MONTANARO

ASSET MANAGEMENT

ESG HANDBOOK

Responsible Investing at Montanaro

Certified B Corporation

Welcome to Montanaro!

This document is designed to tell you everything about our Sustainable Investment approach:
why we think Ethics & ESG are important;
why ESG forms a natural part of "Quality" investing;
how we integrate ESG analysis into our investment process;
our approach to impact investing;
and why being Responsible Investors is integral to our role as long-term shareholders.

Certified B Corporation

This company meets the highest standards of social and environmental impact

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1 - ABOUT MONTANARO

A bit about us:

Montanaro was established in 1991. We have one of the largest and most experienced specialist teams in Europe dedicated exclusively to researching and investing in Global quoted Small & MidCap companies. Our team of 36 is multi-lingual and multi-national (with no less than nine nationalities). This ensures that we have the benefit of local contacts and knowledge that is so essential to detailed, thorough research and due diligence.

As at 31 December 2021, **Montanaro's assets under management were £5 billion (€6 billion)**. Our clients are mainly leading international financial institutions (insurance companies, pension funds, local authorities, endowments, family offices, universities, charities and fund of fund managers). Increasingly our income products in particular have appealed to wealth managers, IFAs and private investors.

Many of these institutions sit at the centre of the sustainability revolution, requiring ESG and impact considerations to be fully imbedded into the investment of their assets. We manage segregated mandates for a number of institutions which have specific sustainability requirements.

We introduced our first **ethical exclusions** in the 1990s, **ESG** was fully integrated into our investment process from 2005 (when we were awarded a mandate by the Church of England) and in 2018 we launched our first **Global Positive Impact Fund**, the Montanaro Better World Fund. In 2019 we won our first Impact mandate from a large **Nordic Public Pension Fund**. This was followed by the launch of a UK onshore version of our Better World Fund in 2020. Today we manage over £1 billion in Global Impact products. **Our ethical framework and ESG analysis are applied to 100% of our assets**.

Our Products:

At December 2021, we manage a total of 6 open-ended Funds, 2 closed-ended, listed Investment Trusts and several segregated mandates. Investors seeking exposure to Global Small & MidCap can choose from Montanaro's wide range of actively managed products:

- **Vehicle:** we manage open-end funds with a variety of share classes (Sterling, Euro, US Dollar, SEK, Accumulation/Distribution, Retail/Institutional shares), closed-end funds and segregated mandates;
- **Geography**: we manage Global, Pan-European, Continental Europe (ex-UK) and UK only products;
- **Strategy:** we offer capital growth, income and global impact strategies.

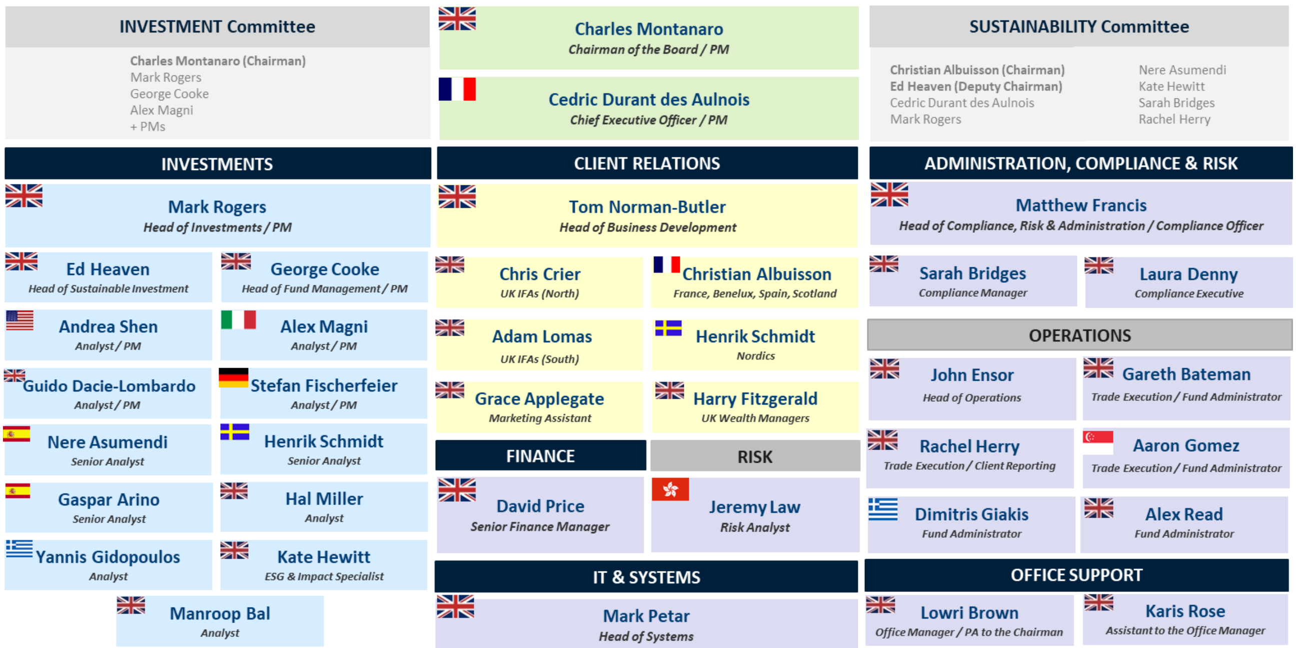
Our Investment Approach:

We are **"Quality Growth"** investors. We take a common sense approach to investing, identifying the highest quality companies with the best management teams that we can hold for the long term.

We believe that you "get what you pay for in life": it is worth paying more for a well-managed, financially sound business that operates in a growth industry and enjoys a sustainable competitive advantage. Businesses with such Quality characteristics are able to "beat the fade" and maintain a high Return on Capital over the long term.

Our Team:

With 36 people - including an investment team of 14 - Montanaro is one of the largest specialist teams in the world dedicated to Global Small & MidCap. We have 8 Fund Managers, 4 of whom have Analyst responsibilities, in addition to 6 dedicated Analysts. This ensures that Research and Fund Management are inextricably linked to achieving attractive returns for our clients.



2 - OUR COMMITMENT TO ESG

Being Responsible Investors

ESG analysis is fully integrated into the investment process for all Montanaro Portfolios. Analysts at Montanaro are responsible for conducting fundamental research alongside ESG analysis. This helps us to build as complete a case as possible for the "Quality" of an investment. To us, being Responsible Investors means considering anything that may influence the long-term financial performance of our investments. Oversight is provided by our Sustainability Committee who formulate our ethical and ESG policies and ensure their consistent implementation across the house. **ESG forms part of Analyst appraisals and is directly tied to remuneration**.

Research (see appendix) supports our view that there is a positive correlation between how well a company manages issues in relation to ESG and what we are ultimately concerned with: the long-term return for our clients. We believe that this approach will help to foster a more sustainable form of capitalism.

We have a long-term investment horizon

We are genuine long-term investors, an increasing rarity these days. We still hold investments made in our first Fund launched in 1993, more than twenty years ago.

We are a truly Sustainable Business

We encourage our colleagues to live sustainably at Montanaro and in the world beyond. In recent years we have launched a number of sustainability initiatives: we have policies to reduce energy use and waste; we offset our carbon footprint; and we are active in the community via charitable work and donations. Our sustainable focus became embedded within the legal framework of our company when we became a certified "B Corporation" in 2019. Montanaro is also a certified UN PRI signatory and has been awarded the "Label ISR" (SRI label) by the French Ministry of Finance. We have been signatories to the UK Stewardship Code since inception and were included in the first approved wave of signatories to the updated 2020 version of the Code.

Sustainability is part of our investment DNA

It forms an integral part of how we think, behave and invest. ESG was first included in our investment process over 15 years ago and today is firmly integrated within our approach. Every Analyst at Montanaro is responsible for conducting ESG and impact analysis on the companies under their coverage. The result is that our investment decision makers "do" sustainability analysis.

We conduct fundamental company analysis

At Montanaro, all research is conducted in-house. This has allowed us to integrate ESG into our investment process. We recognise that this is resource and time consuming, especially in SmallCap where managers cannot rely on external ESG research. It is one reason why we have the largest team of SmallCap Analysts in Europe. It is also why our Analysts are capable of not just assessing a company's finances, but also the more qualitative aspects of a business.

We seek to engage with our investee companies

As fiduciaries of our clients' assets, we take our shareholder responsibilities seriously. Through regular interaction with management teams we seek to promote high standards of ethics, an awareness of environmental and social issues and transparent corporate governance practices. We have an active policy of proxy voting and a track record of seeking to improve companies through engagement rather than exclusion.

We take a stance on ethical issues

There are some companies that we will not consider engaging in. Typically this is where they are involved in operations that we deem ethically detrimental to wider society. Our stance in these areas forms part of our commitment to our fellow stakeholders and helps to foster a longer-term perspective in the asset management industry.

Our Public Commitments:

Certified B Corporation:

- Montanaro became a certified B Corporation in June 2019

The UN Principles for Responsible Investment (PRI): 2009

- An international network of investors working together to put six Principles for Responsible Investment into practice
- Principle 1: *"We will incorporate ESG issues into investment analysis"*

The Stewardship Code: 2020

- *"Investors in the company…play an important role in holding the board to account for the fulfilment of its responsibilities".*

The Carbon Disclosure Project (CDP): 2015

- *"CDP has incentivised…companies…to measure and disclose their environmental information".*

Net Zero Asset Managers Initiative: 2021

Our Funds and Investment Process have been endorsed externally:

Better World Fund Awarded 5 Star Rating by 3D Investing (SquareMile)

- specialist UK ESG Ratings Company: over 200 Funds rated
- only 6 Equity Funds have been awarded a 5 Star Rating

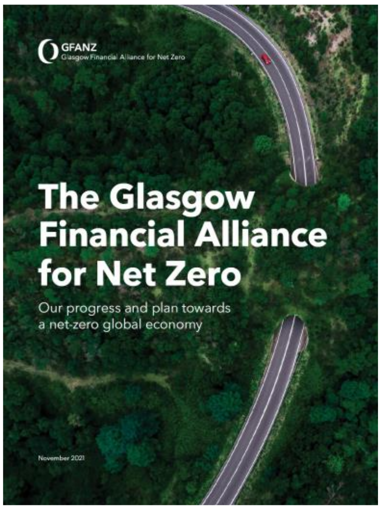
Better World Fund & European Smaller Companies Fund awarded leading SRI label

- awarded by the Finance Ministry after extensive due diligence to recognise "best-in-class" SRI products in Europe

Montanaro are proud to have been recognised for our excellence in the field of ESG:

- 2019: **Winner Best Impact Fund,** Investment Week Sustainable & ESG Investment Awards
- 2019: **Winner Best Impact Report**, Pensions for Purpose
- 2020: **Highly Commended Best Impact Fund,** Investment Week Sustainable & ESG Investment Awards
- 2021: **Winner Best Impact Fund,** Investment Week Sustainable & ESG Investment Awards

Montanaro at COP 26 & Co-Chairing B Corp Finance & Investment Working Group



Montanaro contributed to COP26 both as a member of GFANZ and our chairing of the B Corp Finance & Investment Working Group.

We have been one of the few boutiques to have contributed to the work of the GFANZ taskforce. Specifically, we are part of workstream three, which focuses on *Real Economy Transition Plans*.

