Regnan Global Equity Impact Solutions Strategy

Quarterly Impact Report

Q2 2021

Brought to you by J O Hambro Capital Management

Regnan

The second quarter saw global equity markets continue to make gains as the vaccine roll-out allowed economies to re-open, feeding through to strong corporate earnings. While we remain in the early stages of the cycle, inflation fears have been building, with lockdown-related bottlenecks driving commodity prices higher and leading to supply chain disruption. However, policymakers such as the Federal Reserve expect these inflationary pressures to be transitory, allowing accommodative global financial market conditions to continue. We believe the economic recovery will remain supported by pent up demand, high savings rates and a strong global housing recovery, with the potential to broaden out to emerging markets as vaccination programs gather momentum. Irrespective of the macro, our focus remains, as ever, on investing in mission-driven companies with proven solutions.

During the quarter, the International Energy Agency (IEA) published a landmark report detailing its scenario on how the world reaches net zero emissions by 2050. While the IEA's call for a step change in investment into renewables and energy efficiency is nothing new, its calls for oil and gas companies to stop all new exploration projects from this year is a striking message, coming from a body founded in 1974 with the main objective of keeping global oil supplies flowing. Crucially, the IEA also flagged the huge gap between ambition and reality. Under policies currently in place, the world is headed for a 2.7°C temperature increase. And even if countries meet their net-zero targets in full, temperatures would still rise by 2.1°C. This is much needed food for thought ahead of the UN Climate Change Conference (COP26) meeting in Glasgow later this year.

On a positive note, we are pleased to report some significant engagement successes. Firstly, Umicore, one of the largest emitters in the portfolio, announced a net zero target by 2035 at its inaugural sustainability day. This is an ambitious target, but we believe management have presented a clear strategy to deliver and have set a high bar for the industry. Secondly, Orsted held its capital markets day in June, where it committed to an immediate ban on landfilling of wind turbine blades, with a commitment to reuse, recycle or recover 100% of blades. Blade recycling is an impact risk we have engaged on extensively, and this news is a major step forwards in securing wind power's future as a truly clean energy.

We introduced two new names within the circular economy theme during the quarter. One company is a leader in wood-based cellulosic fibers and is helping improve sustainability of the fashion industry, which today accounts for 10% of global carbon emissions as well as 20% of wastewater. The company's Lyocell fibers require 10 times less water than cotton, have a carbon-neutral footprint and are highly biodegradable. We also initiated a position in a company whose globally-leading solutions are driving digital transformation, across the life cycle of products through computer-aided design, product life cycle management, the industrial internet of things and augmented reality. The company's solutions increase productivity and efficiency of R&D by reducing design time, waste and time to market.

