Future Trends

SRI Report
Q4 2020

Alex Gunz

HEPTAGON Capital

Future Trends: SRI Report

Q4 2020

Welcome to our fourth quarterly Social and Responsible Investing Report for the Heptagon Future Trends Equity Fund. Our inaugural SRI report can be found here.

What's new in this report:

- **The Future Trends Fund has a markedly superior distribution of risk rankings relative to the broad universe of business covered by Sustainalytics** based on an analysis of their most recent set of risk assessments. None of the businesses in our Fund is considered to have a severe risk level and over 50% of our businesses are ranked as having a negligible or low level of risk.
- **Our businesses continue to make good progress in respect of ESG initiatives**. Overall levels of greenhouse gas emissions continue to fall and employee diversity to rise. Specifically, First Solar and Prologis received external accreditations in respect of environmental initiatives during the past quarter. Meanwhile, both Kerry Group and Novo Nordisk recently shared more details on their ESG strategies.
- **ESG considerations remain integral to our investment process.** Our approach is detailed in this report, but interacting with management and understanding their intentions in respect of ESG remains critical. Over the past year, we have completed 22 proxy votes and undertaken over 70 meetings (albeit most of them virtually) with management teams across our broad Future Trends universe.
- **The Future Trends Fund continues to exhibit a high correlation between ESG rankings and portfolio weightings.** Four of the Fund's top-five holdings (and seven of our top-ten) as of 31 December 2020 receive either negligible or low risk ratings from Sustainalytics.

The **Heptagon Future Trends Equity Fund** has five years of track record in a UCITS format, having been launched in January 2016. Throughout this period, the portfolio has always been **highly concentrated** (20-25 names since launch; currently 23) with **low levels of turnover** (typically <20% a year). The Fund is sector, size and geographic agnostic, with **high active share** (typically over 95%).

Fund Launch – January 2016, **Fund AUM** – $182m (31/12/2020), **Strategy AUM** $192m (31/12/2020)

A policy of responsible business investment is integral to the investment philosophy and process of the Future Trends Fund. Integrating ESG principles into our investment process enhances our ability to understand existing and potential risks and opportunities for potential portfolio companies.

The Fund receives 5 Sustainability Globes from Morningstar and achieves a top percentile ranking versus its peers. MSCI currently ranks the Fund in the 94th percentile within its immediate peer group and in the 91st percentile within the global universe of the ~34,000 Funds it covers.

- ✓ Sustainable Investment – ESG Fund Overall
- ✓ Sustainable Investment – ESG Engagement
- ✓ Sustainable Investment – ESG Incorporate

Morningstar Sustainability Globes

How our businesses rank on an ESG basis

For every business under consideration for the Fund, we produce a detailed (3-5 page) note making the investment case, which includes a specific section on its ESG positioning. Our assessment is derived from reading company reports, interacting with the company and taking into account the work done by external providers. We are happy to make these reports available on request.

