Flagship Asset Management

Environmental, Social & Governance Policy

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Table of Contents

ESG policy summary

- ESG refers to the measurement and assessment of potential threats and opportunities of environmental, social and governance factors. **Environmental** criteria consider how a company performs as a steward of nature; **Social** criteria examine how it manages relationships with employees, suppliers, customers, and the communities where it operates; and **Governance** deals with a company's leadership, executive pay, audits, internal controls, and shareholder rights.
- At Flagship we favour a concentrated selection of businesses that have sustainable business models with long runways for growth. ESG considerations are integral to our investment selection process and are key to understanding the long-term drivers or risks to growth.
- An assessment of the company's environmental, social and governance (ESG) practices is part of the research process and is a requirement of every valuation report at Flagship.
- The first instance we take ESG into account in our investment process is in our screening process, secondly in the valuation multiple that we apply to a company, thirdly in our risk assessment and finally in position sizing when constructing concentrated portfolios.
- As stewards of our clients' investments, Flagship employs a proxy voting policy designed to protect and improve the economic value of the investments it makes on behalf of our clients.

Our Investment Philosophy

We follow a long-term, valuation-based investment philosophy. It is process-driven and rigorous, throughout which environmental, social and governance factors play an important role when valuing companies for potential investment.

We invest in high-quality businesses, and our definition of quality is demanding and exclusive. While the definition of quality can have a broad variety of meanings, at Flagship we believe that for a company to be described as such it must have an enduring competitive advantage, valuable intangible assets, networks effects and/or pricing power, recurring revenue streams, strong free cash flow generation and high returns on capital.

Companies which satisfy our definition of quality usually earn a return on capital which is greater than their cost of capital and have a high free cash flow conversion ratio. We invest in companies which have strong balance sheets which is evidenced by low gearing ratios. We select companies with good management teams which seek to maximize value for shareholders.

ESG factors play an important role in both the quality and valuation of a company. For example, material ESG risks could well lead to an impairment of capital and lower future return on capital. There may also be an upside to the valuation of a company if management are taking steps to mitigate ESG risks or proactively better their company's ESG practices.

Our Investment Approach

We follow a proprietary 5-point investment process driven by Quality, Growth, Normal Margin, Mature Multiple and Concentration. This approach leads to highly concentrated portfolios of between 20-25 positions, allowing us to concentrate our equity exposure to our best ideas, ensuring that capital is most efficiently applied to generate the highest possible return. Because of our approach, our global equity portfolios look very little like the index, and very little like our competitors.

All the stocks in our global flexible and equity strategies have powerful business models with long runways for growth. As such, ESG considerations are integral to this investment process and are key to understanding the long-term drivers or threats to growth. Without a commitment to the key pillars of sustainability (ESG) our investee companies would not qualify for client capital.

ESG in our Investment Process

- Issues of environmental, social, and governance are central to our process due to the impact they have on the *sustainability* of a business and to the extent that management has a conflict of interest that may cause it to act contrary to the best interests of its shareholders.
- Companies that take short cuts on environmental, staff and social issues impair the customer perception of a company and can also make staff or talent attraction difficult or impossible. In extreme cases they can put the very existence of the firm into jeopardy.
- Governance is of particular importance. The vast majority of corporate scandals that result in a firm's collapse involve fraud on the part of management (Wirecard, Worldcom, Parmalat, Steinhoff etc.). Additionally, governance structures that allow management or certain shareholders greater voting control than their economic interests create the potential for a conflict of interest and typically negatively impact our assessment of a company. Government control is also something we typically have a strongly negative view on, as typically then the company's priorities lie elsewhere than profits or returns to shareholders.
- The first instance we take ESG into account in our investment process is in our screening process, secondly in the valuation multiple that we apply to a company, thirdly in our risk assessment and finally in position sizing when constructing concentrated portfolios.
- An assessment of the company's environmental, social and governance (ESG) rating is a necessary requirement of every company report at Flagship.

ESG in our Screening Process

- The first place that we take ESG into account is during our screening process for new stock ideas. We have a self-compiled universe of stocks that meet our quality requirements and we draw ideas from this list should their valuations come within range. We believe that the fact that this watchlist has been pre-vetted for quality mitigates our risk of loss of capital provided we buy at reasonable valuations.
- While we used to screen for companies based on quantitative filters that eliminated companies which did not meet our return on equity, stock liquidity (average daily traded value > $10 million) or valuation requirements, we have ceased to do so because these filters missed too many stocks that did meet our quality requirements and failed to exclude others which didn't. No mechanistic filter can compensate for company and industry knowledge built over years, although of course even screening on this basis is imperfect.
- Our global portfolio managers have spent over 14 years investing internationally. Over the course of this time each team member has met with over 1,500 management teams and engaged repetitively with the management of stocks within our watchlist. As such, we have gained valuable insight into what constitutes good corporate governance.
- As a product of our investment philosophy, we typically do not invest in:
    - mining companies which are cyclically exposed to turns in the commodity cycle and capital intensive,
    - utilities whose returns are regulated and are subject to the whims of regulators,
    - state-owned companies which are seldom run for minority shareholders,
    - property companies where we may lack sufficient local knowledge, and
    - pharmaceutical companies where we find it difficult to have conviction in R&D pipeline beyond expiry of current patents.
- The result of our screening process is a watchlist of high-quality companies that incorporate positive, proactive ESG policies which drive their long-term sustainability.

