Ninety One

American Franchise Fund

Sustainable Finance Disclosures

Summary

American Franchise is an active equity fund that seeks to invest in high-quality companies. The Investment Manager, Ninety One defines these as companies that possess enduring competitive advantages, dominant market positions, strong balance sheets, low cyclicality, sustainable cash generation and disciplined capital allocation. The types of businesses that display these attributes tend to have low capital intensity – they have relatively low fixed costs required to produce their goods or services – and lower carbon emissions than the broader US equity universe. The Fund aims to maintain a lower carbon footprint than the benchmark.

How does the Fund incorporate sustainability into its investment process?

Finding high-quality companies requires detailed fundamental analysis. The investment team conducts an in-depth proprietary assessment of the durability of a company's business model and competitive advantage, the resilience of its financial model and the alignment of capital allocation decisions with the long-term interests of shareholders and other key stakeholders. Sustainability is fully integrated into this analysis and is assessed according to the following three pillars:

1. Business model sustainability

This involves assessing how a company interacts with its suppliers, customers, employees, and regulators, as well as the potential threat of increased regulatory scrutiny. The team takes an in-depth look at the sustainability of the company's environmental and social practices, including the sourcing of raw materials, and the management of environmental resources like carbon and water, where applicable. The company's commitment to achieving net-zero targets also receives close attention.

2. Financial model sustainability

The investment team assesses the quality of the company's earnings and accounting practices and the extent to which it manages its capital sustainably, maintaining low levels of debt. Balance sheet strength and consistent cash flows are important features of high-quality companies.

3. Sustainability of capital allocation and corporate governance

The investment team seeks to understand if a company's capital allocation decisions are aligned with long-term shareholders and other stakeholders and whether appropriate governance structures are in place around factors such as executive pay, diversity and independence.

Which companies are avoided?

In the search for high-quality companies, there are certain industries and sectors that do not meet the business model, financial model and sustainability credentials that the team requires as part of its investment philosophy for inclusion in the portfolio. Many of the businesses in these sectors derive a large part of their revenues from products and services that are not sustainable in a low-carbon economy. Therefore, companies are excluded from the potential investment universe (to the best of Ninety One's knowledge) if they are directly involved in:

- Thermal coal extraction or coal-based power generation
- Production and generation of fossil fuels

In addition, the Fund will not invest in companies that (to the best of Ninety One's knowledge) are directly involved in the manufacture and production of controversial weapons (including biological and chemical weapons, cluster munitions, and anti-personnel landmines), or are directly involved in the manufacture and production of nuclear weapons. The portfolio also excludes any company Ninety One deems to be in violation of the UN's Global Compact principles such as, for example, human rights abuse and forced labour.

How is the portfolio constructed?

After exclusions are applied to the investment universe, the investment team conducts its proprietary fundamental research and selects between 20 to 40 high-quality companies for inclusion in the portfolio. A minimum of two-thirds of the Fund's assets will have a lower carbon footprint relative to the benchmark. This is calculated at an aggregated level across the portfolio and means not every holding will necessarily have a lower footprint than the benchmark. The Investment Manager provides transparent reporting each year to show the carbon profile of the Fund and the benchmark.

How are investments monitored from a sustainability perspective?

The investment team applies its sustainability analysis on an ongoing basis to monitor the ESG characteristics of portfolio companies. Engagements take place as an integral part of the investment process, with the investment team initiating engagement on environmental, social and governance topics based on their investment priorities, as identified through their fundamental research.

The extent of engagement activities will vary depending on the materiality of any adverse impacts, ability to exert influence, and the nature or severity of the potential issue. Where engagements on sustainability issues are identified as a critical opportunity to create or preserve value, and where Ninety One believes it can have influence, these are classified as strategic engagements. Strategic engagements involve an engagement plan with identified outcomes, agreed between the investment team and Sustainability team.

Where Ninety One believes engagement is ineffective or companies are not committed to change, it may use the ultimate lever as an investor, which is to reallocate capital.

No sustainable investment objective

This financial product promotes environmental or social characteristics, but does not have as its objective sustainable investment.

Environmental or social characteristics of the financial product

The Sub-Fund promotes better carbon outcomes (i.e., maintaining a carbon profile lower than the Sub-Fund's benchmark) by making investments in companies that meet the standards of the Investment Manager's proprietary sustainability assessments and by excluding investments in certain sectors or business areas (deemed incompatible with a net zero future).

Details of the proprietary sustainability assessment and information on exclusions are explained in the 'Investment Strategy' section below.