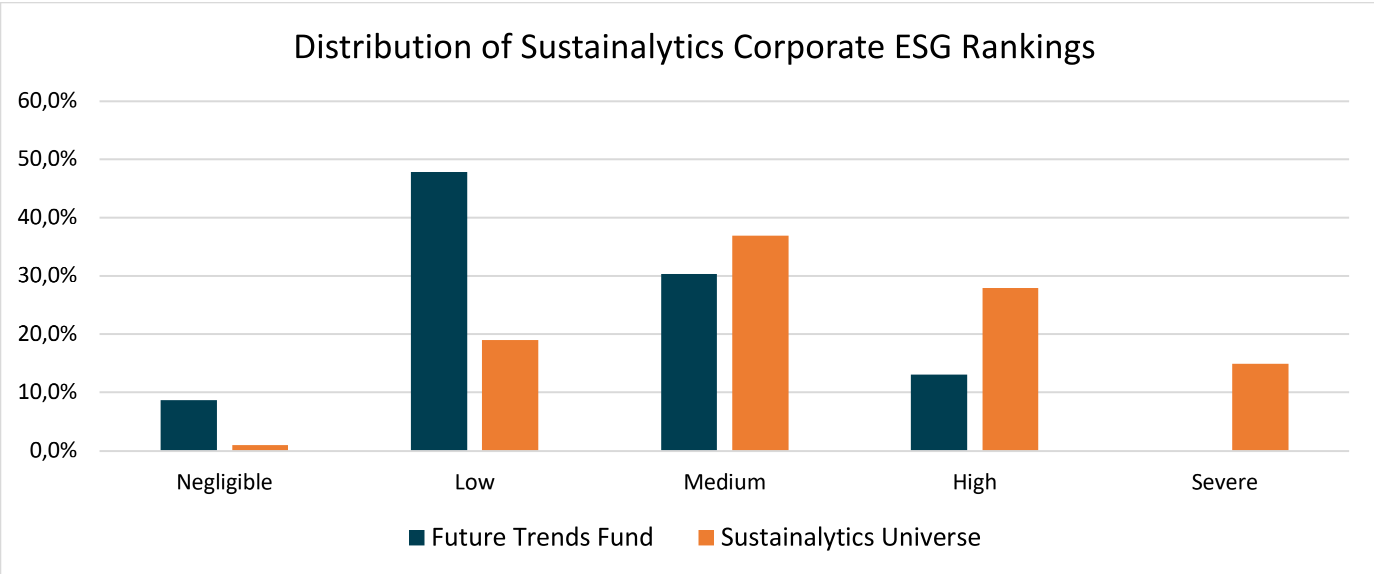
The ranking of businesses based on objective ESG criteria is still an evolving practice. Further, we recognise that since our businesses do not all operate in the same industry (our Fund has always been pan-thematic), factors may vary by business. We use a range of criteria and are constantly reviewing/adding to our list of factors under consideration.

Over the last quarter, we have refined our methodology to incorporate new data available to us from Sustainalytics. Sustainalytics is, arguably, the leading independent global provider of ESG and corporate governance research and ratings to investors. Its ranking methodolgy emphasies good governance as the *starting point* for any discussion about SRI priorities.

- **Businesses are given a 'risk' rating**. These are derived from deep insights into multiple exposure factors including corporate governance, human capital, product governance, ESG integration of financials and business ethics. This results in a composite risk score, where the **lower the risk rating, the better**. Note these ratings (and all others within Sustainalytics) are on an absolute basis rather than being industry/ sector-relative.
- Sustainalytics also awards businesses **a 'momentum' score**. This is centred around direction of travel; whether businesses are getting better in their governance practices and their practical application. Scores here should be considered *in conjunction* with risk ratings. As a general rule, positive momentum should be seen as encouraging and vice versa Low risk ratings combined with stable (or positive) momentum could be seen as an ideal scenario.
- **Companies are additionally assessed on the extent of the controversies in which they have been involved**. These could relate to factors such as anti-competitive practices, data breaches or animal welfare among others. Businesses are scored on a ranking of 1-5, where lower is better.

Sustainalytics groups businesses into five categories of risk rankings ranging from negligible through to severe via low, medium and high. A negligibly ranked business is one whose enterprise value is considered to have a neglible risk of material financial impacts driven by ESG factors, and vice versa.

Across our portfolio of 23 companies, two businesses receive risk rankings of sub-10 from Sustainalytics (meaning the enterprise value of the business is considered to have a negligible risk of material financial impacts driven by ESG factors) and none of our businesses carry ranks of over-40 (considered as severe). Indeed as the table below shows **the Future Trends Fund has a markedly superior distribution of risk rankings relative to the broad universe of business covered by Sustainalytics**.



Source: Sustainalytics, Heptagon Capital. Data as of 31 December 2020.