This work was included in GFANZ's inaugural Progress Report, published as the group's chair, Mark Carney, spoke at Finance Day at COP26.

This work is hugely relevant to a multi-year engagement deep dive that our investment team is working on: *Project: Net Zero Carbon*, an ambitious project aimed at encouraging our investee companies to achieve net zero as rapidly as possible. Data gaps and a lack of consistency in reporting are problems that every investor confronts. GFANZ is aiming to bring existing frameworks together: Assessing Low-Carbon Transition; SBTi; CDP; Climate Action 100+; TCFD; Transition Pathways Initiative; and suggest how companies can best utilise what already exists in the market. It is not about reinventing the wheel.

We are also art of the B Finance Coalition, which we have co-chaired alongside EQ Investors. This group of 11 finance firms, spanning centuries-old banks to fintech start-ups, made a significant call to action at COP26, asking finance firms to join them and amend their constitutional documents to align with broader stakeholder needs. As B Corporations, we have all done this and believe it leaves our businesses better placed to tackle the climate crisis. Whoever is on our Board will have to ensure that the business is being managed in a way that delivers social and environmental good, now and in the future.

3 - ETHICAL & ESG POLICIES

Companies that we consider for investment must pass the criteria set out in the following policies. Each policy has a corresponding checklist which our Analysts complete during the research process. The Ethics and ESG criteria that we highlight below forms form an intrinsic part of Montanaro's assessment of a company's "Quality".

ETHICAL POLICY – our Ethical Exclusions apply across the house

On ethical grounds, we do not invest in companies that are involved in any of the controversial activities listed below (MAM's "Banned List"). In practical terms, this means that we aim to invest in companies which have nil revenue exposure to these areas.

The Sustainability Committee will also review the eligibility of any company that derives a significant portion (c.10%) of its revenue from activities *related* to the below.

MAM's Banned List:

Fossil Fuels
- Exclusion of companies involved in the exploration and production of coal, oil and gas.
- Ban encompasses both onshore and offshore extraction.
- We also ban investment in fossil fuel refinement companies.

Tobacco
- Exclusion of companies involved in the production and distribution of tobacco products.
- Ban encompasses traditional products (e.g. cigarettes) and vaping and e-cigarette products.

Alcohol
- Exclusion of companies involved in the production and distribution of alcohol products.

Gambling
- Exclusion of companies that own or operate gambling facilities of any kind (e.g. casinos, racetracks, lottery operations, online gambling, spread betting).

Pornography
- Exclusion of companies that produce and distribute pornography.
- Ban encompasses magazines, newspapers, videos, films, websites and related software, as well as companies involved in the staging of live sex shows or the ownership of sex shops.

High Interest Rate Lending
- Exclusion of any business whose activity is the provision of home-collected credit ("doorstep lending"), unsecured short-term loans ("payday loans") or pawnbroker loans, directly or through owned-subsidiaries.
- Common indicators of exploitative lending are close to triple-digit Annual Percentage Rates; short loan term durations (less than 18 months); and no requirement for security.

Weapons

- Controversial/Indiscriminate weapons exclusions: of companies involved in the production or supply of indiscriminate weaponry (defined as nuclear weapons, anti-personnel mines, cluster munitions, chemical weapons or biological weapons), *with no turnover threshold to be applied.*
- Any company involved in the production, processing, supply or storage of weapons-grade nuclear fissile materials, *with no turnover threshold to be applied*.
- Any company involved in the provision of parts or services for anti-personnel mines, cluster munitions, chemical weapons or biological weapons, *with no turnover threshold to be applied.*
- Conventional weapons exclusion: Any company deriving more than 10% of its turnover from strategic military sales including conventional military platforms, whole military systems, weaponry or strategic military parts or services.
- Non-military firearms exclusion: Any company deriving more than 10% of its turnover from the production or sale of non-military firearms or ammunition, excepting companies specialising exclusively in products specifically designed for hunting or sporting purposes.
- *Note: Under this policy Montanaro is permitted to invest in companies whose products are used to ensure the safety of military personnel (e.g. protective equipment such as helmets), although such companies must not have exposure to the areas banned above.*

Animal Testing

- Exclusion of companies that conduct (either themselves or via outsourcing) animal testing for purposes other than for regulated healthcare research.
- Where animal testing is conducted for non-healthcare related purposes, it must be required by regulation and we expect companies to have a clear animal testing policy compliant with "The Three Rs":
    - **Replacement:** methods which avoid or replace the use of animals in research;
    - **Reduction:** use of methods that enable researchers to obtain comparable levels of information from fewer animals, or to obtain more information from the same number of animals;
    - **Refinement:** use of methods that alleviate or minimise potential pain, suffering or distress, and enhance animal welfare for the animals used.

ENVIRONMENTAL POLICY

Our Environmental Policy helps us to identify the highest quality companies by guiding us towards truly sustainable investment opportunities. The areas that we focus on are influenced by and support the UN Global Compact.

Via our Environmental Checklist, we assess the risks and opportunities that our companies face from an environmental perspective. By analysing specific areas of environmental and social concern, our companies are encouraged to foster a long-term focus in their business. Our approach helps to drive more accurate risk analysis, helping us to invest companies well-placed to deliver sustainable returns in a changing world. Our Checklist allow us to score companies on their environmental profile and identify issues on which to engage.

We consider specific areas of environmental exposure in our analysis:

- Environmental intensity: how much carbon, water and waste is produced/consumed by our companies?
- Stranded asset risk: how exposed are our companies to unanticipated or premature write-downs of assets?
- Reporting: which companies are failing to report quality environmental data?
- Climate change: which of our companies have taken steps to materially reduce their carbon footprint?

We use MSCI, Bloomberg and company sourced data to measure the environmental intensity of our companies across carbon, water and waste. Where available, we record the carbon intensity of companies across Scopes 1, 2 and 3 on the basis of tonnes of carbon used per million US Dollars of sales generated. We do the same for water and waste. This allows us to compare the carbon intensity of companies across our Approved List.

We also monitor MSCI's Low Carbon Transition score. This combines Management assessments for the following issues: Carbon Emission for all companies; Product Carbon Footprint; Financing Environmental Impact; Opportunities in Clean Tech; and Opportunities in Renewable Energy where available. A score is given from 0-10. Higher scores indicate greater capacity to manage risk.

In addition to the above, we record MSCI's Low Carbon Transition score. Companies with higher Low Carbon Transition score are more aligned with the Low Carbon Transition compared to the companies with lower scores. A score is given from 0-10.

We also assess environmental management culture (in accordance with UN Global Compact Principles 7-9); supply chain management; and the extent to which a company's products/services are a positive influence on the environment. We also record whether a company's operations are certified by a national or global standard (e.g. ISO 14001).

Finally, we consider the quality of a company's environmental reporting and if they have a Net Zero Carbon target or other environmental targets in place. Companies are scored out of 10 for their environmental profile on our Environmental Checklist.

Climate Change: Our views on the "Energy Transition"

Climate change is possibly the greatest challenge facing humanity. To ensure that climate change is kept within a manageable range, a shift in how we produce and consume energy is required. Different views exist on how this can be achieved and the role that investors can play.

There are those who believe that investors should divest from fossil fuel industries. The divest movement – which has been seen before in relation to sectors including tobacco and political movements such as apartheid South Africa – seeks to remove investor support for companies involved in the production and supply of fossil fuels. The aim of this is to drastically reduce, or halt, the amount of fossil fuels extracted from the earth. The scientific argument in favour of this is that between two-thirds and four-fifths of fossil fuel reserves need to remain in the ground in order to limit global warming to a rise of 2°C compared to pre-industrial temperatures (these reserves are often referred to as being "stranded"). There is far more carbon lurking within existing fossil fuel reserves than can be safely burnt.

At the other end of the spectrum are those who believe that investors should continue to invest in fossil fuel related companies. The benefits fossil fuel production have brought to the world are often cited in support of this view: cheaper and more available energy has helped lift millions of people out of poverty, supporting globalisation and the raising of living standards. Turning off capital flows to fossil fuel industries could place this at risk given the Replacement Energy System – e.g. renewables – remains in its infancy. According to research by the energy consultant Lambert Energy Advisory, *"out of the 280 million barrels of oil equivalent energy (BOE) produced to keep…6 billion customers happy, only 7 million BOE will be 'new renewables'."*[1]

Investors stepping into this debate must tread with care. Our aim is to support the shift to a cleaner energy mix as quickly as possible.

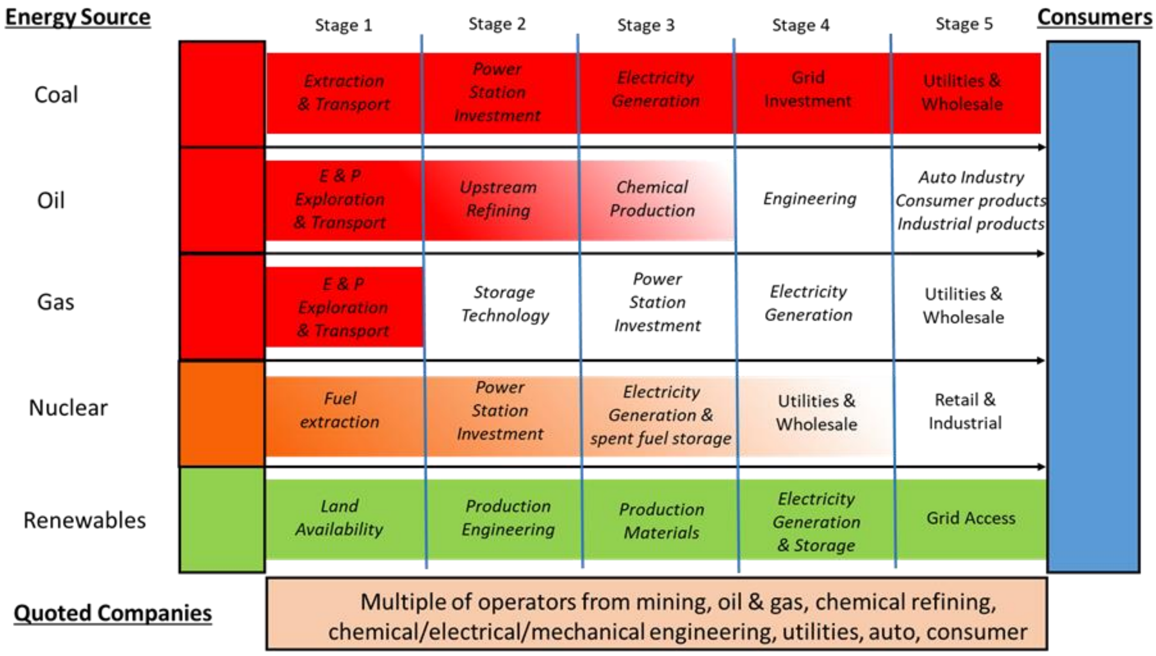
With this is mind, our stance can be summarised as follows:

1. We ban investments in oil, coal, and gas exploration & production companies;
2. To halt and mitigate the effects of climate change, fossil fuels must be kept in the ground;
3. Despite the development of new technologies, the transition to a cleaner energy mix will take time;
4. For now, investing further down the energy value chain is permissible given fossil fuels are likely to be a feature of our world for many years to come;
5. Investment is needed in carbon capture and more efficient storage technologies;
6. All companies have a role to play in the energy transition: we support companies who take steps to reduce their own energy consumption and apply 100% renewable or Net Zero Energy targets, or Science Based Targeting.
7. The Montanaro Better World Fund has set a target that by 2025, at least 20% of companies within Fund by value will have achieved "Net Zero Carbon".

