Independent Franchise Partners, LLP

ESG integration policy – May 2022

Our approach to ESG integration

Franchise Partners seeks to invest in exceptionally high-quality companies - whose primary competitive advantage is supported by a dominant intangible asset - at attractive valuations. Our portfolios are concentrated (typically 20-40 positions) and we employ a patient, long-term buy and hold approach in order to benefit from the free cash flow compounding ability of the companies in which we invest. Our goal is to earn attractive returns over a full market cycle while taking as little business risk and valuation risk as possible. We define business risk as any risk, including environmental, social and governance (ESG) risks, which might impact the long-term health of a business.

We are highly selective about what qualifies a business to be a high-quality franchise. We consider all financially material risks and opportunities when making this quality judgement. This includes analyzing ESG factors. We believe our considered quality assessments combined with our focus on absolute valuation increase the likelihood that our investments can compound our clients' wealth and deliver attractive long-term results. Consideration of financially material ESG factors strengthens our quality and valuation assessments.

Our focus on absolute valuation means we often invest in companies when they are facing an investment controversy. These controversies may at times include an ESG component. We invest in these situations when we have confidence that the company's franchise is intact, that we are being paid to bear those risks, and that the company can address its challenges. Such opportunities can help us deliver attractive long-term investment returns for our clients.

Finally, stewardship is an integral component of the Franchise investment approach. We see ourselves as long-term co-owners of every businesses in which we invest. We view voting and engagement as valuable tools through which we can hold management to account and advocate for changes that are in our clients' best long-term interests. We provide more information on our stewardship work in our *Stewardship Policy.*

Our ESG integration process

Our long-term investment horizon means that it is important for us to consider all risks and opportunities that may impact the durability of a business. We view ESG considerations as part of this broad range of business risks and opportunities that a company faces. The concentrated nature of our portfolio enables us to conduct in-depth, proprietary research and engagement on these factors.

There are three building blocks which support the incorporation of ESG considerations into our investment process.

1. **A proprietary taxonomy of financially material ESG factors*:*** These are the ESG considerations which we believe are most likely to impact our portfolio's performance. We provide our ESG taxonomy in the appendix.

2. **A framework for rating company-specific risks and opportunities:** This framework leverages our ESG taxonomy to identify each company's material ESG risks and opportunities. We then investigate these through our own research, incorporating qualitative and quantitative ESG information from a variety of sources.[1] Our framework focuses on the material absolute risks and opportunities and how they are managed by a company. We do not produce an aggregated ESG score for a company as this can mask the materiality of individual ESG factors.

3. **A climate framework:** This framework sets out the five principles on which we assess a company's approach to managing material climate risks and opportunities. It informs our stewardship activities on climate-related matters. We provide our climate risk framework in the appendix.

As part of our ESG incorporation process, we are members of a selection of leading ESG initiatives that provide research, guidance and collaborative engagement opportunities.[2]

We continue to monitor material ESG risks and opportunities across the investment landscape. We will evolve our approach as necessary to ensure we are effectively incorporating material ESG considerations into our assessments of franchise quality and valuation.

Responsibilities and oversight

The firm's partners have ultimate oversight of our ESG integration policy, and they formally review the policy on an annual basis. This policy applies to all our assets under management.

The investment team has responsibility for the day-to-day implementation of our ESG integration policy. The lead investor for each stock is responsible for identifying, assessing and incorporating ESG risks and opportunities into the investment process. The lead investor is also responsible for voting their companies' proxies and conducting engagement work, ensuring our investment and ESG views are fully reflected in all our stewardship activities. The ESG analyst, who is also a member of the investment team, provides specialist support and expertise.