In terms of **momentum**, almost all (or 22 out of 23) of our businesses are currently demonstrating stable trends in this respect, per the date of their last reviews issued by Sustainalytics. Combined with the above risk scores, this suggests to us that the management teams of our businesses are generally mindful of their ESG imperatives and continuing to implement appropriate policy. It was, however, pleasing to see that Prologis – which already ranks highly in respect of ESG credentials – was the only business in our universe currently to be exhibiting positive momentum trends.

Finally, with regard to **controversies**, 9 of our 23 businesses are considered by Sustainalytics to be subject at present to no or low levels of controversy, while only 4 of our businesses receive a controversry designation of either 'high' or 'significant.' The businesses in question (ordered alphabetically) are Mastercard, Microsoft, MOWI and Novo Nordisk. Having dug into the matters raised, we consider the topics of controversy to be well-understood issues, which although they require careful monitoring, do not change our investment view on the businessss. Anti-competitive practices are the main (general) source of concern. An additional issue for MOWI – which we have discussed in previous reports of this nature – is animal welfare. While there is work to be done in this respect, MOWI ranks ahead of almost all its agriculture peers.

Digging into the rankings –

Below we provide brief profiles on what distinguishes our two most highly-ranked businesses – Prologis and Keysight Technologies – both of which receive negligible risk assessments. In addition, we provide an explanation as to why we remain invested in Steris and Daifuku, which receive the least positive risk rankings within our portfolio from Sustainalytics. As of 31 December 2020, Keysight was the fourth largest weighting within the Future Trends Fund and Prologis ranked eighth. Indeed, **four of our current top-five holdings (ASML, PayPal and Vestas, in addition to Keysight) receive either negligible or low risk ratings from Sustainalytics**. A review of our top-ten holdings would see this ratio move to seven out of ten.

Prologis: The largest owner of industrial real estate globally has a long-standing record of excellence with regard to ESG matters, in our view. Management has published a detailed Sustainability Report with multiple KPIs for many years and has clearly defined goals, particularly in respect of solar power generation (achievable given its large square footage of roof space – the third largest in corporate America) and employee training. Beyond the assessment given by Sustainalytics (which notes "strong corporate governance performance"), Prologis has received numerous other external awards in respect of its ESG initiatives (an example follows later in this report). Additionally, Prologis is the first logistics real estate business globally to have issued green bonds.

Keysight Technologies: The business ranks second across our portfolio in respect of the risk metrics used by Sustainalytics, with the agency seeing its risk level as being negligible. In our interactions with Keysight, we have been impressed by their growing commitment to ESG initiatives. At their last Capital Markets Day (in March 2020, which we attended in New York), management spent considerable time detailing its progress and targets. The company's overall mission statement is to "build a better planet" and Keysight has clear targets regarding energy and water conservation, the strengthening of local communities and improving levels of employee diversity.

Steris: The business scores worst (i.e. with the highest risk score) across the 23 businesses currently in our Fund. Steris' rating of 31.8 places it in the 'high' category of risk, although well below the score of 40.0, under which its risk rating would be considered 'severe.' We have regularly discussed ESG matters with Steris and management has reiterated that it is committed to improving its level of ESG disclosure. It is worth bearing in mind that given the business operates within the field of sterilization, its safety standards are, arguably, among the highest in the world. Steris CEO Walt Rosebrough said to us that "we do more than we talk about" in respect of ESG (per our meeting in March 2020) and it will be important to monitor progress and await increased disclosure.

Daifuku: The business receives the second highest score in respect of risk within our portfolio. Sustainalytics notes that the machinery produced by Daifuku (which is a leader in the field of automation) operates in public places such as hospitals and airports, where it may be subject to defects and hence safety concerns. Sustainalytics also highlights that the leadership position occupied by Daifuku (it ranks number one globally in terms of machinery-handling revenues) may result in anti-competitive practices. While these are valid concerns, there has been no evidence of either impacting Daifuku to-date. By contrast, we have been impressed by its level of disclosure in respect of ESG considerations (Daifuku has published an annual Sustainability Report since 2016) and its corporate governance (in terms of board diversity etc) places it ahead of many Japanese peers.