[1] From speech by Philip Lambert, CEO, Lambert Energy Advisory - *FT Energy Transition Strategies Summit, London, 14th June, 2018*

We have developed an Energy Transition Table (below) to illustrate how we view different areas of energy production. This enables us assess where an energy company sits within the energy matrix.

Energy Transition Table



As well as our exclusions of Exploration and production fossil fuels we also consider:

Nuclear:

High profile incidents such as Chernobyl and Fukushima have negatively impacted the public perception of nuclear power. Some countries, such as Germany, have stepped away from nuclear power altogether. While renewable energy has increased as part of Germany's energy mix, 40% of the country's electricity is generated from hard coal and lignite. The nuclear debate is one that we will continue to monitor. The energy produced is cleaner than fossil fuel energy, but clearly there are other challenges: if something goes wrong the consequences are potentially catastrophic, while the issue of radioactive waste disposal is yet to be settled. Another point to consider, particularly from an investment perspective, is the high cost of nuclear power plants, which makes a decent return on invested capital challenging[2].

Renewables:

The World Energy Council notes that *"the rate of improvements towards cleaner energy is far slower than required to meet emissions targets".* Solar and Wind currently account for just 8% of energy produced. Clearly renewable energy must take up a greater share of the global energy mix if climate change is to be stopped, or reversed. A steady transition is needed, however, so that the most sustainable and efficient technologies emerge. These must not rely on unsustainable subsidies and investors should carefully consider the investment risks of "concept" ideas that have yet to deliver

[2] https://www.ucsusa.org/nuclear-power/cost-nuclear-power#.W2K2YLgna71

a financial return. New technologies must be cleaner than fossil based alternatives across their value chain, not just when they reach the consumer.

In addition to the above, we wish to encourage all of our investee companies to consider their energy consumption and what they can do to reduce their own carbon footprint. Companies that have a publicly stated "Net Zero Energy" goal should be applauded. Such targets can help the energy transition, allowing the "Carbon Budget" (the estimated amount of carbon we can use without breaching the 2°C limit) to be used by areas of the economy where it is most essential. With the carbon budget in mind, we encourage companies to sign up implement Science Based Targets. These can help investors to best contextualise a company's energy usage.

We also engage with companies to better understand and influence the steps they take in relation to their carbon emissions. We want to encourage our companies to aid the transition to a lower-carbon economy, hence in 2015, we became signatories of the Carbon Disclosure Project. We also encourage our companies to consider joining the RE100 club, a network of companies committed to 100% renewable power.

The focus on a business's environmental impact is only likely to increase over time: three of the ten UN Global Compact Principles are dedicated to the environment. These state that companies should *"support a precautionary approach to environmental challenges…promote greater environmental responsibility…and encourage the development…of environmentally friendly technology[3]".* We encourage companies to continue improving their levels of environmental reporting.

SOCIAL POLICY

Our Social Policy allows us to analyse specific social factors, leading to more accurate risk analysis of investment opportunities. The areas that we focus on are influenced by and support the UN Global Compact.
We engage with companies on social issues – by doing so, we believe that we can help to encourage management teams to contribute to a more sustainable world, which will ultimately lead to better investment returns.

We use MSCI, Bloomberg and company sourced data to measure and record the following:

- % Employee Turnover;
- % Women in Workforce;
- % Women in Management;
- Gender Pay Gap Breakout;
- Company 5-year tax rate;
- Underlying tax rate;
- Estimated Tax Gap;
- Social tax rating.

[3] https://www.unglobalcompact.org/issues/environment/

Additional areas that we focus on include: Human rights; Bribery & Corruption; Equal Opportunities; Labour Practices; Human Resources & Training; Supply chain management.

Companies are scored out of 10 for their social profile on our Social Checklist.

CORPORATE GOVERNANCE POLICY

We wish to align the interests of company management teams with the interests of long-term shareholders. Ensuring high standards of corporate governance forms an important part of this. Our logic here is simple: good corporate governance increases the quality of a business; the higher the quality of a business, the greater the sustainability of returns.

Our Checklist considers:

- Remuneration of the Executive Board;
- Capital Allocation Record;
- Board Independence;
- Board Ownership;
- Board Diversity.

Remuneration:

We consider the level of executive compensation, including base salary, bonuses and long-term incentives. In particular, we are interested in the structure of remuneration packages and the role of the Remuneration Committee. The right kinds of incentives can ensure that management are focused on what matters most for shareholders: creating sustainable shareholder value. As long-term investors, we want the interests of management to be aligned with ours. We expect management teams to behave ethically and responsibly in relation to pay, taking into account the impact excessive executive pay can have on other stakeholders.

Capital Allocation Record:

When we model a company's financials, we also analyse the capital allocation record of the management team. This tells us whether management have been deploying capital efficiently and effectively, thereby enhancing the long-term value of the business. To ascertain this, we analyse Return on Capital Employed (ROCE) relative to the cost of capital. Shareholder value is created when economic ROCE is sustained at a level above the cost of capital. We are specifically interested in what management are directing their capital towards. We consider the level of reinvestment in the business; the acquisition track record; the dividend policy; share buyback programs and the level of cash relative to debt.

Board Independence, Ownership & Diversity:

Companies should aim to have the right governance structure in place. In general, we look for Boards to have a majority of Non-Executive, fully independent Directors. We recognise, however, that this may not always be possible or warranted in the case of small companies. An executive founder, or a family, may retain a material interest in the business and a significant presence on the Board. Therefore, we consider the suitability of Boards on a case-by-case basis, taking into account Director tenure, skills and reputation. We expect companies to disclose sufficient biographical information about Directors to enable investors to make a reasonable assessment of the value they add to the company. We want to see our investee companies achieve Board independence over time.

Voting:

Voting is a vital part of our engagement with companies which is why we vote at all AGMs. We receive independent third party corporate governance reports and voting recommendations from Institutional Investor Services (ISS) ahead of meetings. These are used for advice only. Our Analysts systematically review all resolutions ahead of shareholder meetings and we voice our concerns where required. We aim to discuss any issues with management prior to voting against or abstaining. As such, we consider ourselves as “active” shareholders rather than “activists”.

4 - Sustainability COMMITTEE

Our Sustainability Committee is made up of experienced members from across our business. Its primary responsibility is to ensure that Montanaro's ESG efforts remain coordinated across the house. The Sustainability Committee meets officially on a quarterly basis. Meetings have a set agenda:

1. Review of previous minutes and action points
2. Review of engagement activity
3. ESG engagement with clients
4. Client reporting (ensuring that institutional client demands are managed appropriately)
5. Review of ESG within the Investment Process
6. ESG seminars / events attended / training required
7. Latest developments of ESG standards & guidelines and their implications
8. Long-term ESG objectives for Montanaro

In addition, members of the Sustainability Committee assess and vote on the impact credentials of potential investments for the Montanaro Better World Fund ("BWF"). A company cannot be invested in BWF unless the Committee has approved it for impact.

Our Sustainability Committee:

Christian Albuisson
CHAIRMAN

Ed Heaven
HEAD OF SUSTAINABLE INVESTMENT

Cedric Durant des Aulnois
CEO

Mark Rogers
HEAD OF INVESTMENTS

Nere Asumendi
SENIOR ANALYST

Sarah Bridges
COMPLIANCE ANALYST

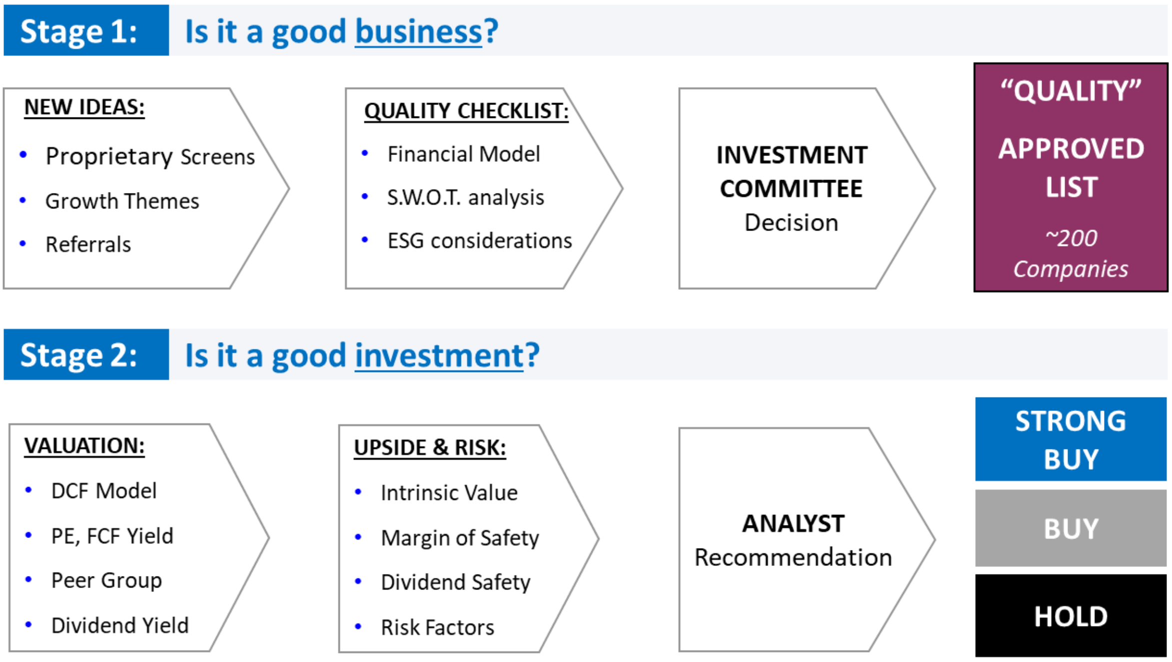
The Sustainability Committee:

- reviews, challenges and debates every impact report submitted by our Analysts;
- has rejected c.20% of companies on impact grounds.

We do not invest in companies that fail on impact

5 – ESG IN THE INVESTMENT PROCESS

The following investment process is applicable to all Montanaro Funds, although BWF has an additional “impact” stage which is explained in the Impact section of this handbook.



Our investment process has two distinct stages:

The **first stage** focuses on identifying High Quality companies. In essence, we aim to answer the question: "**Is it a good business?**". If the answer is “No” then we stop there.

Idea generation is the first stage of the process which is done internally. We have built a proprietary screen that ranks the Global SmallCap universe (12,000 companies) by Quality (we blend 14 metrics covering Profitability, Growth, Leverage, Cash and Volatility). We also use MSCI’s ESG scores to help us search for new ideas and filter out those companies that are unlikely to meet our Quality criteria.

We further generate ideas by speaking to our investee companies (“who are your best competitors?”, “your best suppliers / customers?”) as well as to our clients across the world. Importantly, our ideas do not come from brokers.