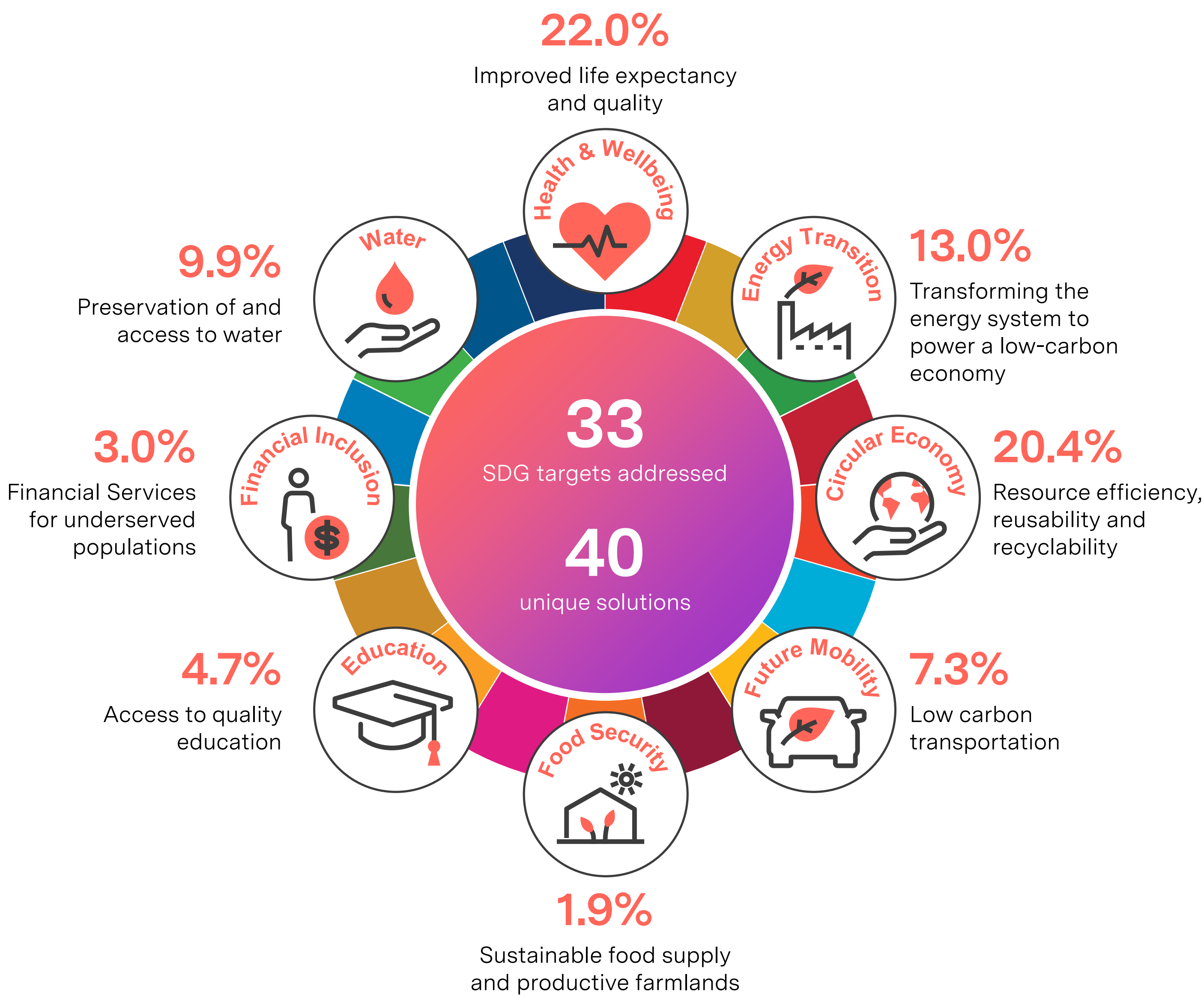
We recently published the first edition of the Regnan Radar series, '**Methane: cows, hydrogen and the future of the Arctic**'. While much attention has centered on carbon emissions, methane is rightly attracting more attention in decarbonization plans, having 28 times greater global warming potential than CO_2. We are excited by our recently released third thematic research piece, '**Inclusion: an overlooked opportunity for investors**', which makes the case for a redirection in focus from diversity to inclusion and equity to better realize the potential of the entire workforce. A summary of this thematic deep-dive, authored by our Regnan Insight and Advisory Centre colleagues, is included in this quarter's impact report. We encourage readers to access the full report here.

Mohsin Ahmad,
Fund Manager,
Regnan Global Equity Impact Solutions

The Regnan Global Equity Impact Solutions strategy is a solutions-first strategy. It is focused on investing in mission-driven businesses that address underserved environmental and social challenges and deliver real, systematic change for the better. The team aspire to demonstrate that investing for impact not only makes good environmental and social sense; it also makes good financial sense. The intention is to broaden the appeal of impact investing and redirect capital towards impact investing. We aim to do this by delivering our investors market-beating long-term returns because we have identified 'system changers' that innovate, disrupt and ultimately produce positive environmental, social and financial outcomes.

Regnan Global Equity Impact Solutions

Portfolio exposure by impact theme



Source: Regnan/JOHCM as of June 30, 2021. Note: Thematic exposure attribution to eight impact themes based on estimates of company revenues or other relevant metrics. Cash position: 1.7%. Neutral impact (13.2%) is estimated where revenues not directly tied to any theme. Negative impact (2.8%) estimated where revenues may be detrimental to UN Sustainable Development Goals (SDG).

THEMATIC FOCUS
BEYOND DIVERSITY

Equity and Inclusion as an overlooked opportunity for investors

In a business environment, where ingenuity and quality decisions are critical, it is imperative for companies to maximize the contributions that people make at work.

