M&G Pan European Select Fund

ESG Key Performance Indicators (KPIs) – Annual Review

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FOR INVESTMENT PROFESSIONALS ONLY

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- *In this report we highlight eight key performance indicators (KPIs) that we consider to be materially significant from an ESG perspective*
- *In order to consider key ESG performance indicators at a fund level, we have focused on factors that are relevant across the entire portfolio.*

The value and income from the fund's assets will go down as well as up. This will cause the value of your investment to fall as well as rise. There is no guarantee that the fund will achieve its objective and you may get back less than you originally invested.

The M&G Pan European Select Fund invests in a concentrated portfolio of quality, sustainable companies, with the consideration of Environmental, Social and Governance (ESG) factors integrated throughout the investment process. We believe ESG awareness is a matter of good stewardship, and a sensible part of any sustainable investment strategy aimed at maximising long-term economic returns.

Sustainability refers to the long-term durability of a business, and incorporates aspects including financial strength, competitive advantages and ESG factors. Such considerations include how a company is run, as well as how it treats its customers, its employees and the environment, for example. We 'screen in' companies that meet these requirements, including them in our watchlist of stocks we would like to own when the timing and price are right. We perform deep fundamental research on this list, looking at all the financial and non-financial elements affecting the business. We then wait patiently for behavioural episodes that allow us to invest in these companies at attractive valuations.

In addition to 'screening in' we also formally 'screen out':

- Companies deemed to be in breach of the UN Global Compact Principles on human rights, labour, the environment and corruption; and
- Producers of tobacco and controversial weapons (comprising biological, chemical and nuclear weapons, cluster munitions, depleted uranium, anti-personnel mines and white phosphorous).

Finally, the fund does not invest in companies involved in gambling, adult entertainment, the extraction of thermal coal, oil shale and tar sands.

Key ESG Performance Indicators

When researching stocks for the portfolio, we consider the materiality of ESG factors relative to a given company or industry. We also undertake ongoing ESG analysis on individual holdings within the portfolio, building an evolving picture of sustainability issues relevant to that company. For example, while raw material sourcing represents a significant risk for the fashion industry, the same does not apply to the financial sector (where responsible lending might be considered), or for an IT company (where cyber security might be a much larger risk). We internally score the holdings in our portfolio, rating them against these issues of materiality.

Resources deployed to monitor the ESG impact of the funds are mainly internal to M&G. They comprise the Select team's three embedded analysts, one of whom leads our engagement with companies, as well as the team's investment specialist – we believe in the importance of conducting our own research and forming independent views. To assist with the decision-making process, we will however scrutinise research and indicators from several third-party providers and get support from our corporate finance and stewardship team for our engagement efforts.

In order to consider key ESG performance indicators at a fund level, we have focused on factors that are relevant across the entire portfolio:

Environmental	Social	Governance	Human rights
• Total CO2 equivalent emissions to revenue (million USD) • Total water usage to revenue (million USD) • Waste reduction %	• Employee satisfaction % • Female managers %	• Board gender diversity % • Average board tenure years	• Signatories to UN Global Compact principles

These are by no means the only ESG factors that we consider at a company level, but we feel they are the most practical at a portfolio level. These factors are regularly reported by the majority of companies, they are transparent and reliable and work across sectors, allowing us to report consistently. These KPIs are not intended to represent a comprehensive overview of the many factors that are analysed as part of our ESG assessment, nor our ongoing monitoring of, and engagement with, investee companies.

Indicators are sourced from Eikon Reuters to facilitate updating and consistency of data.

KPI 1: Total CO_2 equivalent emissions to revenue (US$)

Category: Environmental

This indicator measures the quantity of greenhouse gas produced both directly and indirectly to support a company's activities. It is measured in tonnes of carbon dioxide equivalent (CO_2e) to allow for different gas emissions to be compared on a like-for-like basis relative to one unit of CO_2. It is expressed per US$ million of revenues to allow comparisons of companies of different sizes.

The figures incorporate Scope 1 (direct emissions) and Scope 2 (indirect emissions related to the consumption of electricity) greenhouse gas emissions and excludes Scope 3 emissions (direct emissions from the supply chain).

While a useful data point, we would caveat that for a highly concentrated fund, like the M&G Pan European Select Fund, one or two holdings can occasionally tilt this ratio dramatically up or down. It is also important to bear in mind that the fund will not refrain from investing in energy-intensive companies if we are satisfied that the company produces products that cannot be substituted and leads its industry in terms of energy efficiencies.

KPI 2: Total water usage to revenue (million US$)

Category: Environmental

This indicator measures the amount of water needed to support a company's activity and therefore measures the efficiency of the use of water. While water covers two-thirds of the earth's surface and is renewable, local shortages and quality problems are frequent. Water withdrawn for industrial purposes, if not returned in its original quantity and quality, can contribute to the lowering of water tables. Water might not be used directly in the production process, but is often used for cooling, heating and cleaning. Because water consumption cannot always be avoided, in the case of the production of beverages for example, the indicator only measures the intensity of the water intake of the production process.

It is measured as the total amount of water used in cubic meters divided by revenues in US$ to allow the comparison of companies of different sizes.