Investment strategy

Sustainability Framework

As part of the fundamental analysis stage of the investment process, the Investment Manager assesses the investee companies using the pillars listed below to determine whether they meet the standards required by the Investment Manager. This analysis uses a variety of qualitative information and available data. There will be no mechanistic reliance on external ESG ratings and scores.

Sustainability is fully integrated into the analysis of every company and is assessed according to the following three pillars:

1. Business model sustainability

This may include, for example, (i) sustainability of relationships with suppliers, customers, and employees; (ii) relationships with regulators, the threat from increasing regulatory scrutiny; (iii) sustainability of environmental practices, raw material sourcing, energy efficiency, water usage, carbon footprint; and (iv) climate resilience of investee companies (including their commitments to achieve net-zero targets).

2. Financial model sustainability

This may include, for example, (i) quality of accounting policies; (ii) sustainability of the capital structure and working capital cycle; and (iii) cash flow sustainability and tax rate.

3. Sustainability of capital allocation and corporate governance

This may include, for example, (i) alignment of business and capital allocation with long-term shareholders and other stakeholders, including employee relationships; (ii) appropriate executive compensation aligned with long-term value creation; and (iii) assessment of traditional governance issues such as risk management, board diversity and balance, independence of key committees (such as audit and remuneration), related party transactions, executive track records, and turnover.

Exclusions

In addition, the Sub-Fund avoids sectors that are deemed incompatible with a net zero future. As a result, the Sub-Fund will not invest in companies that are directly involved in the following business activities (to the best of the Investment Manager's knowledge):

- thermal-coal extraction or power generation; or
- production and generation of fossil fuels.

Furthermore, the Sub-Fund will not invest in companies that (to the best of the Investment Manager's knowledge):

- are directly involved in the manufacture and production of controversial weapons (including biological and chemical weapons, cluster munitions, and anti-personnel landmines; or
- are directly involved in the manufacture and production of nuclear weapons; or
- the Investment Manager deems to be in violation of the UN's Global Compact principles.

Over time, the Investment Manager may, in its discretion, elect to apply additional exclusions to its strategy that it believes are consistent with the Sub-Fund's investment policy. Such changes will be disclosed on the Investment Manager's website as they are implemented and subsequently updated in this document at the next available opportunity.

Additional Considerations

As part of its strategy, the Investment Manager will also engage with investee companies regarding climate-related disclosures and encourage robust transition plans aligned with net zero. These engagements concentrate on opportunities with potential to effect positive change or to deepen knowledge and insight, with respect to sustainability considerations.

The Sub-Fund's holdings will be monitored on an ongoing basis by the Investment Manager. A holding may be sold for a range of reasons but in particular, if the investment case for the holding has been weakened or it no longer satisfies the investment objective and policy of the Sub-Fund.

Good Governance Practices

The Investment Manager follows an internal investment framework to analyse any governance issues related to investee companies. This is rooted in widely accepted governance principles and guidelines which are outlined in the Investment Manager's Ownership policy on its website. The following corporate governance themes are core to Ninety One's policy in relation to managing governance related issues and determining good governance:

- Leadership and Strategic Control, including board diversity, independence and engagement;
- alignment with the long term, including remuneration and governance of sustainability issues;
- climate change, including adequacy of management and disclosure of risks;
- protecting capital through capital management and preserving shareholder rights; and
- audit and disclosure, including financial reporting quality and auditor competence.

Third-party data complements the governance assessment.

For the Sub-Fund, assessing the good governance practices of companies is part of the fundamental analysis that the Investment Manager performs on each investment. The Investment Manager considers, amongst other elements, sound management structures, employee relations, remuneration of staff, and tax compliance.

Where a governance issue is identified, the Investment Manager may engage directly with company management on this issue and /or exercise proxy voting rights in an effort to catalyse change.

Proportion of investments

The minimum proportion of investments that meet the environmental or social characteristics promoted by the Sub-Fund (i.e., ' Aligned with better carbon outcomes') is 66% of its assets.

Monitoring of environmental or social characteristics

The Investment Manager seeks to maintain a carbon profile lower than the Sub-Fund's benchmark. On at least an annual basis, the Investment Manager will report on the following sustainability indicators:

- the carbon profile of the Sub-Fund; and

- the carbon profile of the benchmark.

The carbon profile of the Sub-Fund is calculated by taking the sum of the annual 'financed emissions' based on the percentage held by the Sub-Fund of each assessable investment's enterprise value. This is normalised by dividing by the total amount of dollars invested by the Sub-Fund in the investments to give a comparable footprint.