Diversity can bring broader talent into an organization. But Regnan Insight and Advisory Centre research shows **equity and inclusion** are critical factors in realizing the performance potential of a diverse workforce.

The research – including a review of academic and industry literature, interviews with practitioners and analysis of leading organizations – identifies a number of organizational conditions capable of supporting better performance.

The challenge? This requires a greater focus on the organization itself, rather than on the candidates it seeks to appoint and retain.

It is imperative – for both performance and social equity reasons – that organizations rise to this challenge. A focus on diversity without equity and inclusion can hinder contributions from people in non-dominant groups and undermine future diversity efforts.

Our research highlights:

- A need to re-examine priorities in Diversity, Equity and Inclusion (**DEI**)
- Organizational levers **companies** can use to enable diverse talent to flourish
- DEI issues **investors** should seek from the companies they hold – whether for performance or equity reasons

For investors and companies alike, the goal should be organizational settings that allow all talent to flourish-including talent that is traditionally under-represented.

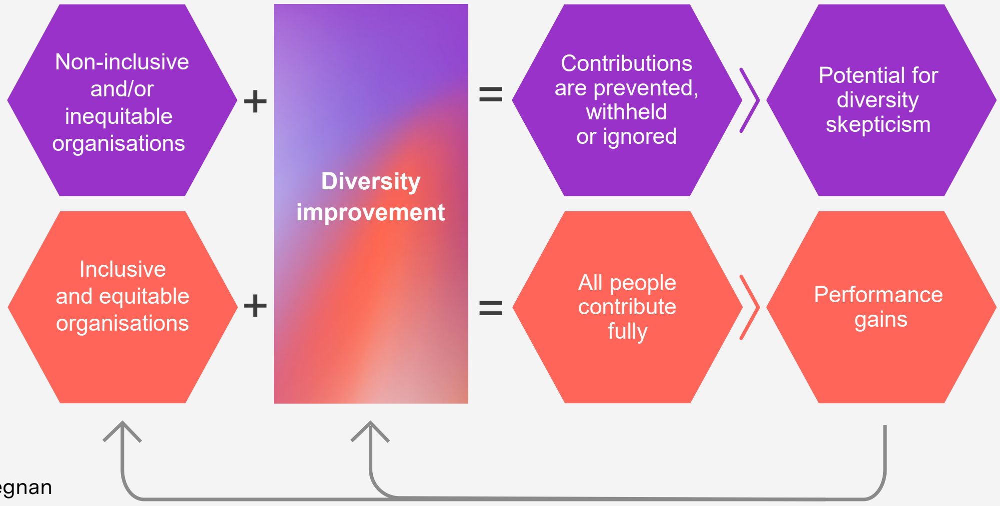
Reframing the business case: from diversity to equity and inclusion

Our analysis suggests that greater observable diversity and stronger performance both result from more equitable and inclusive organizations. Therefore targeting diversity alone is sub-optimal and even counterproductive – both for a business and for members of under-represented groups.

A more effective approach prioritizes organizational conditions needed to better realize the potential of the workforce. This can be achieved by ensuring due attention to the contributions of those whose potential is least likely to be realized under the status quo.

This upends the conventional framing of diversity as an “extra”. It positions diversity, equity and inclusion as essential to maximizing business performance. Achieving this requires a redirection of focus from diversity to equity and inclusion.

Equity and inclusion as the pathway to performance gains



Source: Regnan

Our model for effective Diversity, Equity and Inclusion

Adapting a model developed by Cornell University Associate Professor Lisa Nishi, we highlight three areas of focus for equity and inclusion that, in our view, warrant greater investor attention: equitable employment practices, supportive culture, and inclusive decision-making.

Essential pre-requisites for effective Diversity, Equity and Inclusion (DEI):

1 Equitable employment practices **FAIR**

2 Supportive culture **SAFE**

3 De-biased decision-making **OPEN**

Equitable employment practices eliminate bias throughout formal processes that govern the employment relationship at all stages: recruitment, remuneration, development and progression. The best responses take a proactive approach, for instance correcting power imbalances that skew a group's confidence in pay negotiations and may perpetuate inequitable pay outcomes. This also addresses bias that occurs through uneven distribution of other resources within the organization, such as access to opportunities for development or recognition.

