Independent Franchise Partners, LLP

Environmental, social and governance (ESG) integration policy – August 2024

Our approach to ESG integration

Franchise Partners' goal is to earn attractive, long-term risk-adjusted returns for our clients. We seek to do this by investing in exceptionally high-quality companies – whose primary competitive advantage is supported by a dominant intangible asset – at attractive valuations. We manage concentrated portfolios (typically 20-40 positions) and employ a patient, long-term buy and hold approach in order to benefit from the free cash flow compounding ability of the companies in which we invest.

We integrate ESG considerations into our investment process to support our goal of delivering attractive returns for our clients. We consider ESG risks and opportunities in our research process to strengthen our understanding of a company's quality and valuation. Similarly, we undertake active engagement and voting to ensure companies act in the best long-term interests of our clients and manage financially material risks.

Our returns led approach to ESG integration and stewardship focuses on the financially material risks that matter to a company's franchise durability and its valuation. Our long-term holding period means we take an equally long-term perspective when assessing the materiality of ESG factors. Further, we take a broad view of materiality and consider how ESG factors impact a company's brand, reputation, and appeal to employees. These can be important factors in maintaining the health of a company's intangible assets.

Our incorporation of ESG into the investment process is not about avoiding risk, but helps us understand risk better to gain a more comprehensive perspective of a company's quality and appropriate valuation. This means we may see investment opportunities in companies facing some form of ESG-related controversy, or that have room to improve their management of material ESG risks. We think these opportunities can help us deliver attractive long-term investment returns for our clients.

We will, however, only invest if we have confidence that the ESG risk does not impair the company's competitive advantage, we think the valuation pays us to bear those risks, and that the company can address its challenges. We gain this confidence through our in-depth, proprietary research.

We provide more information on our engagement and voting work in our *Stewardship Policy* and our *Voting Policy.*

Our ESG research process

Our ESG integration process is founded on in-house research, supported by proprietary frameworks.

There are multiple ways in which ESG considerations feature in our research process.

In cases where an ESG topic is one of the most important drivers of a company's valuation or the strength of its franchise, the lead investor for the stock incorporates it into their investment research note.

All company investment notes also include an ESG section compiled by the lead investor and ESG analyst.[1] This process acts as a touchpoint for the lead investor and ESG analyst to ensure the investment note captures any financially material ESG considerations.

In addition, where ESG risks are material and complex, the ESG analyst may work with the investor to produce an ESG-focused report. This allows us to examine the ESG risks in even greater depth, and brings a wider range of perspectives and sources into consideration.

Importantly, all investment research, including ESG-focused research, is circulated among the whole investment team for feedback and discussion at our regular investment meetings.

We use three proprietary frameworks to provide structure to our ESG approach and help us identify financially material ESG considerations.

1. **A taxonomy of financially material ESG factors*:*** These are the 13 ESG considerations that we believe are most likely to impact the performance of the companies in the Franchise investment universe. We provide our ESG taxonomy in the appendix.

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

3. **A culture framework:** Experience has taught us that an organisation's culture can materially affect the durability of a company's franchise. This framework brings structure to our analysis of culture and how we discuss our views within the investment team. The framework has six pillars: adaptability, employee focus, customer focus, long-term orientation, governance quality, and consistency of culture.

We use a wide variety of qualitative and quantitative information sources in our research process.[2] In addition, we are members of a selection of leading ESG initiatives that provide research, guidance and collaborative engagement opportunities.[3]

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

Responsibilities and oversight

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

[1] Since February 2023, all new and updated company investment notes include an ESG section. As at 31 July 2024 an ESG section had been compiled for all portfolio companies.
[2] In addition to a broad array of qualitative information sources, we consult the following ESG data sources: MSCI ESG Research, the Science Based Targets initiative, Carbon Disclosure Project (CDP), Bloomberg and Institutional Shareholder Services.
[3] We are members of or signatories to the following organizations: CDP, The Investor Forum, Task Force on Climate-related Financial Disclosures, Net Zero Asset Managers initiative, UN Principles for Responsible Investment and the UK Stewardship Code.

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

We have deliberately allocated responsibilities for assessing and managing ESG risks to our investment team as it leads to more effective identification of financially material ESG risks, and the closer incorporation of them into the investment process.

Reporting and transparency

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

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

Appendix 1: Proprietary ESG taxonomy

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

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

Appendix 2: Climate framework

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

We assess companies on the following five criteria:

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

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

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

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

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

Appendix 3: Fossil fuel statement as signatories to NZAMI

As signatories to the Net Zero Asset Managers initiative (NZAMI) we are required to disclose information on our approach to investments in fossil fuels.

The Franchise investment approach does not have a fossil fuel exclusion policy. However, we note that companies directly involved in the exploration and production of fossil fuels are capital intensive and lack pricing power. As a result, they do not meet our Franchise criteria.