Once an idea has been identified, the Analyst will spend several days analysing the business, its industry and articulating the investment case. The Analyst will complete Quality and ESG Checklists as well as a Financial Model. If the Analyst is confident that this is a good business that we should own for the next 10 plus years, they will present it to the six person Investment Committee which decides whether it should be added to our "Approved List". Only companies that have been formally approved (there are c.200 currently) are available for investment.

The **second stage** of the process focuses on answering the question: "**Is it a good investment?**".

Having established that a company meets Montanaro’s “Quality” criteria, the Analyst then conducts valuation work using a proprietary DCF model to work out the intrinsic value of the business.

Once this is completed, the Analyst will produce a Target Price for the share of equity. Alongside this, an official recommendation (STRONG BUY / BUY / HOLD) is placed on the stock, reflecting Analyst conviction. These are subject to change, based on company performance and market conditions.

Finally, we meet management typically twice a year and always visit the operations of our companies, wherever they are located in the world. These site visits helps us to "kick the tyres" by seeing the operations of the company with our own eyes and meeting other members of staff. Analysts prepare detailed questions in advance of meetings and site visits, which enables us to set the agenda and get the most out of our time with the company. Site visits are labour intensive but add considerable value. These face-to-face meetings are excellent opportunities to raise any concerns we may have about ESG.

Our bespoke ESG Checklists:

Scores for each ESG area weighted and then aggregated to produce a final ESG score out of 10. We weight the Corporate Governance section of our checklist higher than Environmental and Social as we believe management are ultimately responsible for a company's approach to ESG. An example summary section of an ESG Checklist is shown below:

MONTANARO ETHICS & ESG CHECKLISTS

SUMMARY

	Score	% Weight	General Comment / Key Issues
ETHICS	Pass	/	The company has a very poor score on its Environmental Checklist. The company publishes very little data on its environmental footprint and does not publicly disclose its approach to environmental matters. We need to arrange an engagement with management to understand why disclosure in this area is so poor.
ENVIRONMENTAL (1 to 10)	2.0	30%	
SOCIAL (1 to 10)	6.0	30%	
CORPORATE GOVERNANCE (1 to 10)	6.0	40%	
ESG Score (1 to 10)	**4.8**	**100%**	
ESG Rating	**REVIEW**		
Engagement Required?	**YES**		

Conclusions from our ESG analysis are presented to the Investment Committee when a stock is first considered for Montanaro's Approved List. The Committee will decide to continue with, or discard, a new idea based on the Analyst's findings. Companies with a total ESG score of below 5 are flagged on the checklist under "Review" (as shown above) meaning that engagement is required if we wish to invest in the company.

Analysts continue to update ESG Checklists throughout the holding period as new information comes to light, for example after a set of results, the AGM, or an engagement. The Sustainability Committee monitors the ESG scores of companies on our Approved List at quarterly meetings to understand how Analysts are scoring companies. Scores for every company on the Approved List are formally reviewed by Analysts, with support from MAM's ESG & Impact Specialist, and discussed with the Sustainability Committee on at least an annual basis.

Our clients have long-term time horizons (five years plus) and our approach to ESG reflects this long-term commitment. As a result, we are happy to invest in a company with a weakness in its ESG profile so long as management express a willingness to engage with us and a desire to improve areas of weakness. These checklists have led to engagements that have resulted in better conviction in the investment case and also decisions to sell stocks, for example:

- **Increased conviction:** The Environmental reporting of a Swedish company we invested in was notably poor, with little detail given on Scope 1, 2 or 3 emissions. After engaging with the CEO of the company, we encouraged them to sign up to sign up to the Science Based Targets Initiative in support of the CDP Science Based Targets Campaign. The company has done this and delivered an improved Sustainability Report with a greater level of reported environmental data. This allowed our Analyst to increase the Environmental Checklist score and increased our confidence in the investment case.

- **Reduced conviction:** We spoke to a company listed in Hong Kong about their plans to transition to a less carbon intensive business model following the completion of the company's ESG Checklist. Management informed us that they are unlikely to set any environmentally linked targets for their business as there is little incentive from the Chinese government for them to do this. Coupled with some concerns about the ownership structure that were flagged by the Analyst in the Corporate Governance Checklist, we decided to sell our holding.

Our ESG Checklists also help us to set ESG priorities. In particular, they allow us to identify risks common to many of our companies. When we identify such risks, our Head of Investments and Head of Sustainable Investment works with the team to explore the issue in greater detail via an engagement "Deep Dive". The purpose of these Deep Dives is to engage with companies from across our Approved List and improve our understanding of a particular risk and the quality of our analysis. In recent years we have conducted engagement Deep Dives on:

- **Nutrition**: our consumer Analysts wanted to better understand how food companies were responding to healthy eating trends and government regulation on unhealthy foods;
- **Supply Chain Management**: we noticed that the management of supply chains was frequently a low scoring area on our ESG Checklists. Analysts indicated that low supply chain visibility was one reason scores in this area were low. We engaged with a number of companies in order to better understand how companies were approaching supply chain management. This improved our analysis of this area, allowing us to identify best and worst supply chain management practice.

Our Deep Dive reports are available on Montanaro's website. A detailed explanation of our ESG Policies and Checklists is contained within our ESG Handbook, which is also available on our website.

A full example of our ESG Checklist is shown below:

MONTANARO ETHICS & ESG CHECKLISTS

SUMMARY

	Score	% Weight	General Comment / Key Issues
ETHICS	Pass	/	Chr Hansen seems committed to responsible business practices as reflected by their comprehensive number of policies ranging from quality and product safety to people, knowledge and sourcing. However, despite awards and good initiatives for labour practices, disclosure could still be improved. Looking into integrating TCFD targets from next fiscal year, as they already report with another methodology.
ENVIRONMENTAL (1 to 10)	8.5	30%	
SOCIAL (1 to 10)	7.6	30%	
CORPORATE GOVERNANCE (1 to 10)	5.5	40%	
ESG Score (1 to 10)	**7.0**	**100%**	
ESG Rating	**PASS**		
Engagement Required?	**NO**		

ETHICS CHECKLIST

Does the Co. meet MAM's minimum standards? Pass

Business Exposure	Pass / Fail (fail any company with >10% of revenue exposed to restricted areas)	
Exploration & production fossil fuels	Pass	No major problems identified. Chr Hansen products are all natural: Cultures & Enzymes (improve taste, preservation, nutritional value..), Health & Nutrition (probiotics -documented, infant formula). Chr Hansen is committed to reducing annual global yogurt food waste by 2% by 2020 through bioprotection. Products also reduce salt from cheese (Saltlite up to 50%), sugar from yogurts, and replace antibiotics with probiotics. Ranked #1 most sustainable company in the world by Corporate Knights (last year #66). The one slight criticism received during an ESG committee is that a significant portion of products are used by the dairy industry (exposure to cows, which contribute to methane emissions).
Tobacco producers & distributors	Pass	
Alcohol producers & distributors	Pass	
Controversial weapons	Pass	
Gambling	Pass	
Pornography	Pass	
High Interest rate lending	Pass	
Animal testing (ex-healthcare related)	Pass	
Other areas of concern	No	

Environmental Checklist

Score: 8.5

6.80

Environmental Data	(Data from column AD)	
Carbon Intensity Scope 1 (tonnes/USD million sales)	20.2	ISS rates it as a medium performer in terms of carbon risk rating. It rates above peers (14.8t) 2x in terms of scope 1 and 2.
Carbon Intensity Scope 2 (tonnes/USD million sales)	18.4	
Carbon Intensity Scope 3 (tonnes/USD million sales)	70.6	
Carbon Intensity Scope 1+2+3 (tonnes/USD million sales)	109.2	
Water Intensity (vs. sales) (m3 water/million sales)		
Waste Intensity (tonnes/USD million sales)	3.0	
Low Carbon Transition Management (1 to 10)	5.3	
Low Carbon Transition Score (1 to 10)	6.3	

Environmental Assessment	Yes/No	Level	
Environmental management	Average	3	They supply biological residues as natural fertilisers for farmers, and now it is also used for biogas production. Danish sites run on 100% renewable energy. Part of 'Business Ambition for 1.5°C' (Paris agreement). Looking into adding TCFD targets next year.
Climate change target	Good	4	
Supply Chain Management	Average	3	
Environmt. value add of product /service	Good	4	
Quality of reporting	Good	4	

Key Environmental Issue	
Climate targets	We engaged with Chr Hansen regarding TCFD targets as they are currently reporting according to the COP Report on Progress principle (quite different from TCFD). Response: "We are actively working on a range of other topics related to sustainability – Science Based Targets, fully integrated and audited non-financial reporting, and studying the impacts of the EU Taxonomy, to name a few, and we are indeed also looking at implementing TCFD reporting. What we don't like about proposal 9a is that is forces us to commit to TCFD reporting for this current year that we're 2½ months into, and we are not certain we will have systems and ressources in place to be able to do this."

Social Checklist — Score: 7.6

Social Data		(Data from column AD)
% Employee Turnover		10%
% Women in Workforce		43%
% Women in Management		
Gender Pay Gap Breakout		No
Human Rights Policy		Yes
Anti-Bribery Ethics Policy		Yes
Equal Opportunity Policy		Yes
Company 5-year tax rate [see model]		22.7%
Underlying tax rate [see model]		22.7%
Estimated Tax Gap		0.0%
Social tax rating	Average	3

In Chr Hansen's website, under the responsibility section, there are environmental sustainability, workplace responsibility and business integrity including a whistle-blower hotline and their position on corruption. The diacetyl lawsuits are ongoing but relate to the flavours division that was sold in 2012.
Tax is in line with Danish tax rate of 22%.

Social Assessment	Yes/No	Level
Labour Practices	Good	4
HR Management / Training	Average	3
Health & Safety (Accidents)	Good	4
Supply Chain Management	Average	3
Social value add of product / service	Very good	5
Other (Modern Slavery, stakeholders...)	Very good	5
Anti-bribery controls	Good	4
Quality of reporting	Average	3

Moved from a biannual to an annual employee engagement survey. Green pension solutions available in Denmark (half of workforce).
In 2019/20 Chr. Hansen received the Transformation Award Winner in the British Safety Council 2020 International Safety Award.

Key Social Issue

Diacetyl lawsuit

Chr Hansen is a defendant in several diacetyl related lawsuits relating to the period when products containing diacetyl were produced (flavours division that was sold) that allegedly caused personal injuries resulting from the exposure to diacetyl vapours. The company has insurance cover for losses from those claims. This will disappear following the sale of Natural Colors division.

Corporate Governance Checklist — Score: 5.5

8.2

Remuneration of Executive Board — Average — 3

Measurement metric	Base Salary	Annual Bonus	LTIP
Strategic KPIs		Yes	Yes
Profit Share			
EVA/ROCE			
Relative TSR			Yes
EPS/Net Profit Growth		Yes	Yes
ESG			

According to ISS "The structure of the company's compensation framework does not raise any material concerns, as it generally appears to be designed to promote alignment between pay and performance. Although ex-post disclosure on performance targets is generally preferred, it is noted that the variable pay plans appear to be aligned with the company's strategy and guidance".
Short term Targets: FCF, EBIT before special items, organic growth and individual non financial targets. LTIP: EBIT before special items, organic growth, retention, relative TSR.