A **supportive culture** empowers all employees to perform at their best. This includes informal norms, interpersonal behaviors and organizational resources deployed to support work-life balance (regardless of reason), accommodating individual differences (for instance in physical changes to the workplace) and ensuring psychological safety, trust and respect within and across teams (including via effective conflict resolution mechanisms).

De-biased decision-making focuses on an organization's ability to elicit, understand and adapt itself to feedback from its people. This can be explicit feedback (for example through self-reporting tools) or observed (for example via regrettable turnover).

Supporting all people to fulfill their potential requires perspectives beyond those that shape the status quo. The richest insights may come from people within an organization who lack positional authority or membership of the dominant group.

Considerations for investors:

- The absence of these practices in an organization can indicate elevated risk.
- Lack of bottom-up feedback as a basis for top-down DEI initiatives suggests limited performance gains from a company's DEI programs.
- The strength of these decision-making processes are at least as important as any numerical data.

Inclusive organizations have been found to deal with performance issues 3.6 times better.[1]

Organizations and investors have redoubled diversity efforts in recent years. These efforts are largely well-intentioned. But evidence strongly suggests that attention is better initially directed to equity and inclusion, rather than to diversity, both for business performance and for social equity reasons.

A sole focus on representation is insufficient. DEI policies should address bias – whether unconscious, careless or convenient for incumbents or dominant groups.

Instead of focusing exclusively on numerical representation, DEI programs must give due attention to the distribution of power and authenticity of approach. This is needed to cultivate a culture where people can fully contribute and organizations can deliver business and social benefits.

Investors who fail to pay attention to the essential pre-requisites for effective DEI will not only miss vital indicators of future performance – they may, via their engagement efforts, further entrench counterproductive activities.

[1]Bersin, J Why diversity and inclusion as become a business priority, 2019 update, https://joshbersin.com/2015/12/why-diversity-and-inclusion-will-be-a-top-priority-for-2016/.

Case Study #1 CASE STUDY

This company's activities contribute to the following SDG targets and Regnan themes:

TARGET 12.4
TARGET 12.2 TARGET 15.1

12 RESPONSIBLE CONSUMPTION AND PRODUCTION
15 LIFE ON LAND
Circular Economy

Theory of Change

Fashion represents up to 10% of global CO_2 emission, 20% of waste water and 6% of global pesticide use. This is compounded by the fact that a new garment is used only about 60 times, down from 120 times 10 years ago, and 87% of garments are incinerated or landfilled. Wood-based cellulosic fibers from this company use 10 times less water than cotton, have a neutral carbon footprint (not taking into account carbon sequestration from forests), are highly biodegradable, and almost exclusively use chemicals that are recycled in a loop process. This company is also developing a technology that can include 30-50% recycled cotton together with Lyocell.

What the company does

This company focuses on producing wood-based cellulosic fibers. These have a variety of textile applications as well as use in some personal hygiene products. The fibers have superior technical properties and better environmental footprint relative to conventional fibers. This company produces three types of fibers: Viscose, Modal and Lyocell. Each fiber has different technical properties that make them applicable across a wide range of applications and can be used in both affordable and high-end clothing. The company has been the innovation and sustainability frontrunner in the industry for decades, developing technology and business practices that ensure a superior environmental profile. These have enabled the company to build a strong market position and brand awareness.

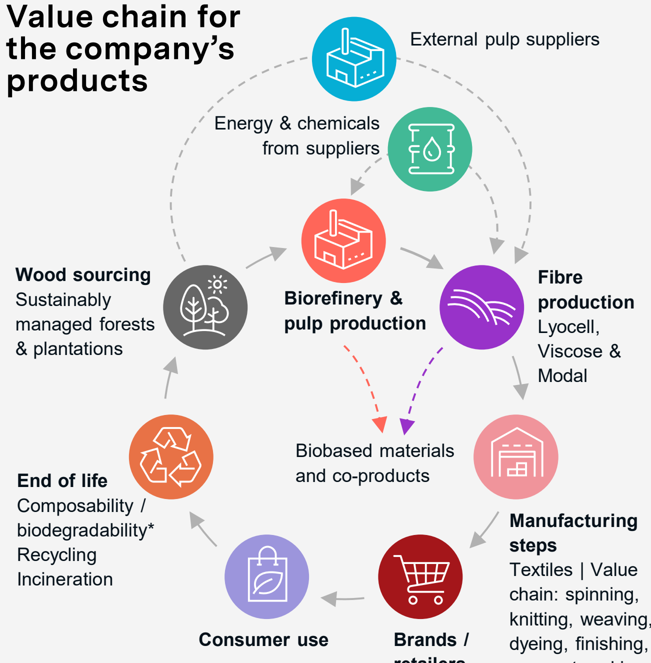
Fashion represents up to 10% global CO_2 emission, 20% of waste water and 6% of global pesticide use