The Sub-Fund's promotion of better carbon outcomes is calculated at the aggregate Sub-Fund level. This means not every investment held will have lower carbon emissions than that of the Sub-Fund's benchmark at any single time.

In addition, the Sub-Fund will not invest in companies that (to the best of the Investment Manager's knowledge):

- are directly involved in thermal-coal extraction or power generation
- are directly involved in the production and generation of fossil fuels
- are directly involved in the manufacture and production of controversial weapons (including biological and chemical weapons, cluster munitions, and anti-personnel landmines; or
- are directly involved in the manufacture and production of nuclear weapons; or
- the Investment Manager deems to be in violation of the UN's Global Compact principles.

Exclusions are monitored in a trade management system, with breaches reported monthly. Other measurable commitments, such as % alignment with environmental and social characteristics are monitored independently by the Investment Risk team. Analysis of sustainability indicators is incorporated and described within the investment research process

Methodologies for environmental or social characteristics

As quality investors, the investment team has a natural bias away from low-quality, capital intensive, financially leveraged and cyclical parts of the market, such as energy, utilities and resources, where many of the world's largest emitters are found. The team also excludes all companies deemed incompatible with a net zero future, as described above.

As part of its fundamental research and analysis, the Investment Manager maintains a proprietary Climate Strategy Assessment for every holding within the sub-fund, as well as for potential investments considered for the Sub-Fund. The Investment Manager seeks to ensure there is sufficient decarbonisation ambition in the high-quality companies selected for the portfolio, Each assessment analyses whether the company is providing appropriate carbon disclosures and has credible targets with transition pathways in place to achieve net zero emissions by 2050 or before. The Climate Strategy Assessment evaluates companies across fifteen criteria, including whether:

- they are measuring Scope 1, 2 and 3 emissions; whether they are disclosing emissions data to the CDP;
- if they have appropriate short and long-term quantitative targets and strategies in place to achieve net zero;
- have these targets been certified by the SBTi; and
- if there is accountability at board level in terms of specific responsibility for climate change strategy and remuneration linked to climate change performance.

The output of this analysis helps prioritise engagement with those companies identified as having little or no carbon emissions disclosure and/or do not yet have credible net zero targets and transition pathways in place that are aligned with the Paris Agreement.

Data sources and processing

The Investment Manager uses a variety of third-party data service providers that specialise in the provision of Environmental, Social and Governance (ESG)data to measure the attainment of the Sub-Fund's environmental and social characteristics. Ninety One's primary ESG data service providers are MSCI, ClarityAI and S&P Trucost that aggregate company reported data for use by the Investment Manager and provide estimated/modelled data where data is not available. This may be supplemented by proprietary ESG analysis, equivalent, or internally estimated data. As the Sub-Fund invests across many jurisdictions there is great variability in data availability and quality. The Investment Manager mitigates this by using reputable third-party sources and may engage with vendors where there is disagreement with the output of the data.

Sustainability data vendors are reviewed by internal stakeholders prior to onboarding. This process helps develop an understanding of the quality of data, coverage, and estimation methods. Based on this review the Investment Manager determines acceptable levels of data quality. The Investment Manager's analysts perform a key role in the review and support process to promote continuous improvement of data quality through engagement with both companies and data vendors.

The level of estimation can vary by data type and region. Carbon data quality has significantly improved over the last few years, scope 3 data remains subject to a high level of estimation.

Limitations to methodologies and data

Measuring how the environmental or social characteristics are met (i.e. its sustainability indicators) is dependent on the availability and quality of data. The Investment Manager aims to use reported data from companies and government sources, however, in some cases may need to approximate data where appropriate data is not available. Approximation is typically done by vendors including estimated data. Data coverage is improving but may not always be representative of corporate activity. When appropriate the Investment Managers aims to disclose where estimated or modelled data is used as well as the need to exercise caution when using this data for decision making or comparative purposes.

Where limited data is available, the Investment Manager uses its research and due diligence process to assess environmental and social characteristics.

Due diligence

The Investment Manager applies a holistic approach to sustainability embedded within its investment philosophy and process, which goes beyond using third-party metrics to assess sustainability criteria. of the research process assesses the durability of a company's business model and competitive advantage, the resilience of its financial model and the alignment of capital allocation decisions with the long-term interests of shareholders and other key stakeholders. Companies with sustainable business models, manage their various stakeholders for the long-term, including environmental resources, which can enhance their returns and cash flows, and lower their risk and cost of capital as a result.