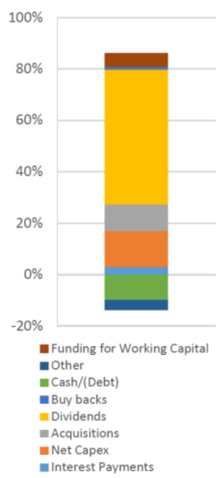
Overall level of pay: High

ISS: remuneration falls within one sample standard deviation of the ave

Capital Allocation Record — Very good — 5

Metric	Year T-4	Year T-3	Year T-2	Year T-1	Year T	AVERAGE
ROACE	40%	41%	40%	37%	34%	**39%**
ROIC	15%	17%	17%	17%	17%	**16%**
Invested Capital growth	2%	18%	9%	3%	11%	**9%**
	T - 5 to T	T - 4 to T	T - 3 to T	T - 2 to T	T - 1 to T	
Return on Incremental Capital	25%	21%	23%	17%	14%	**20%**

Metric	Year T-4	Year T-3	Year T-2	Year T-1	Year T	Total
Cash Flow	192,000	215,800	266,800	285,700	277,700	**1,238,000**
% Allocated to:						
Interest Payments	6%	5%	4%	4%	4%	**4%**
Funding for Working Capital	4%	3%	9%	10%	9%	**7%**
Net Capex	13%	14%	20%	18%	30%	**19%**
Acquisitions	0%	78%	27%	0%	(24%)	**14%**
Dividends	96%	38%	72%	76%	81%	**73%**
Buy backs	16%	(8%)	(2%)	1%	2%	**1%**
Cash/(Debt)	(34%)	(30%)	(3%)	(9%)	(1%)	**-13%**
Other	0%	0%	(27%)	0%	(0%)	**-6%**

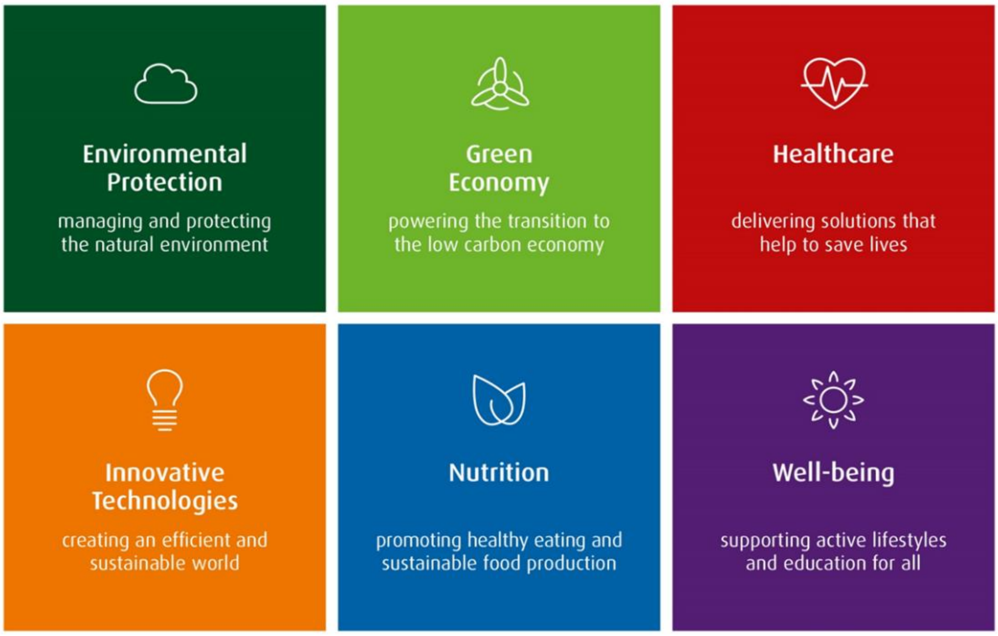


Board Independence & Ownership			Score: 8.5
(Data from column AD)			
Chairman	Dominique Reiniche		ISS: There are 2 boards: execs and non-exec. Here is the board of directors (12 non-execs), which has 4 employee and 1 shareholder representatives (Novo Nordisk hold 21.98% of capital). The BoD is 58% independent.
CEO	Mauricio Graber		
ESG Culture	Very good	5	
CEO Duality		No	
Board Size		11	
% Non-Exec. Director on Board		100%	
% Independ. Directors		64%	
% Women on Board		36%	
% Female Executives		22%	
% Independ. Director in Compen. Com.		100%	
Board Independence rating	Average	3	
Board Diversity rating	Very good	5	
Quality of reporting	Good	4	

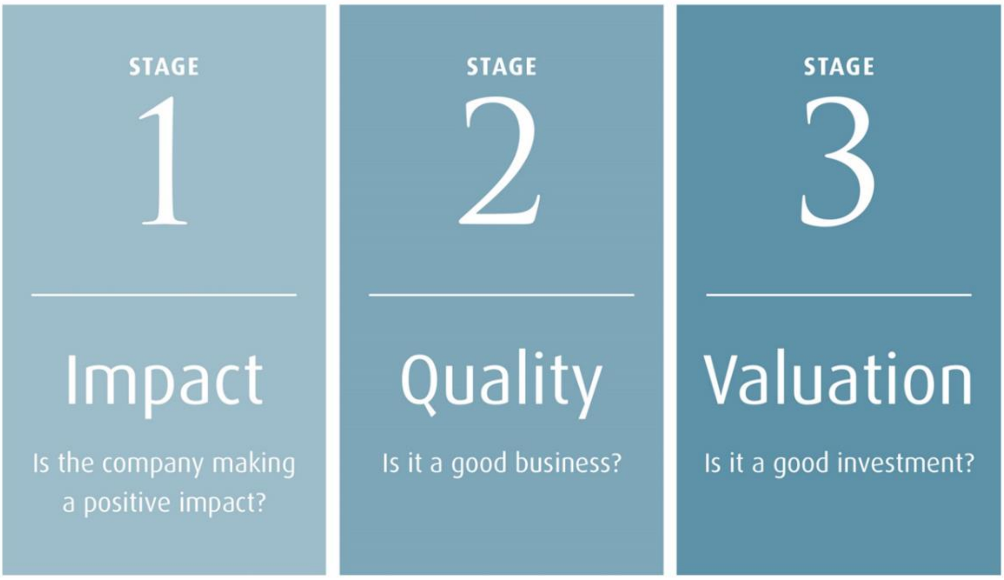
6 – IMPACT INVESTING

In April 2018, we launched the Montanaro Better World Fund (“BWF”).

BWF invests globally in Small & MidCap companies whose products or services make a positive impact by helping to solve some of the world’s greatest challenges in support of the UN Sustainable Development Goals. Companies within the Fund are aligned to six themes:



Assessing impact:
The investment process for BWF is largely the same as for our other Funds. We are interested in assessing the Quality of a company (Stage 2) and the valuation of the investment (Stage 3). However, “Stage 1” is unique to BWF and considers impact:



Stage 1:

Analysts complete an Impact Profile for every company that we consider for investment in BWF. These reports analyse the strengths and weaknesses of a company's impact case and alignment with the Fund's six impact themes. This analysis is presented to members of the Sustainability Committee who vote to pass or fail the stock for impact. Voting is coordinated by the Head of Sustainable Investment and recorded in the Impact Voting Log.

An example of a company Impact Profile is shown below. The template used is the same for every company that we consider for BWF:

IMPACT PROFILE: ALFEN BEHEER

Company Profile: Alfen operates at the heart of the energy transition providing smart energy solutions to enable the electricity grid of the future: reliable, sustainable and innovative. They have a unique combination of activities as they design, engineer, develop, produce and service smart grids, energy storage systems, and electric vehicle charging equipment. They combine their activities in integrated solutions to address the electricity challenges of their clients.

They are headquartered in Almere, the Netherlands, in three buildings with associated production facilities. In addition they are present in Belgium, Finland, France, Germany, Norway, Sweden, and the United Kingdom and serve the rest of Europe through our partners and resellers.

KEY SUSTAINABILITY CRITERIA		Yes / No
Key sustainability challenge addressed?	Yes	*Must be a "yes"*
>50% revenue thematically aligned?	Yes	*Must be a "yes"*
Support UN SDG Goal?	Yes	*Must be a "yes"*
Clear intentionality of management?	Yes	*Must be a "yes"*
Additional product / service?	Yes	*Must be a "yes"*
Affordable product / service?	Yes	*Must be a "yes"*
Support UN SDG Target?	Yes	
Support UN SDG Indicator?	Yes	
Measurable "outputs" to products / services?	Yes	
Reported data sufficient to measure impact?	Yes	
Customer base includes "underserved" groups?	Yes	

IMPACT MANAGEMENT PROJECT CLASSIFICATION	
Highlight one of the below:	
A	Act to avoid harm: *mitigates or reduces negative outcomes for people, the planet and the economy*
B	Benefit stakeholders: *generates positive outcomes for people, the planet or the economy*
C	Contribute to solutions: *generates positive change for groups that would otherwise experience outcomes below the nationally or locally acceptable level*

What problem(s) are the company's products or services helping to solve?

Alfen is helping facilitate the transition to the Green Economy. Their products are helping to deliver renewable power across energy networks; helping to provide the infrastructure needed to support the growth of EVs; and help improve storage options for energy produced from intermittent renewable sources, such as solar and wind.

Core Better World Theme (please select from drop-down list)

Green Economy

UN Sustainable Development Goals - Alignment	
UN SDG:	**Goal 7. Ensure access to affordable, reliable, sustainable and modern energy for all**
TARGET:	*7.1 By 2030, ensure universal access to affordable, reliable and modern energy services*
INDICATOR	*7.1.2 Proportion of population with primary reliance on clean fuels and technology*
TARGET:	*7.2 By 2030, increase substantially the share of renewable energy in the global energy mix*
INDICATOR	*7.2.1 Renewable energy share in the total final energy consumption*

ESG Information (from ESG Checklist)			
1	Does company pass Quality Checklist?	Yes	*(A company cannot make a positive impact if it is not sustainable)*
2	Meets Ethical Exclusion Criteria?	Yes	*(Certain areas of the economy do not support our vision of "positive impact")*
3	Minimum ESG Score of 6?	Yes	*{(A company may make a positive impact but behave in an irresponsible way)*
4	Minimum E, S & G Scores of 5.5?	Yes	
5	Company responsive to Engagement?	Yes	*(Active engagement can help to foster positive impact behaviour)*
6	Any other issues precluding inclusion in BWF?	No	

Key Performance Indicator(s)

Number of units sold (e.g EV charging station). 1.4 million tonnes of CO2e emissions avoided. 142,000 households supplied with renewable energy.

Products & Services

Three product categories:
Smart grid solutions (65% of revenue)
Alfen offers an in-house developed, produced and assembled range of secondary transformer substations. In addition, they have in-house developed and produced devices for grid automation and a proprietary back-end system for remote management and control of electricity grids. They also supply microgrids, grid connections and supplementary offerings for e.g. the greenhouse horticulture sector, EV fast-charging hubs and solar PV farms.

EV charging equipment (25%)
Since 2008, Alfen has been developing and producing electric vehicle charging stations for all types of electric vehicles. Alfen offers an in-house developed and produced range of smart and connected electric vehicle (EV) chargers for use at home, office and public locations. They have a proprietary online management platform for their charging infrastructure and offer standardised solutions for smart charging, load balancing and charging hubs.