Why the company is in the portfolio

Textile made of cotton and polyester generates significant environmental externalities. The fashion industry is responsible for 10% of annual global carbon emissions. Additionally, 20% of wastewater worldwide comes from fabric dyeing and treatment. Fashion is a significant source of pollution and material waste as a staggering 87% of garments are incinerated or sent to landfill. This is compounded by the fact that new garments are typically worn about 60 times, half the average number of uses a decade ago. Wood-based cellulosic fibers from this company use 10 times less water than cotton, have a neutral carbon footprint (not taking into account carbon sequestration from forests), are highly biodegradable, and use chemicals that are recycled in a loop process. The company is also developing a technology that can include 30% recycled cotton when combined with Lyocell.

Demand for specialty fibers is likely to accelerate due to a combination of pressures. The sustainability credentials of fashion brands are becoming more important, with increased focus on the materials used. Increased use of Lyocell volumes supports bigger shifts by large fashion brands. The company's superior environmental profile allows it to sustain a price premium due to lack of alternatives and continued innovation. The superior environmental profile of Lyocell and Modal, as well as their attractive physical properties, make them appealing, high quality fabrics. At the same time, the company's backward integration strategy, which involves the expansion of its in-house dissolved wood pulp production capacity, a key input, will reduce the cost base and make it more stable, providing a cost advantage which we expect to support margins.

Value chain for the company's products



Textiles | Value chain: spinning, knitting, weaving, dyeing, finishing, garment making

Nonwoven | Value chain: roll-good producer, converter

Source: The company.
*All standard fibers from the company are compostable and biodegradable in freshwater, marine and soil conditions. The composability and biodegradability of final consumer textile and nonwoven products depend on the material composition (fiber blend) and processing in the value chain steps.

Case Study #2

CASE STUDY

This company's activities contribute to the following SDG targets and Regnan themes:

TARGET 8.4 TARGET 9.4

8 DECENT WORK AND ECONOMIC GROWTH

9 INDUSTRY, INNOVATION AND INFRASTRUCTURE

Circular Economy

Theory of Change

Productivity growth across OECD countries was lower in the decade leading up to 2016 than it was in any other decade from 1950 (UN). While technological progress and innovation has continued, the adoption of Industry 4.0 solutions with potential to deliver significant productivity improvements remains low, particularly from small and medium-sized enterprises where the costs of upgrading can be prohibitive. This company's solutions drive digital transformation, which reduces waste and scrap in the products they design, creates efficiencies in their manufacturing processes, and optimizes the operations of their customers' processes. The company provides global leading software solutions across the life cycle of products through computer-aided design, product life cycle management, the industrial Internet of Things and augmented reality. The company's solutions increase productivity and efficiency of R&D by reducing design time by up to 30%, make manufacturing more efficient and less wasteful, with up to 30% reduction in prototypes, thereby reducing costs and raw material use, and reducing the time to market by up to 57%.

What the company does

The company's offerings in computer-aided design (CAD), product lifecycle management (PLM), the Internet of Things (IoT) and augmented reality (AR) help its customers digitize their operations and collaborate. In CAD, its offering is used to create 3D computer models and simulation to optimize the design for products ranging from wind turbines to phones. The company's software suite for PLM enables collaborative content and process management helping manage the full life cycle of products, from production through to end of life recycling. With one offering, the company provides a platform for developing applications for the Internet of Things, helping industrial customers improve the efficiency of their operations with predictive maintenance and data analytics.

Its augmented reality product, overlays digital information such as repair instructions onto the view of physical objects and processes. Covid has helped accelerate adoption of the company's solutions, making them a necessity by enabling remote working, avoiding the need to travel and physical presence, for example through the company's AR solutions.

