access to relevant data for decision-making and more efficient reporting capabilities.

We welcome any feedback or questions on our investment approach and engagement activities, and look forward to sharing our growth with you in future reports.

11. Appendix

Proxy voting

Voting rights are a valuable asset that we believe should be managed with the same care and diligence as any other asset. While our votes against management appear to be low, it is rarely the first step in our engagement process. Where we disagree with a proposal, we prefer to raise the issue through constructive dialogue with the management. If we are unhappy with the response then a negative vote can be used to voice our dissent and we communicate our rationale appropriately. Our goal is to apply our corporate governance guidelines in a consistent manner, though our overriding principle is that all votes must be made in the best interests of our clients at the time of asking.

Proxy voting record 2021–2022

	Management proposals 2021	Shareholder proposals 2021	Total	Management proposals 2022	Shareholder proposals 2022	Total
With management	4,220	2	4,222	4,210	4	4,214
Against management	224	1	225	198	0	198
Abstained	0	0	0	0	0	0
Take no action	10	0	10	15	0	15
Unvoted	0	0	0	0	0	0
Total	**4,454**	**3**	**4,457**	**4,423**	**4**	**4,427**

FSSA's full proxy voting record is available on the First Sentier Investors website.

We invite you to learn more about FSSA Investment Managers through our website and social channels.

Exclusions policy

We invest where we perceive the management operates the business effectively and acts in the interests of all stakeholders. To guide us, our exclusions policy rules out specific industries or applies thresholds where appropriate. Our latest exclusion policy is available on our website.

Carbon footprint

The carbon footprint of FSSA's portfolios and related metrics are updated quarterly and available on our website.

Investment insights

We have written short articles on our companies, investment trends and market themes across our various strategies, also available on our website.

LinkedIn page

Visit our LinkedIn page for the latest news and investment insights from the team.

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