ESG challenges and opportunities in emerging and frontier markets

An asset manager’s viewpoint

Geneva, 31 May 2018
Two decades of successful investments

1997
Founded in Stockholm

Active Investor
On the ground research, company meetings
Investment process integrating ESG risks and opportunities

Quality and Growth
Focus on high quality companies benefiting from structural growth
Opportunities outside of energy and commodity space

USD 4.2bn
in assets under management
Public equities and real estate
International client base including first-tier financial institutions

Strong team
27 investment professionals in 5 research offices
Portfolio managers with 130 years+ of combined experience in emerging and frontier markets

Strategies
Eastern Europe including Russia, Turkey, Balkan and Baltics
Emerging Asia including China A-Shares and China Environmental
Global Emerging and Global Frontier Markets
Real Estate Baltics

Responsible
Active shareholder and ownership
PRI signatory
Founding idea – what drove our success?

The collapse of the Soviet Union - a historic transition in Europe

- East Capital founded on the belief that the convergence between East and West would offer many opportunities

Guiding principles

- Research is often scarce and of poor quality
- Need to engage with companies for better governance
- Indices overemphasize legacy assets and do not capture the real economy

Sourcing information first hand from companies

- Combining proprietary fundamental research with qualitative research integrating ESG
- Company meetings to assess credibility of management and identify risks
- Focus on domestic themes

Expansion outside of Eastern Europe

- 2010 Hong Kong hub for Asian investments
- 2014 Launch of East Capital Global Frontier Markets
- 2015 Dubai opened for Middle East and Africa
- 2017 Launch of East Capital Sustainable Emerging Markets
Back in the days
How we invest in our universe
Typical ESG factors

- Environmental Costs
- CO₂
- Natural resource management
- Waste
- Extreme weather/natural disasters
- Environmental costs
- CO₂ emissions
- Natural resource management
- Waste
- Extreme weather/natural disasters

Research
Media
Authorities
Customers
Sector initiatives
Stock exchanges
Investors
Employees
NGOs
Communities
Other...
Does conventional ESG approach create value?

- Using **generic ESG scores** does not create alpha in EMs
- 84% of data in popular ESG databases concerns existence of policies
- Need to **meet companies and understand management approach**
- **No ESG consensus**—different data provider’s sustainability ratings often diverge with correlation between the two major rating systems at just 0.32

Source: East Capital, Goldman Sachs, April 2017; UBS Quant Research, Sep 2017; Cary Krosinsky, The Failure of Fund Sustainability Ratings, Feb 2018. Back-test: equally weighted indexes based on ESG scores and MSCI EM Index components; all data in USD
# Our ESG pillars

<table>
<thead>
<tr>
<th>ESG pillar 1:</th>
<th>ESG pillar 2:</th>
<th>ESG pillar 3:</th>
<th>ESG pillar 4:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sector exclusions (negative screening) Since 2007</td>
<td>Controversy (norms-based) screening Since 2010</td>
<td>Proprietary ESG scores Since 2016</td>
<td>Voting and engagement Since 1997</td>
</tr>
</tbody>
</table>

**ESG pillar 1: Sector exclusions (negative screening) Since 2007**

**WHAT:**
- All portfolios exclude companies that are known to generate significant share of revenues from:
  - Weapons
  - Tobacco
  - Pornography

**HOW:**
- Screening implemented in analyst’s/PM’s initial analysis
- External screen available if uncertain
- Portfolios re-confirmed annually, controversial weapons confirmed semi-annually

**ESG pillar 2: Controversy (norms-based) screening Since 2010**

**WHAT:**
- Semi-annual screen and “alerts” in between
- Alerts us of suspected breaches of international conventions and norms on human rights, labour standards, environment, health & safety or bribery
- Input for dialogue and engagement

**HOW:**
- External research partner

**ESG pillar 3: Proprietary ESG scores Since 2016**

**WHAT:**
- 10 Red Flags section + more extensive ESG scoring section
- Separate SDG module
- Leverage our unique resources, experience and track record in EM and FM
- Focus on most relevant and material ESG risks AND opportunities in our markets

**HOW:**
- Scoring done by analysts/PMs: own judgment remains critical
- Start with Red Flags for all holdings, full ESG score and SDG module score for all Key Active Positions
- Scores reviewed annually or upon major event

**ESG pillar 4: Voting and engagement Since 1997**

**WHAT:**
- Active ownership to add value post investment
- Communicate our views and expectations as owner
- Initiate engagement where relevant

**HOW:**
- Proxy voting
- Filing shareholder proposals
- Nominating and electing independent directors
- Letters to portfolio companies
- Engaging on our own
- Members of external engagement forum
- Collaborating with other investors, associations, initiatives if relevant
Why invest responsibly?

How can we
There are different ways of addressing ESG...

Values-based exclusions

Norms-based exclusions

Best-in-class

Thematic approach

OR **combining** some of the above
EAST CAPITAL

...but here are the most important components

ESG integration

- Inclusion of ESG risk factors into traditional financial analysis:
  - Income statement
  - Balance sheet
  - CF analysis
- May impact decision to invest, or lead to adjustment of modelling assumptions, level of conviction and/or size of holding

Active ownership

- Proxy voting at AGMs and EGMs
- Initiate a company engagement: a dialogue to contribute to positive change
- File shareholder proposals
- Nominate independent directors
- Collaborate with other investors
- Other forms of active ownership
ESG is critical to companies’ sustainability

ESG Scorecard

- **Proprietary**
- A comprehensive tool to ensure that companies demonstrate sustainable earnings growth over the mid- and long-term
- Leverage our unique resources