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KPI 3: Waste reduction

Category: Environmental

Checking that companies are taking proactive steps to recycle and reduce waste helps gauge how seriously they approach sustainability. While a substantial commitment for any company, there is evidence that waste reduction can yield tangible benefits when implemented across the board. In addition to reducing the cost associated with the disposal of waste, it can in some instances lead to higher revenues from selling recyclable products. More than anything, it is an indicator of a 'sustainable' mindset at management level.

It is calculated as the percentage of companies within the portfolio that report on initiatives to recycle, reduce, reuse, substitute, treat or phase out total waste.

KPI 4: Employee satisfaction

Category: Social

Companies are not abstract entries in a spreadsheet: they are very tangible entities built over decades, sometimes centuries, relying on people for their successful day-to-day operation and growth. Employees are not only operating valuable assets, but are valuable assets themselves. This is valid across any industry, but specifically relevant for asset-light business models such as financial services, IT and large-scale employers. Research led by the University of East Anglia's Norwich Business School published in February 2018 suggests a strong link between a company's financial performance and the satisfaction of its employees. The study analysed 35,231 Glassdoor ratings for 164 UK companies over the period 2014-2017 and revealed that the top-rated public companies experienced additional stock returns of up to 16% a year.

It is calculated as the proportion of satisfied employees as reported by the company.

KPI 5: Female managers

Category: Social

There is growing evidence that companies are likely to perform better financially if their workforce is more diverse. A study from McKinsey & Co published in January 2018 found that firms in the top quartile for gender diversity are 21% more likely to post above-average profitability compared with companies in the bottom quartile. It is clear to us that a diversified workforce will help foster stronger cultures, problem solving and innovation. A diversified workforce will also help attract and retain talent. While diversity is a broad term covering a wide range of characteristics such as race, ethnicity, gender, age and religion, we believe that the number of female managers is one relevant indicator of diversity that has become reasonably easy to track. The percentage of female managers remains considerably below that of their male peers, but we would expect to see a gradual improvement over time, especially in the companies in which we are invested.

It is calculated as the proportion of female employees in the total workforce.

KPI 6: Board diversity

Category: Governance

We believe that board diversity is equally as important as diversity of managers and can positively influence corporate governance and performance. Many studies show that a diverse board is good for business. Research conducted by accountancy firm Grant Thornton in 2015 showed that the shares of UK FTSE350 companies with at least one female board member outperformed those with male-only boards by 0.53%, on average.

The 30% Club, which aims to achieve a minimum of 30% women on UK FTSE boards, and of which M&G is an active member, lists the numerous advantages of a diverse board:

- diversity of thought, broader perspectives, background expertise when it comes to taking decisions: this is crucial when considering that corporate boards decide on all strategic areas, from purchasing – where traditionally women make around 70% of decisions – to executive compensation and choice of CEOs.

- better reflection of a company's customer base, with the benefit that companies will be more in tune with what clients ultimately expect of a product/service

- truer reflection of today's global economy, making companies more nimble and adaptable

It is calculated as the percentage of women on the board.

KPI 7: Average board tenure

Category: Governance

The fund invests for the long term, with an average holding period of five years or more. We therefore aim for boards and CEOs to share this long-term vision to ensure our interests are aligned. While changes might sometimes be justified to restructure parts of a business, we place a lot of value on board stability and commitment to build sustainable businesses. By the same token, it is important to avoid board entrenchment and make sure directors are not all of the same generation and mindset. While we do not believe in a magic number, we look for board tenures broadly in line with our average holding periods and discourage very short (less than two years) or very long (over 10 years) tenures.

It is calculated as the average number of years each board member has been on the board.

KPI 8: Global compact signatories

Category: Human rights

There is growing acceptance that companies hold their share of responsibility for the fulfilment and respect of international human rights standards. With many listed companies operating on a global scale, this applies not only to the management of employees but also to the work of suppliers. In a world where social media spreads news in a matter of seconds, ignoring human rights issues is not an option for companies that want to avoid irremediable damage to their reputation and brand. We recognise that, due to the complexity of their supply chains, certain companies will not be in a position to avoid minor issues. Nevertheless, when conducting our due diligence, we will scrutinise whether a company has sufficient resources to monitor and quickly tackle any alleged abuse that might surface.

For this indicator, we use the percentage of companies that are signatories to the United Nations Global Compact (UNGC) Principles. UNGC has become the conventional norm to gauge levels of corporate responsibility. Two of the 10 principles specifically refer to human rights and require that companies should support and respect the protection of human rights as well as ensuring that they are not complicit in any human rights abuses.

KPIs at a glance

KPI	Environmental			Social		Governance		Human Rights
	Total Co2 Eq Emissions to Revenue USD	Total Water Use to Revenue Mln USD	Waste Reduction	Employee Satisfaction	Women Managers	Board Gender Diversity, Percent	Average Board Tenure	Global Compact BMK
M&G Pan European Select	192	748	94%	79%	35%	29%	6.7	55%
MSCI Europe	151	4,201	92%	77%	32%	33%	6.6	76%

Source: Eikon Reuters, 25 November 2019

Please note that the fund invests mainly in company shares and is therefore likely to experience larger price fluctuations than funds that invest in bonds and/or cash.

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