Some additional comments on ESG ranking

While we are of the view that sustainably oriented businesses ought to have good governance practices and that this constitutes the starting point for our ESG considerations, we also pay additional attention to environmental and social matters. Our work in this field is evolving and does not currently have as much granularity as the governance insights provided by Sustainalytics. The below data (which has also featured in previous ESG reports and is sourced from Bloomberg) offer good proxies for corporates' progress in respect of their environmental and social objectives. We will look to add to this over time.

- **Greenhouse Gas (GHG) Emissions/ Revenues:** This metric measures the total tons of GHG emissions per millions of reported local currency revenues; lower is better. This is a good measure of a businesses' environmental credentials. Businesses equivalent to over 80% of the Fund's assets currently disclose this information, an improvement on the 73% figure noted a quarter prior. The average figure for the businesses disclosing this information in our Fund was 43.5 at the end of Q4, an improvement relative to Q3 (49.0) and a marked improvement relative to the end of Q1 (83.8) when we first started recording the data. Vestas, Novo Nordisk and Prologis rank most highly in respect of low GHG emissions despite operating in very different industries (wind turbines, diabetes drug manufacturing and industrial real estate, respectively), although it is perhaps not uncoincidental that the former two are both Danish businesses, which often have high levels of ESG stewardship.

- **Percentage of Female Employees:** We use this as a metric for considering the quality of businesses within our universe on social factors; higher is better. Businesses equivalent to 81% of the Fund's assets currently disclose this information (slightly higher than the prior quarter). Although there is wide dispersion across our portfolio holdings, our average business has ~35% female employees, unchanged relative to the prior quarter. Orpea, a leading provider of accommodation and care services for the elderly perhaps unsurprisingly ranks highest in respect of this metric (at 83%), while based on last disclosed data, ASML, Chegg and Vestas currently rank most notably below average. Note, with the impending calendar fourth quarter reporting season imminent, these rankings may change considerably in the coming month or so.

What we did during Q4 2020

The final quarter of the year marked a continuation of our ongoing interaction with company management teams. **Over the three-month period ending 31 December 2020, we met virtually with 19 management teams, including 13 from within our portfolio.** During the past year, we participated in over 70 meetings, slightly more than in 2019. As a sign of the times, however, just 7 of our 2020 meetings took place in person relative to over 50 in the prior year. Importantly, we have met live and/or spoken with all of our portfolio holdings over the past 12 months, with the exception of Alibaba (although we attended its virtual capital markets day in September 2020).

ESG considerations constitute a crucial discussion topic in almost all our meetings and we believe it behooves us as a responsible manager of assets to push our businesses on how and where they should be improving their strategies.

Of particular note from our interactions with businesses during the past quarter was our conversation with **Thermo Fisher**. Thermo receives an ESG risk rating of 18.4, considered as low by Sustainalytics (see above for methodology, and note this assessment was last reviewed in November 2020). In our conference call with senior Investor Relations, Thermo highlighted that ESG is "deeply embedded" in its culture, even if this is not always enunciated formally and externally. Some of this disconnect stems from the decentralized nature of the organization, which means that not all data (for example, on employee diversity) is collated. However, going forward, Thermo emphasized that we should expect to hear more on its ESG progress and that it had indeed recently completed its first materiality survey.

Given the time of the year (i.e. most companies have fiscal periods ending in December), we only participated in one proxy vote over the past quarter, for Microsoft, which has a June fiscal-year end. We voted in-line with all of Microsoft's (uncontroversial) proposals. **Year-to-date, we have undertaken 22 proxy votes** and in several instances (for example, Equinix, IBM, Illumina and Orpea), we have objected to proposals made. Our rationale was detailed in previous ESG quarterly commentaries. Note also that we exited from our position in Illumina during the third quarter of last year.