Energy storage systems (10%)
Alfen offers an in-house developed and produced range of modular energy storage systems for applications such as load balancing, peak shaving, grid frequency control, e-trading, microgrids and mobile power supply. They offer both stationary and mobile battery energy storage solutions. Their proprietary developed embedded software and back-office enables remote control and supports all major storage applications.

What is attractive from an impact perspective is that the above product lines ccan be used to form ''building blocks'' and used in complex integrated systems and solutions that overlap across its three business lines.

In their 2018 IPO prospectus (although note that Alfen has operated for over 80 years), Alfen highlight the following key competitive advatages which I list here as I think they are relevant to the impact case:
• well positioned to benefit from current trends in relation to the energy transition;
• technologically advanced supplier with open architecture approach and an asset-light business model;
• integrated offering and end-to-end solutions for Smart Grids, EV Charging and Energy Storage; and
• market leading positions in its home market and ''first mover'' in other Western European countries.

There is clear alignment to the UN SDGs are highlighted above. Pleasingly, Alfen also reports in detail against four of the SDGs (Goals, 7, 8, 9 and 12). I view Goals 7 and 9 as particularly relevant to the products and services of the business (Goals 8 and 12 and more focused on labour practices and company operations):
- **Goal 7:** The renewable energy share of total energy production is increasing year on year driven by the ambition to meet climate goals. Alfen is making a positive contribution through its offering of smart energy solutions to accelerate the transition to a sustainable energy system. This will ultimately enable Alfen's customers to unlock an energy system with affordable and clean energy. The journey towards a sustainable energy system also brings challenges as more and more decentralised and intermittent renewables have to be connected to the grid and as the electricity consumption in the energy mix is rising strongly. To efficiently accommodate this, increasingly complex and smart energy solutions are required. Alfen believes it is unique in offering and seamlessly combining its Smart grids, EV charging and Energy storage solutions to address the electricity challenges of its customers.
- **Goal 9: SDG 9:** The energy transition requires a complete overhaul of the current energy system, making it smarter and adding grid capacity. Investment in research & development is key to deliver the required smart energy solutions of the future as continuous innovation is needed to grid-connect renewable energy as effectively as possible, to smartly and reliably charge electric vehicles while safeguarding the grid, and to offset imbalances between supply and demand by embedding energy storage infrastructure. Alfen is committed to keep investing in research & development for new, sustainable solutions through enhanced product design, increasingly smart products, and improvements in material efficiency and manufacturing processes. As such, Alfen employed 57 R&D FTEs (11% of the total workforce) at 31 December 2019 and continues to invest in the R&D department going forward.

Helpful measurement performance indicators are also identified by Alfen:
For SDG7 – Affordable and Clean Energy: potentially avoided CO2 emissions by the use of Alfen's EV charging equipment, as well as the potential number of households powered by solar PV parks where Alfen provided its microgrid solution;
For SDG8 - Decent Work and Economic Growth: safe working environment performance captured by the Lost Time Injury Frequency Rate, as well as the sickness absence rate;
For SDG9 - Industry, Innovation and Infrastructure: provide insight through sharing Alfen's investments in R&D together with impactful innovation examples;
For SDG12 - Responsible Consumption and Production: results of Alfen's Operational Excellence program

Areas of concern / Room for improvement / Engagement

No area of concern that I identified, but I did not notice any reference to Net Zero Carbon or the Science Based Target Initiative in the annual report of latest presentation. This is something we can ask the company about.

Need for further Engagement with the Company? YES

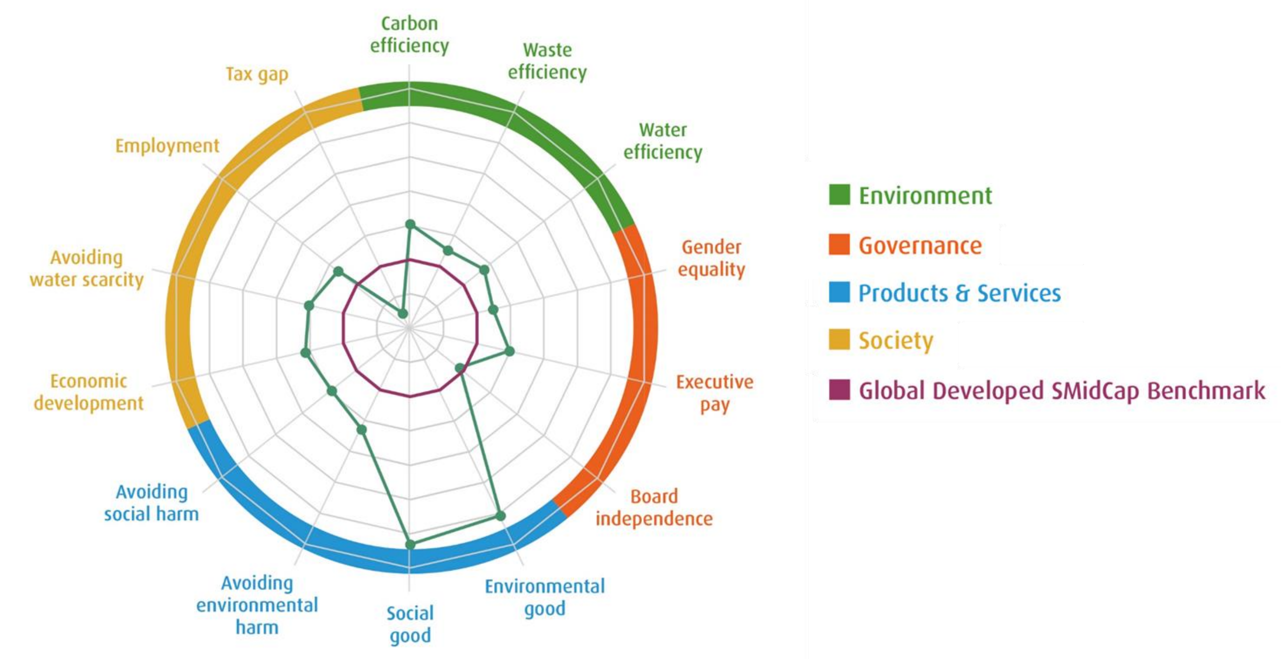
Include in Net Zero Carbon Project

	More than 50% revenue alignment to Funds Six Core Themes?	% of sales
1	**Environmental Protection:**	**0%**
	Pollution control	0%
	Water treatment	0%
	Waste recycling & management	0%
	Testing, inspection & certification	0%
2	**Green Economy:**	**100%**
	Renewable energy	0%
	Smart infrastructure	100%
	Energy transition	0%
	Efficient transportation	0%
3	**Healthcare:**	**0%**
	Treatment of illnesses & disease	0%
	Medical innovation	0%
	Affordable healthcare	0%
	Prevention	0%
4	**Innovative Technologies:**	**0%**
	Manufacturing efficiencies	0%
	Smart robots & artificial intelligence	0%
	Connected world	0%
	Cybersecurity	0%
5	**Nutrition:**	**0%**
	Efficient food production	0%
	Sustainable distribution	0%
	Healthy eating	0%
	Food security	0%
6	**Well-being:**	**0%**
	Changing demographics	0%
	Active lifestyle	0%
	Education	0%
	Safety	0%
TOTAL		100%

Annual Impact Report:

We publish an award-winning annual **Impact Report** detailing the progress of BWF from both an investment return and impact perspective. This is available on our website: https://montanaro.co.uk/fund/montanaro-better-world-fund/

The report includes independent analysis from Impact Cubed:



7 – ENGAGEMENT

As responsible shareholders we believe that it is our duty to engage with our investee companies where necessary. In our experience, active engagement can help to foster positive long-term change in the way businesses are run and potentially lead to better investment returns and improved societal and environmental outcomes.

Engagement forms a key part of our long-term approach, allowing us to identify and manage risks within our portfolios, fulfil our stewardship responsibilities and consider other stakeholders (a duty of all B Corps). Engagement is used as a tool to better understand a company's impact, leading to better investment decisions.

Engagement is typically initiated and conducted by our Analysts as it is they who hold the closest relationships with our investee companies. Support is provided by the Sustainability Committee who review engagement activity at quarterly meetings. The Head of Sustainable Investment may lead certain cases, such as those involving multiple stakeholders, collaborative engagements, or those that affect a number of companies within a portfolio. We typically engage with ~30% of a portfolio in any one year on company-specific issues. We do not seek to boost statistics and do not class management meetings at which ESG questions are asked as engagement.

How we engage

There are a number of channels open to us when we seek to engage with a company. These include:

- Direct engagement with the management and /or Board;
- Speaking to industry competitors;
- Speaking with industry representatives such as Trade Unions;
- Liaising with other shareholders;

Engagement process

Our engagement process can be summarised as follows:

1. <u>Issue source</u>: we can become aware of issues that require engagement through a number of sources. Our Ethical & ESG Checklists are a primary source as they force our Analysts to "score" a company on Ethical & ESG grounds. A low score in a particular area often suggests that engagement of some kind is needed. Company meetings and site visits also provide us with an opportunity to discover whether an issue exists that requires engagement. In addition to this we also monitor company newsflow, through the information provider Factiva as well as more mainstream news sources.

2. <u>Deciding to engage</u>: if an Analyst (or any other member of Montanaro's staff) feels that engagement is needed with a company, the relevant Analyst will discuss the issue with the Sustainability Committee at an ad hoc meeting, or via email. They will agree on which of the Engagement Channels to pursue given the case details and the Analyst will then go ahead and engage.

3. Recording engagement: all engagement activity is recorded on Montanaro's ESG Engagement Log. Any activity is deemed to be "ongoing" until formally closed. It is the responsibility of the Sustainability Committee to review this Log at each meeting to monitor progress and discuss priorities.

4. Monitoring engagement: once we have initiated engagement with a company the Analyst and Sustainability Committee – supported by other members of the Investment Team, such as the Head of Research – monitor the company's response. This can go a number of ways:
   - The company responds promptly and assuages our concerns and/or provides material evidence to prove that they are going to solve the issue at hand.
   - The company responds promptly but we are not satisfied by their answer. We engage further. In some cases we may speak to competitors of the company to better understand the industry, or an industry body, such as a Trade Union or discuss the matter at a shareholders forum.
   - The company does not respond, so our Analyst engages again with management. In some cases we may choose to escalate the matter to another member of the company's senior management team in an effort to garner a response.
   - The company does not respond and appears unlikely to do so, so we liaise with industry bodies or other shareholders in order to gain further support for our cause, or better understand the situation.

5. Reaching a conclusion: in an ideal world we wish to reach a positive conclusion on every matter of engagement. Our single aim when we engage with companies is to encourage an improvement in behaviour that leads to more sustainable business practices. We are realistic, however; engagement is often a complex business in itself. We do not place a deadline on engagement as in our experience, complex issues can take time to resolve. As long-term shareholders, our focus is on ensuring the improvement of a company's performance over a long time period. However, if our engagement subsequently leads us to doubt the longer term attraction of an investment, that investment will be reviewed and could be sold.