Reporting and transparency

We are committed to disclosure and transparency. We provide the following to clients as part of our ESG reporting:

- Qualitative and quantitative information on our voting and engagement activities
- Assessment of climate-related risks at the portfolio and individual stock level
- Examples of incorporation of ESG considerations into the investment process

[1] In addition to a broad array of qualitative information sources, we consult the following ESG data sources: Bloomberg, Carbon Disclosure Project, ISS, MSCI and Trucost.
[2] We are members of or signatories to the following organizations: Carbon Disclosure Project, The Investor Forum, Task Force on Climate-related Financial Disclosures, UN Principles for Responsible Investment and the Workforce Disclosure Initiative.

Appendix 1: Proprietary ESG taxonomy

Our taxonomy represents the ESG risks and opportunities that we believe are the most financially material for the Franchise universe. It is informed by external frameworks, and tailored to complement the Franchise investment process and philosophy.

Category	Factor	Description
Environmental	**Climate change physical risk management**	Evaluation of a company's efforts to mitigate the impact of material climate-related physical risks within its operations and/or supply chain.
	Environmental impact management	Assessment of how effectively a company mitigates material risks and exploits opportunities related to its environmental impact and that of its supply chain.
	Product design/impact	Evaluation of a company's product strategy to capture opportunities and mitigate risks driven by environmental regulation or consumer preferences.
Social	**Culture and human capital management**	Assessment of how the company manages material risks and opportunities in its direct workforce in order to achieve its business goals.
	Supply chain management	Evaluation of how the company identifies, mitigates and monitors material social risks in its supply chain, such as child labour or worker exploitation.
	Customer treatment	Assessment of the company's approach to topics which impact customer trust and satisfaction, and which may also carry regulatory risk. These include product safety, data privacy and marketing practices.
	Product design/impact	Evaluation of the company's product strategy to capture opportunities and mitigate risks as a result of changes in consumer preferences or regulation driven by societal concerns.
Governance	**Board quality**	Examination of the board's structure, composition, diversity and skills to evaluate whether it can provide sufficient oversight and challenge to the management team.
	Remuneration alignment	Analysis of the company's remuneration structures and their alignment with business goals and our interests as long-term shareholders.
	Capital allocation	Assessment of management's track record and skills in capital allocation.
	Company ownership structure, shareholder rights and communication	Analysis of how the company's shareholder base might impact its strategic direction and the treatment of minority shareholders. Evaluation of basic shareholder rights, including transparency and shareholder communication.
	Anti-competitive behaviour risks	Analysis of material legal and social risks related to anti-competitive practices, including collusion or price fixing.
	Bribery and corruption controls	Assessment of risks related to bribery and corruption, including policies, oversight and response to historic incidences.

Appendix 2: Climate framework

Climate change presents both risks and opportunities for the companies in which we invest. Our climate framework provides structure to the incorporation of climate-related risks and opportunities in our research process. This framework also guides our engagement work and voting action on climate-related resolutions. Where we believe a company is not making sufficient efforts to manage its material climate-related risks, we may engage to encourage stronger practices.

We assess companies on the following five criteria:

1. **Governance:** Companies should demonstrate expertise and accountability for climate issues at board and executive team level. Climate issues should be integrated into the company's strategy and organizational structures in an effective manner.

2. **Disclosure**: Companies should disclose material information related to climate change following the recommendations of the Task Force on Climate-related Financial Disclosures. Companies should participate in the Carbon Disclosure Project (CDP) as an effective means to provide this information to the investment community.

3. **Targets**: Companies should set time-bound emissions reduction goals in-line with a 1.5°C warming scenario. The difference between a 1.5°C and 2°C scenario is material. Therefore, companies should be ambitious in their targets to minimize regulatory impact and reputational damage. These goals should cover a short, medium and long-term time frame and encompass at least a meaningful proportion of Scope 3 emissions.

4. **Products and services:** A company's strategy should take into account how climate change might impact its products and services as a result of regulation or a change in consumer behavior.

5. **Physical risk management:** Companies should assess the resilience of their operations and supply chains in the face of physical risks and take effective mitigating action.