The Investment Manager initially produces a one-page investment report to determine the strength of a potential investment case, before an investment specialist is tasked with completing a detailed fundamental research report. The Investment Manager does not rely on a screen utilising sustainability criteria as third-party metrics can be unreliable and/or incomplete. This holistic approach to sustainability also means to the Investment Manager can identify and assess material sustainability issues and opportunities in the research stage of its process.

A consistent framework is applied by the Investment Manager for all research. Due diligence on sustainability factors are assessed through a stakeholder lens within each element of this framework:

- Business model: sustainability of relationships with suppliers, customers, employees, governments and regulators;; and environmental and social sustainability, including raw material sourcing and water usage as well as a company's carbon footprint and transition pathway towards net zero emissions.
- Financial model: quality of earnings and integrity of accounting policies; sustainability of a company's capital structure, working capital cycle, tax rate and free cash flow.
- Capital allocation: alignment with the interests of key long-term stakeholders; appropriate executive compensation and incentives aligned with long-term value creation; assessment of governance issues such as risk management, board balance, diversity and inclusion, independence of key committees (such as audit and remuneration), related party transactions, executive track records and turnover.

Valuation: material sustainability factors are reflected in the analysts' assessments of a company's risk/reward, as applicable, which will have a bearing on their recommendation for portfolio inclusion and position sizing. However, please note portfolio changes are typically not made on ESG assessments alone, but as a result of our investment process of which ESG analysis is a part.

Within the Business Model section of the full fundamental research report, the investment specialist completes a proprietary Climate Strategy Assessment, which evaluates the company across fifteen criteria (as described previously). The output of this analysis helps the Investment Manager prioritise engagement with those companies identified as having little or no carbon emissions disclosure and/or do not yet have credible net zero targets and transition pathways in place that are aligned with the Paris Agreement.

Engagement is considered both as part of the initial due diligence process, prior to investment, and on an ongoing basis, where required, to reduce risk and protect or enhance the value of an investment. The extent of engagement activities will vary depending on the materiality of any adverse impacts, ability to exert influence, and the nature and severity of the potential issue. The weekly team meetings held by the Investment Manager are an important forum for discussions around existing portfolio holdings. When a company characteristic changes, the Investment Manager will revisit the investment case to ensure that the existing investment in the company is appropriate.

Engagement policies

The Investment Manager implements active stewardship and its rights as shareholders to preserve and grow its clients' assets, including engagement with the companies in which it invests. Engagements take place as an integral part of the investment process, with the investment teams initiating engagement relevant to environment, social and governance characteristics based on their investment priorities as identified through their fundamental research. The extent of engagement activities will vary depending on the materiality of any adverse impacts, ability to exert influence, and the nature or severity of the potential issue. Where engagements on sustainability issues are identified as a critical opportunity to create or preserve value, and where the Investment Manager believes it can have influence, these are classified as strategic engagements. Strategic engagements involve an engagement plan with identified outcomes, agreed between the investment team and Sustainability team.

In addition, in relation to Article 8, where significant adverse impacts are identified or there is potential non-compliance with good governance requirements the investment team will identify the materiality of these and the potential need for engagement to address these issues, in conjunction with the Investment Risk and Sustainability team. Aligned with the Investment Manager's broader approach to engagement and stewardship, individual engagements will be categorised as general, strategic or advocacy (collaborative) engagements depending on the materiality and form of the engagement. Further information on the Investment Manager's approach to engagement is available on their website.

As long-term shareholders, Quality investors are well placed to engage actively with company management and ensure that capital allocation is aligned with the long-term interests of shareholders and other key stakeholders. Engagement is considered both as part of the initial due diligence process, prior to investment, and on an ongoing basis, where required, to reduce risk and protect or enhance the value of an investment. The extent of engagement activities will vary depending on the materiality of any adverse impacts, ability to exert influence, and the nature or severity of the potential issue. The Investment Manager's Climate Strategy Assessments of each individual holding help prioritise engagement with those companies identified as having little or no carbon emissions disclosure and/or do not yet have credible net-zero targets or transition pathways that are aligned with the Paris Agreement.

Where the Investment Manager believes engagement is ineffective or companies are not committed to change, it may use the ultimate lever as an investor, which is to reallocate capital.

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Telephone calls may be recorded for training, monitoring and regulatory purposes and to confirm investors' instructions. For more details please visit www.ninetyone.com/contactus

Important information

All investments carry the risk of capital loss. Past performance is not indicative of future performance.

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