Escalation

Our escalation strategy falls into two parts:

1. **Internal:** If an Analyst or another member of the team leading an engagement fails to get satisfactory answers to an engagement matter, then they will discuss the next steps with members of the Sustainability Committee. They will decide if further engagement is required and will be constructive. If we decide not to escalate the engagement further, then the Analyst will discuss the case with the Investment Committee and the Analyst may recommend that the stock is sold. If we decide further engagement is warranted, then we will proceed to step two.

2. **External:** Escalation typically begins by escalating the engagement up the corporate hierarchy. For example, if our first point of contact has been the Head of Investor Relations, then we may ask to speak to a member of the Executive Team (typically the CEO or CFO). If they prove unresponsive, then we will seek to speak with members of the Board (such as the Chair or Chair of the Remuneration Committee). In the world of SmallCap, many

companies have majority stakes that are owned by the founder, or family members of the founder. We have experience of escalating matters with companies which have resulted in meetings with family shareholders who have not, or do not usually, meet with minority shareholders. In some instance we will also escalate matters more widely, either by speaking to industry bodies or other shareholders. In serious instances, we may indicate that we are withholding our support by abstaining or voting against management. If the above steps do not allow us to realise the aims of the engagement, then we may choose to divest the shares.

Deep Dive Engagements explained: Deep Dive engagements are commissioned by the Sustainability Committee. We select subjects that have either been identified as common areas of weakness for our companies during ESG analysis, or focus on an issue that we consider a market-wide or systemic risk. We select a number of companies from across our Approved List and engage with management and other stakeholders in order to improve our understanding about a particular subject. Deep Dives also have specific engagement objectives. For example, in 2020 a Deep Dive project focused on climate change and the objective was to encourage companies to set ambitious science-based climate targets.

ESG targets:

In addition to our Fund's SFDR classifications (Article 8/9) certain MAM Funds have ESG targets which influence the focus of our engagement activity:

Montanaro Better World Fund:

- **Environmental**: at least 20% of the companies within the Fund by value to have achieved "Net Zero Carbon" by 2030;
- **Social:** at least 30% of Women on Boards across the Fund by 2025;
- **Governance**: at least 75% of Independent Directors across the Fund by 2025;
- **Human Rights:** at least 70% of companies within the Fund reporting an Anti-Bribery Policy by 2025.

Montanaro European Smaller Companies Fund:

- **Environmental**: at least a 20% reduction in carbon intensity (Scope 1 & 2) by 2025;
- **Social:** at least 40% of Women on Boards across the Fund by 2025;
- **Governance**: at least 70% of Independent Directors across the Fund by 2025;
- **Human Rights:** at least 70% of companies within the Fund reporting an Anti-Bribery Policy by 2025.

8 – VOTING

- We seek to exercise all of our voting rights.
- We make our own voting decisions.
- We do not choose to automatically support the Board or management of an investee company and instead apply our proprietary guidelines.
- We have and will abstain or vote against resolutions from time to time.
- We publish Voting Activity Summary Reports on our website

We exercise our voting rights

Voting is a vital part of our engagement with companies. This is why we attempt to vote at all Annual General Meetings for the holdings within our Funds. We also do this for segregated mandates where we have authority to do so. We do not engage in stock lending in the Montanaro Funds (although our segregated clients may have their own policies on this).

We make our own voting decisions

We receive independent third party corporate governance reports and voting recommendations from Institutional Investor Services (ISS) ahead of meetings, however we use these for advice only; our Analysts systematically review all resolutions ahead of shareholder meetings and we voice our concerns where required. We aim to discuss any issues with management prior to voting against or abstaining.

We apply the same voting decisions across all portfolios, unless a segregated mandate client has specified that a particular voting policy be applied. We keep a record of our voting rationale.

We publish Voting Activity Summary Reports on our website

We use ISS to process our proxy voting. All voting activity is recorded in our Proxy Voting Log, and can also be reviewed on the ISS portal. The Sustainability Committee reviews voting activity for the quarter at each meeting, and we publish a summary of our voting statistics on our website. This includes the number of proposals where we voted either in favour, against or abstained on different subjects such as approving Remuneration policies, electing Directors, and approving capital increases.

A more detailed breakdown of how we voted on specific issues and our rationale for doing so is provided to clients on a case-by-case basis and is recorded in our reports to the FRC Stewardship Code as part of our responsibilities as signatories. We also report annual voting statistics to the UN in line with our responsibilities under the Principles for Responsible Investment.

A more detailed explanation of our voting process is available on our website.

9 – UK STEWARDSHIP CODE

Montanaro has been signatories to the UK Stewardship Code since its inception in 2010. Our response to the iteration of the 2016 Code was graded "Tier 1" (the highest available rating).

In September 2021, Montanaro was listed as a first wave signatory to the revised 2020 UK Stewardship Code. Our annual statement can be found on our website:
https://montanaro.co.uk/sustainable-investing/

Signatory of:

STEWARDSHIP CODE | 2021

10 – DATA AND SERVICE PROVIDERS

The following companies provide services to Montanaro. Each is reviewed as explained below:

ISS: We receive independent corporate governance reports and voting recommendations from Institutional Investor Services (ISS) ahead of votable meetings. We use these for advice only and review every ISS voting recommendation before we submit our vote.
Review: Annual review is led by the Sustainability Committee. We review voting records to ensure that votes have been cast according to our policies and stated preferences (in instances where we have decided to vote against the ISS recommendation). We also arrange annual meetings with ISS to discuss their service offering to ensure that it remains cost effective and we are utilising the full range of their services.

MSCI: We receive environmental data from MSCI on the companies within our Small & MidCap investment universe. This data is incorporated into our ESG Checklists, allowing us to better understand the environmental footprint of the businesses in which we invest. As of 2022, we receive MSCI ESG ratings for companies within our global investment universe, helping us to filter for new ideas and compare our own ESG analysis with a mainstream data provider.
Review: Annual review is led by the Sustainability Committee. The focus is on ensuring that the data is being supplied to us in a timely manner (we request a fresh batch of data every quarter-end); that the data is accurate; and we understand what estimations have taken place, allowing us to identify which companies are not reporting environmental data themselves. This helps us when we engage with companies. For example, over the course of 2020 we engaged with a number of companies in the Better World Fund to get them to improve their reporting of carbon data.

Bloomberg: We source company level ESG data from Bloomberg which is incorporated into our ESG Checklists.
Review: Annual review is led by the Head of Investment Analytics covering the entire scope of the Bloomberg offering, including the data and content used for performance and company analysis. From an ESG perspective, we record the percentage of companies that report on various ESG metrics, which influences company engagement as we work with management teams to improve the disclosure of ESG related data.

Impact Cubed: The company provides us with independent impact analysis on the Better World Fund Portfolio. The Fund is measured against 14 sustainability criteria and compared against both its benchmark and a wider peergroup of funds.
Review: Annual review is led by the Sustainability Committee.

Factiva: Global news monitoring and search engine Factiva allows us to monitor company newsflow and identify news stories related to our companies that we may otherwise not see by simply focusing on mainstream news sources. We use this primarily as a tool to help us identify issues on which engagement may be required.
Review: Annual review is led by the Sustainability Committee. In 2020, our review found that certain stories highlighted to us via the Factiva system were not particularly current. An old news

story is not useful as the opportunity to have engaged with management may have passed. To try to mitigate this, we have retrained staff on how to use Factiva and have brought it under the responsibility of our ESG & Impact Specialist, who joined the business in January 2021.

Summary Review: As well as a review of individual providers, the Sustainability Committee also reviews the full scope of our providers and considers if there is a "gap" in their offering. During 2020, the Committee decided to launch a search for a provider of impact analysis to aid the reporting of our impact strategy, the Better World Fund. After conversations with several providers, we enlisted the service of Impact Cubed. We were impressed with their methodology and look forward to working with them to support our impact reporting as we work towards the publication of the Better World Fund Impact Fund in the spring of 2021. We will review their service on an annual basis.

11 – BECOMING A B CORPORATION

Certified B Corporations® (B Corps™) are defined as for-profit companies that use the power of business to build a more inclusive and sustainable economy. As of June 2019, there are 2,800 B Corps in 130 industries and 60 countries around the world. Just 198 of these are based in the UK.

- They meet the highest verified standards of social and environmental performance, transparency and accountability.
-
- Certified B Corporations amend their governance so that, by law, they can make decisions and implement practices that consider not just shareholder value, but the impact on all stakeholders - employees, customers, society, and the environment.
-
- B Corp Certification is a highly selective status. Companies must document their positive impact to qualify and undergo verification every three years to maintain their Certification.
-
- Certified B Corporations range from multinational corporations [Natura] to wholly owned subsidiaries [Seventh Generation] to small businesses [Harvest Market] serving local communities.
-
- It is one of the only certifications that is not for a product or service but for the whole business behind the product or service.
-
- B Corporation Certification helps consumers identify companies with a mission and helps investors to select investments that align with their values.

Becoming a B Corp was a natural step in Montanaro's Responsible Investment journey.

The Certification process uses credible, comprehensive, transparent and independent standards of social and environmental performance. The B Corp assessment process measures a company's performance in five categories:

1. **Governance;**
2. **Workers;**
3. **Customers;**
4. **Community;**
5. **the Environment.**

The assessment is marked out of 200 and the pass mark to become a B Corp is 80. The median score for businesses who complete the impact assessment is 50.9.

Montanaro's 2019 B Corp score was 81.8. Our report can be viewed in full at:
https://bcorporation.net/directory/montanaro-asset-management

12 – SUSTAINABILITY AT MONTANARO

We expect high ESG standards from the companies in which we invest and as a certified "B Corp" we aim to practice what we preach.

Net Zero Carbon

Montanaro has a Net Zero Carbon target for 2030. Green Element is helping us to calculate our environmental footprint. In 2020, Montanaro emitted 26 tonnes of CO_{2e}, the majority of which came from Scope 2 emissions. We estimated the energy used by all of our employees as they worked from home.

Bees at 53 Threadneedle Street

We are located in one of the City's older buildings, just along from the Bank of England. To support a city-wide biodiversity project, we have two beehives on our roof. Each contains up to 50,000 honeybees.

Charities

Montanaro founded and supports Tribal Survival, a UK registered charity, which aims to promote the well-being of indigenous people across the world. In partnership with The Giving Department, Montanaro also provides support to local charities across London.

Sustainable Office

Our team is multi-cultural and comprises ten different nationalities. We promote diversity, equality and sustainability throughout our business. Our recycling projects saved 1,750kg of CO_2 in 2020, half of our saving in 2019 as we worked from home.

APPENDIX

WHAT DOES RESEARCH SAY ABOUT ESG?

Appraising investment opportunities consistently from an ESG perspective can prove problematic. The reason for this is because, as Professors Elroy Dimson, Paul Marsh and Mike Staunton acknowledge[4], it can be hard to find a definition of an "unethical" company that is universally acceptable.

For instance, Medtronic, a medical devices company, is a constituent of the FTSE4Good Index but has a tax-inversion scheme that has been deemed unethical by certain stakeholders. The US supermarket, Walmart, scores highly on certain ESG metrics, but was divested by the Norwegian Sovereign Wealth Fund due to unacceptable labour practices.

Yet, when things go wrong, ESG failings are often highly visible. In recent years we have witnessed the unethical behaviour of the banking sector which contributed to the Global Financial Crisis; the environmental failings of BP after the Macondo oil disaster; and Tokyo Electric Power Company's social neglect, in the wake of Japan's Tsunami disaster. In all cases, shareholders and their fellow stakeholders suffered.