ESG in our Valuation Multiple

- The intrinsic or fair value of a business is the amount that another businessman would pay for the whole business if he bought it for the long term. The fair value is determined by valuing the whole business being bought rather than just a share.
- Businesses that are increasing their sustainable competitive advantages can also increase their margins over time as they develop a greater lead over competition.
- As investors we need to be compensated for political risks within the countries we invest as well as the risk inherent in the individual company's business model. Certain businesses are located in less risky countries than others and certain businesses exhibit traits that we determine to be of higher quality and lower risk. These will be assigned a higher multiple (therefore lower discount rate) than businesses located in riskier countries or lower quality businesses. The magnitude of the premium or discount to the average multiple is qualitatively assessed by the analyst.
- We perform a qualitative assessment of ESG when arriving at this premium or discount. Where ESG risks are too high, we may conclude that the company isn't investable at all.
- Specifically, management governance and corporate culture plays a large role in this assessment. Company culture is very important in a company's success, and it's very difficult to change; particularly in large organisations. When evaluating company management and directors, we ask various questions which highlight whether a good quality governance structure exists that is independent, aligned with minority shareholders, relies on conservative accounting policies and is cognisant of potential regulatory changes to ensure a long-term performance culture is embedded. Typical questions we ask ourselves include:
    - Does the company embody a culture of excellence?
    - Does the company have a clear focus and are management aligned to shareholders?
    - Does management have a proven history of ethical standards, astute capital allocation and creating shareholder value?
    - Does management have a significant part of their net worth invested in the business?

ESG in our Risk Assessment

- When valuing the risks of a business, we use a margin of safety principle (discount to intrinsic value) required to own the business in our portfolio. We require a lower margin of safety to hold a higher quality, sustainable business that is predictable to forecast. The margin of safety we require would increase where we assess ESG risks to be high.
- ESG factors are considered when analysts monitor stocks under their coverage and by portfolio managers of the portfolio as a whole. The team seeks to identify ESG risks such as changes in corporate structure, board or management changes, controversies or regulatory or reputational risks. It is important that the analyst applies their mind as to whether the investment case still holds, and importantly if the latest information results in a change to the analyst's fair value for the business.
- We pay particular attention to governance when valuing stocks and employ a fraud checklist when scrutinising company financial statements. This checklist covers accounting policy and any changes made to this policy, working capital and non-GAAP metrics. In relation to these sections, we ask ourselves the following questions:
    - Does the company have an aggressive revenue recognition policy even if this is justified by the industry?
    - Is revenue recognized when customer still has a right to revenue and if so, is a reserve raised for estimated returns?
    - Has there been a change to any accounting policy (specifically revenue recognition) in last year?
    - Have there been any changes to accounting estimates in last year?
    - Has there been a sale of receivables during the year? If so, this must be excluded from cash flow from operations when calculating free cash flow outflow.
    - Have there been any changes to non-GAAP metrics in last year (for same store sales growth and the number of subscribers)?
    - What are the material divergences between same store sales growth and the change in revenue per store?
    - What does management include/exclude when highlighting a non-GAAP metric as a surrogate for earnings?
    - Do management draw a distinction between maintenance capex and expansion capex?

ESG in Portfolio Construction

A function of our confidence in the sustainability of a portfolio company's earnings is taking into account in the position sizing. Given that we believe ESG considerations can impact earnings, these risks are a material component of our position sizing decisions. A function of concentrating investing is that position sizes have a larger impact on our portfolios, thus careful scrutiny must be undertaken in the long-term sustainability of each portfolio holding.

Proxy Voting Policy

Flagship Asset Management (Pty) Ltd is an authorised financial service provider and licensed category 2 discretionary portfolio manager under the Financial Advisory and Intermediary Services Act. As stewards of our clients' investments, it is our responsibility to ensure that the businesses in which our clients are invested, are always managed in such a way as to maximise stakeholder value over the long term. As such, where company management polls shareholders' votes on certain actions, votes are cast on our clients' behalf in a manner consistent with their best interests and with the objectives of protecting, sustaining and improving their long-term wealth in mind.

Flagship's primary objective with this proxy voting policy is to protect or improve the economic value of the investments it makes on behalf of clients. Flagship will vote against any agenda item that threatens this economic value, in particular where we have concerns over proposed changes in the capital structure of the business, or inappropriate or misaligned management remuneration and incentivisation, that may negatively impact the creation of business value.

Flagship's portfolio managers are responsible for all proxy votes. Records of all proxy votes are maintained.