Our tools

Red flags
10 critical ESG areas to focus on when initiating coverage of a name:
- Production of a “Red Flag” score
- No more than 2 flags, unless very specific reason to accept higher level of risk (such as expectations of decreasing risk in future)
- More than 3 flags, further research typically not warranted

ESG score
Detailed ESG analysis from an EM and FM perspective
- Production of “ESG Score”
- Focus our ESG analysis and make sure we are asking the right questions

SDG module
Additional module to assess investment risks and opportunities related to the UN Sustainable Development Goals (SDGs)
What we have learned: the main value added of ESG integration

• Executed by the investment team, ensures similar approach and a holistic analysis of company quality across teams and regions

• Conclusions are used to focus resources, bring material sustainability topics onto agendas

• Spark peer pressure among companies to improve scores over time. Particularly impactful where regulatory and/or consumer pressure on sustainability are lagging
Active investment managers = Active owners

- We take an active role in portfolio companies:
  - Actively seek to address relevant ESG issues
  - Independent board members
  - Exercising voting rights at meetings

- We meet with companies and other stakeholders

- We also engage with authorities (governments, stock exchanges) on how to strengthen the local market framework
Associations and initiatives

**PRI** (Principles for Responsible Investment)
Signatory since October 2012

**API** (leading association of minority investors for better Corporate Governance in Russia)
Active member since 2002 and represented on the Board since 2010

**ACGA** (Asian Corporate Governance Association)
Member since 2009

**CECC** (China Environment Chamber of Commerce)
Member since 2016

**CDP** (Carbon Disclosure Project)
Investor signatory since 2014

**BICG** (Baltic Institute of Corporate Governance)
Presenter of ESG issues from the investor perspective in BICG’s CG training programs for executives in the Baltics since 2009

**Fondbolagens förening** (Swedish Investment Fund Association)
Member of Working Group for Corporate Governance and Sustainability since 2011

**ALFI** (Association of the Luxembourg Fund Industry)
Member of Responsible Investing Market Intelligence and Outreach Working Group since 2016
China’s war on pollution

East Capital China Environmental

Portfolio sector breakdown

- Clean Energy: 29.3%
- New Energy Vehicles: 27.3%
- Energy Efficiency: 17.2%
- Waste Management and Recycling: 11.5%
- Water infrastructure & technologies: 3.8%
- Air pollution treatment: 7.8%
- Transportation infrastructure & railways: 2.3%
- Cash & others: 0.7%

Source: East Capital as of 2018-03-01
Thank you!

Dubai
Hong Kong
Luxembourg
Moscow
Oslo
Stockholm
Tallinn
Active ownership to create value post investment

Identify

**Proactive** based on issues or areas of improvement identified in East Capital’s proprietary research process, which includes our ESG scorecards.

**Reactive** based on:
- current events
- norms based screening
- invitation from other investors

Assess

Engagements are then selected based on East Capital’s ability to influence a company and add value.

Portfolio weighting is also considered when prioritizing engagements.

Main goals of the engagement are identified.

Engage

We engage with either the management team or the board through:

- **on the ground meetings** with companies as well as our extensive local networks
- letters, phone calls or emails to companies
- collaboration with others

Monitor/Report

Discussed in team meetings and monthly meetings

Progress is monitored on a case-by-case basis

Where there are no signs of progress, there may be changes to the portfolio (depending on the materiality of the issue)

East Capital’s Annual Sustainable Investment Report

---

1000+
Company meetings

~20
Company engagements on specific ESG topics

~10
Engagements with governments, regulators or policy makers

~70%
of market value proxy voted at AGMs/EGMs

13
Directors nominated

1
East Capital Award for best Corporate Governance

Source: East Capital. Figures for 2017
Our sustainability journey

1997
East Capital is founded
Start engagement and voting

2002
Sent our first letters to all our portfolio companies on our expectations as owners
Become active members of Russian corporate governance association, API

2004
Launch of East Capital Awards

2007
Implement sector exclusion criteria for all fund products

2010
Start semi-annual controversy screening of all funds
Establish new role Head of Corporate Governance and Sustainability

2011
Expand voting and nomination and election of independent directors

2012
Become signatory of Principles of Responsible Investment, PRI

2013
Joined GES Engagement Forum which engages on norms-based ESG controversies

2015
Integra, a landmark court case, puts East Capital on the map for protecting minority investors
Decision to create our first thematic product – East Capital China Environmental

2016
Launch of East Capital’s new, proprietary ESG scorecard
China Environmental awarded LuxFLAG Climate Finance label

2017
Launch of Sustainable Emerging Markets fund
Launch of East Capital Best Corporate Governance Award
Every effort has been made to ensure the accuracy of the information in this document but it may be based on unaudited or unverified figures or sources. The information in this document should not be used as the sole basis for an investment.

East Capital’s services and investment products may not be available to all people in all jurisdictions. East Capital’s services and investment products may not be offered, sold or distributed in any country unless such offer, sale or distribution is made in accordance with local registrations or any applicable exemptions from any registration requirements provided by the local laws and regulations.

Information about our services, investment products, prospectuses, financial reports, distributors and where the funds are registered for sale can be obtained at East Capital (www.eastcapital.com).

Investment in funds always involves some kind of risk. Past performance is no guarantee for future performance. Fund units may go up or down in value and may be affected by changes in exchange rates. Investors may not get back the amount invested. As East Capital invests in foreign markets, currency fluctuations can affect the funds’ values.

This communication has been distributed by East Capital (Dubai) Limited, regulated by the Dubai Financial Services Authority. The information contained in this communication is intended for Professional Clients only, and no other persons should act upon it.