While ethical failings can appear obvious in hindsight, a problem for proponents of ESG investing is that there is no simple "forward-looking" way of evaluating ESG risk. Yet such difficulties should not preclude ESG from forming part of an investment process. In fact, there is academic support for such an approach:

- It is becoming increasingly difficult for investment decision-makers to dismiss ESG, given investors *"readily quantify business goodwill and other equivalently nebulous intangibles[5]"*.

- Responsible investing *"recognises that the generation of long-term sustainable returns is dependent on stable, well-functioning and well-governed social, environmental and economic systems[6]"*.

- Considering ESG issues helps to protect all stakeholders, as *"shareholders…can exercise considerable influence over the management of companies[7]"*.

- Sustainability policies are a means of "*pre-emptive insurance for adverse ESG events[8]"*.

- Worthwhile ESG policies require *"knowledge of the subject matter and criteria used to measure it[9]"*.

We would suggest that there is no definitive proof that ESG increases shareholder returns. We would argue, however, that correctly integrated into an investment process, considering ESG makes

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[4] *Credit Suisse Global Investment Returns Yearbook 2015*, *Responsible investing: does it pay to be bad?* Elroy Dimson, Paul Marsh and Mike Staunton, London Business School, pg. 20
[5] ibid
[6] http://unpri.org/wp-content/uploads/1.Whatisresponsibleinvestment.pdf
[7] http://ec.europa.eu/environment/archives/finserv/fisum.pdf
[8] http://www.smithschool.ox.ac.uk/library/reports/SSEE_Arabesque_Paper_16Sept14.pdf
[9] http://www2.deloitte.com/content/dam/Deloitte/us/Documents/risk/us-aers-sustainability-reporting-landscape.pdf

positive investment returns more likely, rather than less. With this in mind, we would agree with the following statements:

- ESG "*considerations often have a role to play in the proper analysis of investment value*[10]*".*
- "S*ocially and environmentally responsible policies…[minimise] risks by anticipating and preventing crises that can affect reputation and cause dramatic drops in share prices*[11]*"*.
- *"Stock price performance is positively influenced by good sustainability practices*[12]*"*
- *"Sound sustainability standards lower the cost of capital of companies*[13]*"*
- *"Solid ESG practices result in better operational performance*[14]*"*
- "C*orporate engagement can pay, whether the focus is on environmental and social issues or on corporate governance*[15]".

In addition to the above, it is worth highlighting certain findings from a comprehensive report by Deutsche Bank, *Sustainable Investing, Establishing Long-Term Value and Performance, 2012*[16]. The report clearly demonstrates that there is academic support for considering ESG factors in investment decisions. Indeed, as the renowned economist Michael Jensen states, *"it is obvious that we cannot maximise the long-term market value of an organisation if we ignore or mistreat any important constituency*[17]*"*.

[10] *Credit Suisse Global Investment Returns Yearbook 2015*, *Responsible investing: does it pay to be bad?* Elroy Dimson, Paul Marsh and Mike Staunton, London Business School, pg. 20

[11] *The Commission Green Paper on promoting a European framework for Corporate Social Responsibility* COM (2001) 366 final (18/07/2001).

[12] http://www.smithschool.ox.ac.uk/library/reports/SSEE_Arabesque_Paper_16Sept14.pdf

[13] Ibid

[14] Ibid

[15] http://www.oekom-research.com/homepage/english/oekom_CR_Review_2013_en.pdf

[16] https://institutional.deutscheawm.com/content/_media/Sustainable_Investing_2012.pdf

[17] As cited in *Drivers of Long-Term Business Value: Stakeholders, stats and strategy*, Koehler & Henspenide, Deloitte, 2012

The Deutsche Bank report analyses the findings of *"over 100 studies…[including] 56 research papers, as well as 2 literature reviews and 4 meta studies"*:

- *"100% of the academic studies agree that companies with high ratings for CSR and ESG factors have a lower cost of capital in terms of debt (loans and bonds) and equity. In effect, the market recognises that these companies are lower risk than other companies and rewards them accordingly".*

- *"89% of the studies we examined show that companies with high ratings for ESG factors exhibit market-based outperformance, while 85% of the studies show these types of company's exhibit accounting-based outperformance".*

- *"The single most important of these factors, and the most looked at by academics to date, is Governance (G), with 20 studies focusing in on this component of ESG (relative to 10 studies focusing on E and 8 studies on S). In other words, any company that thinks it does not need to bother with improving its systems of corporate governance is, in effect, thumbing its nose at the market and hurting its own performance all at the same time".*

- *"Strong corporate commitment to ESG (or E, S or G) is positively correlated to a lower cost of capital. Again, this finding is evident in all the studies we analysed".*

GLOSSARY

Key terms used in the Field of Sustainable Investing[18]:

Concept	Definition	Source
Ethical Investment	Investment philosophy guided by moral values, ethical codes or religious beliefs. Investment decisions include non-economic criteria. This practice has traditionally been associated with negative (or exclusionary) screening.	Mercer, 2007
Values-Driven Screening	Values-based (also referred to as negative or exclusionary) screening is defined as an investment approach that excludes some companies or sectors from the investment universe based on criteria relating to their policies, actions products or services. Investments that do not meet the minimum standards of the screen are not included in the investment portfolio. Criteria may include environmental, social, corporate governance or ethical issues. For example, specific industries or sectors such as weapons manufacturers, or specific companies considered to be poor environmental, social or governance (ESG) executors.	Mercer, 2007
Socially Responsible Investment (SRI)	SRI, as it first emerged, was very similar to ethical investing in that it allowed a level of trade-off between corporate social and financial performance when making investment decisions, and predominantly utilized exclusionary screening. However, modern SRI represents an investment process that seeks to achieve social and environmental objectives alongside financial objectives, utilizing both values-driven, and risk and return screening.	DBCCA analysis 2012; Mercer, 2007
Sustainability	Sustainability or sustainable development refers to the concept of meeting present needs without compromising the ability of future generations to meet their needs. It encompasses social welfare, protection of the environment, efficient use of natural resources and economic well-being.	Brundtland Report, 1987; Mercer, 2007
Risk & Return Screening	Risk and return (or positive) screening is defined as an investment approach that includes non-traditional criteria relating to the policies, actions, products or services of securities issuers. Portfolios are tilted towards stocks that rate well on the nominated criteria, which can include ESG or ethical issues.	Mercer, 2007
Corporate Governance	Procedures and/or processes according to which an organization is directed and controlled. Corporate Governance structure specifies the distribution of rights and responsibilities among the different participants in the organization – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision making. National and international best practice standards exist.	OECD, as cited in Mercer, 2007
Universal Owner	A large asset owner who, as a consequence of its size, owns a slice of the whole economy and market through its portfolios. Universal owners adapt their actions with the intent of improving long-term performance by benefiting the whole economy and market in a logical but ambitious extension of sustainable investing. They justify these actions on financial grounds.	Towers Watson, 2011
Environmental, Social and Corporate Governance (ESG)	The term that has emerged globally to describe the environmental, social and corporate governance issues that investors are considering in the context of corporate behavior. No definitive list of ESG issues exists, but they typically display one or more of the following characteristics: (i) issues that have traditionally been considered non-financial or not material; (ii) a medium or long-term time horizon; (iii) qualitative objectives that are not readily quantifiable in monetary terms; (iv) externalities not well captured by market mechanisms; (v) a changing regulatory or policy framework; (vi) patterns arising throughout a company's supply chain; and (vii) a public-concern focus.	Mercer, 2007
Best-in-Class Approach	Investment approach that focuses on companies that have historically performed better than their peers within a particular industry or sector on measures of environmental, social and corporate governance issues. This typically involves positive or negative screening or portfolio tilting.	Mercer, 2007
Responsible Investment	The integration of ESG considerations into investment management processes and ownership practices in the belief that these factors can have an impact on financial performance, in particular over the medium to longer-term. Responsible Investing (RI) can be practiced across all asset classes.	Mercer, 2007; DBCCA analysis

[18] https://institutional.deutscheawm.com/content/_media/Sustainable_Investing_2012.pdf

Key terms related to Corporate Social Responsibility and Shareholder Engagement[19]:

Concept Name	Definition	Source
Corporate Social Responsibility	Approach to business which takes into account economic, social, environmental and ethical impacts for a variety of reasons, including mitigating risk, decreasing costs, and improving brand image and competitiveness. This approach is sometimes implemented by means of a comprehensive set of policies and procedures integrated throughout a company, encompassing a wide range of practices, including: corporate governance, employee relations, supply chain relationships, customer relationships, environmental management, philanthropy and community involvement.	Mercer, 2007
Stakeholder	Individuals or organizations with an interest in the actions and impacts of an organization. They may be customers, suppliers, shareholders, employees, communities, members of special interest groups, non-governmental organizations, or regulators.	Mercer, 2007
Active Ownership	The voting of company shares and/or the engaging of corporate managers and boards of directors in dialogue on ESG issues as well as on business strategy issues. Increasingly pursued in an effort to reduce risk and enhance shareholder value. Can also be referred to as "Shareholder Activism".	Mercer, 2007
Shareholder Engagement	The practice of monitoring corporate behavior and seeking changes where appropriate through dialogue with companies or through the use of share ownership rights, such as filing shareholder resolutions. Shareholder engagement is often employed in attempts to improve a company's ESG performance.	Mercer, 2007
Proxy Voting	The delegation of voting rights from entitled voters who do not attend shareholders' meetings to delegates who vote on their behalf. Proxy voting allows shareholders to exercise their right to vote without committing the time involved in actually attending meetings. Proxy voting policies can include specific guidance on ESG and ethical decisions.	Mercer, 2007
Corporate Social Performance	A business organization's configuration of principles of social responsibility, processes of social responsiveness, and policies, programs, and observable outcomes as they relate to the firm's societal relationships.	Wood, 1991:693[23]
Corporate Financial Performance	A term widely used within academia to refer to the financial or economic performance of a company. In general, academic studies have tended to focus on either financial accounting measures (for example, Return on Assets or Return on Equity) or economic measures (usually a company's stock performance) to measure, rank and compare the CFP of different companies.	DBCCA analysis 2012
Corporate Citizenship	A term used to describe a company's role in, or responsibilities towards society. For this reason it is sometimes used interchangeably with corporate social responsibility, although this concept is extended by some to refer to the political activities – and perhaps even rights – of a company.	DBCCA analysis 2012
Integrated Reporting	A growing practice of corporate reporting that demonstrates the linkage between an organization's financial performance in relation to environmental, social, and governance (ESG) factors that underlie the organization's core activities. By "integrating" financial and non-financial data, Integrated Reporting can help businesses take more sustainable decisions and enable investors and other stakeholders to transparently understand an organizations true performance.	DBCCA analysis 2012
Triple Bottom Line	A holistic approach to measuring a company's performance on environmental, social and economic issues. The triple bottom line focuses companies not just on the economic value they add, but also on the environmental and social value they add or destroy. This concept is frequently utilized in CSR or sustainability reporting.	Mercer, 2007; DBCCA analysis 2012

[19] https://institutional.deutscheawm.com/content/_media/Sustainable_Investing_2012.pdf

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