What our companies did in Q4

We present below some selected highlights of the steps taken by the businesses within our Fund to improve further their ESG credentials during the past quarter. If we were to highlight the ESG trends most salient across our Fund *over the course of 2020* then three things would clearly stand-out: **employee and stakeholder safety became an increased priority over the course of the pandemic; firm commitments were increasingly made towards improving racial diversity; and, becoming carbon neutral over the**

next 5-10 years remains top of mind. While obviously encouraging, it will be important to track progress on these commitments over time.

First Solar saw its current Series 6 range of photovoltaic (PV) solar modules become the first in the world to receive an EPEAT rating from the Green Electronics Council, a leading industry body. EPEAT is the de facto gold standard ecolabel used by public and private sector institutional purchasers globally. First Solar says that the carbon footprint of its panels is up to 6 times lower and its water footprint up to 24 times lower than crystalline silicon PV panels manufactured using conventional methods.

Kerry Group announced the launch of a new sustainability strategy called "Beyond the Horizon" in October 2020. Its five key objectives comprises (1) reaching over 2bn people with sustainable nutrition solutions by 2030 (2) reducing operational emissions by 33% by 2030, reaching net zero before 2050, and reducing emission intensity of the supply chain by 30% by 2030 (3) ensuring that all plastic packaging will be reusable, recyclable or compostable by 2025 (4) halving food waste by 2030 and diverting all waste from landfill, and (5) sustainably sourcing all priority raw materials by 2030.

Mastercard announced a series of important initiatives during the fourth quarter. These include its Girls4Tech programme, which has already reached and trained over 1m females in 30 different countries. Mastercard has set a new target of reaching 5m by 2025. In addition, Mastercard detailed the expansion of its Priceless Planet Coalition (founded in January 2020) and tasked in coming up with innovative ways of addressing climate change. Finally, Mastercard's GrainChain initiative will see the business apply its proprietary blockchain technology to provide suppliers and farmers across the Americas with visibility into supply chains across 24 different commodities.

Novo Nordisk hosted a 90-minute presentation for the investment community in November where it went through in detail its progress in respect of ESG initiatives, both internally and with its broader stakeholder community. At the core of its strategy is the view that "long-term value to society is driven by a strong sense of purpose and by being a responsible business." The business disclosed little that had not been highlighted in separate press releases, but it was reassuring to hear Novo comment in more detail on its 'circular zero' environmental initiatives and its commitment to preventing obesity/diabetes through better education and other related programmes.

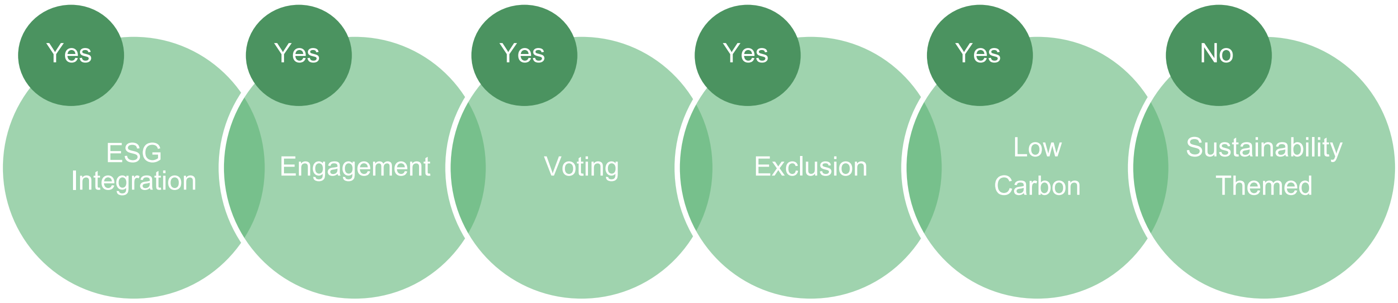
Prologis issued a press release in December highlighting that it had received an A (the highest) rating from the global environmental nonprofit organisation, CDP (formerly the Carbon Disclosure Project). Only 3% of the 9,600 business considered by CDP receive this ranking and it constitutes a reflection of the leadership efforts undertaken in respect of its actions to mitigate climate change and contribute to a low-carbon economy. We note this award is consistent with the high rankings the business receives from other ESG-focused organisations.