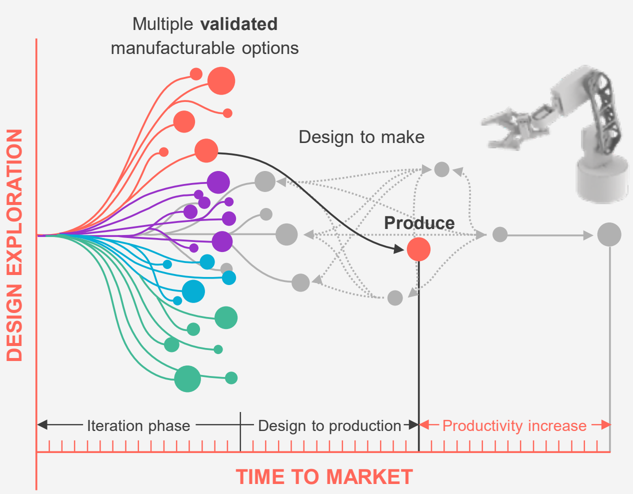
Why the company is in the portfolio

The company has the only platform covering the full suite of CAD, PLM, Industrial IoT and AR. Its products are used to create, update and simulate physical products. Designers can optimize products in a virtual space, lowering development costs and improving resource efficiency, reduce time to market and optimize product performance. Artificial intelligence programs aid design engineers in producing the designs that meet their requirements while not compromising material strength qualities.

Integrating real-time IoT data and insights enhance decision-making, predict outcomes, resolve problems remotely, and improve operational efficiencies to reduce waste, preserve water and energy usage.

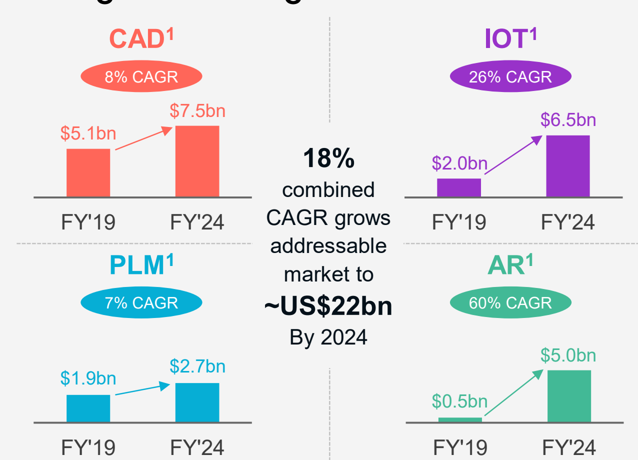
The company also helps improve access by making its products available for free through K-12 and University programs, along with standards-based curriculum. This helps make the products its develops and the engineering design process more accessible to a broader range of users.

Generative design



Source: The company.

Scaled leader across key software areas driving industrial growth



Source: 1. The company.

Regnan

About Regnan

At Regnan we've been thinking forward and shaping the responsible investment movement since 1996 – long before it became mainstream.

2020 marked our expansion into funds management supported by the investment platform of J O Hambro and the Pendal Group. We've brought together proven sustainability and impact teams with track records tested through cycle, with the depth of insights provided by our engagement, advisory and research team.

Our collective purpose is to contribute to a more sustainable future by developing and promoting principled, rigorous and outcome-oriented approaches in responsible investment.

Client solutions sit at the heart of all that we do and are based on four key pillars:

- Delivering our clients attractive investment returns; we aim to grow their real wealth over the long term.
- Understand the materiality of sustainability issues to deliver improve decision-making and real world outcomes.
- Creating differentiated, innovative strategies that serve a purpose in client portfolios.
- Our strategies are authentic and provide significant exposure to underlying sustainability opportunities.

Regnan Global Equity Impact Solutions

The Regnan Global Equity Impact Solutions strategy is a solutions-first approach, focused on investing in mission-driven businesses that address underserved environmental and social challenges and deliver real, systematic change for the better. It is a high-conviction, global, multi-capitalization portfolio with low turnover and a strong emphasis on driving impact by engaging companies to improve measurable outcomes.

Regnan Sustainable Water and Waste

Our Thematic Investing team joined Regnan in April 2021 and launched the Regnan Sustainable Water and Waste Strategy in September 2021. Combining exposure to both water and waste-related companies makes this strategy a distinctive thematic investment proposition with diversification benefits.

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