Appendix: A reminder of our ESG philosophy and principles –

We seek to identify and invest in a diverse range of businesses offering exposure to the key trends which we believe will help shape the future. These naturally align with the **Sustainable Development Goals**, to which almost all of our investments have formally committed**.** It is our view that these trends are poised to grow sustainably and in importance broadly *regardless* of the economic backdrop and regulatory dynamics. Examples of trends to which the Fund is exposed include alternative energy, food innovation and healthcare solutions.

At the same time, **the Fund will not invest in areas such as fossil fuel extraction, alcohol, tobacco, adult entertainment, gambling, civilian firearms, weapons and nuclear power**. From a governance standpoint the Fund also avoids businesses with questionable accounting and/ or governance practices, favouring transparent boards and avoiding dual share class structures.

Sustainability Fund Classification



A full list of ESG considerations which are used in our analysis (and may vary by sector) follow below -

- alignment with UN Sustainable Development goals;
- environmental and social reporting, disclosures and transparency;
- material environmental and/or social controversies;
- human rights considerations;
- environmental practices;
- employee and board-member diversity;
- anti-corruption policies;
- unethical business conduct;
- board structure; and
- executive compensation

Thank you for your interest in and support for the Future Trends Fund. We welcome any feedback or questions you may have.

Signatory of: PRI Principles for Responsible Investment

Alex Gunz, Fund Manager

Important information

Past performance is not an indication or guarantee of future performance and no representation or warranty is made regarding future performance. This communication is for information purposes only. It is not an invitation or inducement to engage in investment activity.

The document is provided for information purposes only and does not constitute investment advice or any recommendation to buy, or sell or otherwise transact in any investments.

The contents of this document are based upon sources of information which Heptagon Capital believes to be reliable. However, except to the extent required by applicable law or regulations, no guarantee, warranty or representation (express or implied) is given as to the accuracy or completeness of this document or its contents and, Heptagon Capital, its affiliate companies and its members, officers, employees, agents and advisors do not accept any liability or responsibility in respect of the information or any views expressed herein. Opinions expressed whether in general or in both on the performance of individual investments and in a wider economic context represent the views of the contributor at the time of preparation. Where this document provides forward-looking statements which are based on relevant reports, current opinions, expectations and projections, actual results could differ materially from those anticipated in such statements. All opinions and estimates included in the document are subject to change without notice and Heptagon Capital is under no obligation to update or revise information contained in the document. Furthermore, Heptagon Capital disclaims any liability for any loss, damage, costs or expenses (including direct, indirect, special and consequential) howsoever arising which any person may suffer or incur as a result of viewing or utilising any information included in this document.

For all definitions of the financial terms used within this document, please refer to the glossary on our website: https://www.heptagon-capital.com/glossary

Risk Warnings

The Fund is subject to special risk considerations including geographic concentration risk, portfolio concentration risk and operational risk. The investment return and principal value of an investment will fluctuate so that the investor's shares, when redeemed, may be worth more or less than their original cost. Any investor should consider the investment objectives, risks and charges and expenses of the Fund carefully before investing. Where an investment is denominated in a currency other than the investor's currency, changes in rates of exchange may have an adverse effect on the value, price of, or income derived from the investment.

Heptagon Capital LLP, 63 Brook Street, Mayfair, London W1K 4HS
tel +44 20 7070 1800
fax +44 20 7070 1881
email london@heptagon-capital.com

Partnership No: OC307355 Registered in England and Wales
Authorised & Regulated by the Financial Conduct Authority (FRN: 403304).