

# M&G Pan European Select Fund

## Annual ESG review

FOR INVESTMENT PROFESSIONALS ONLY

November 2019



In the following report, we provide an overview of:

- The fund's sustainable ethos
- Our voting record over the previous year
- Our engagement activities over the previous year
- The ESG key performance indicators (KPIs) against which we compare the fund to its benchmark

*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.*

### Introduction

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, determined by considerations 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 watch-list 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 of the financial and non-financial elements affecting a 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.



## Voting

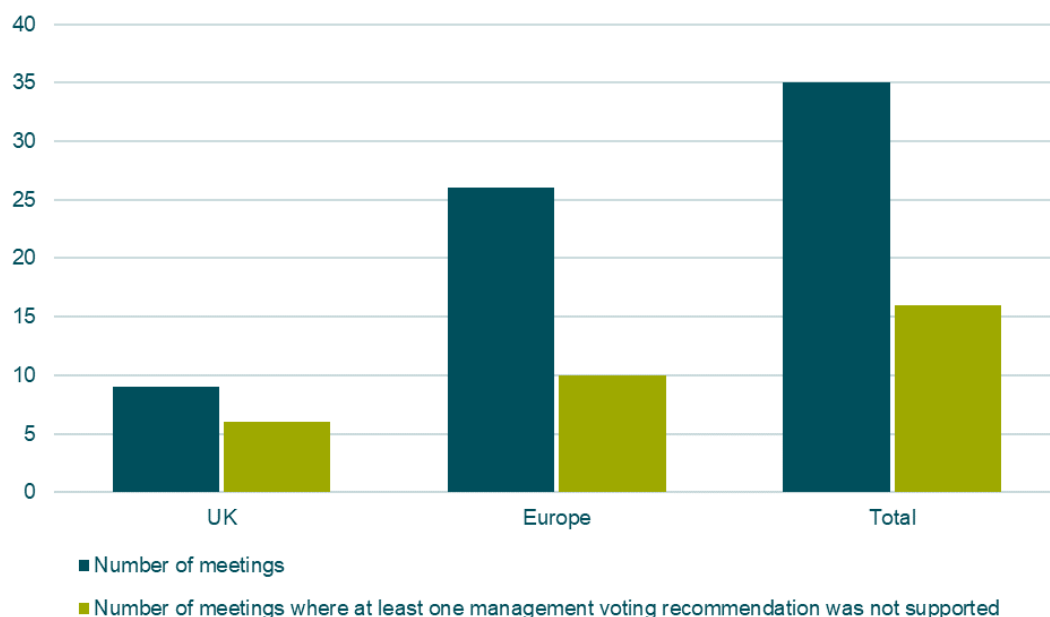
Between 30 September 2018 and 30 September 2019, we voted at 35 shareholder meetings (i.e. all of our holdings within the period), comprising nine UK-listed companies and 26 European.

Investors should note that the fund holds a small number of investments, and therefore a fall in the value of a single investment may have a greater impact than if it held a larger number of investments. The fund can be exposed to different currencies. Movements in currency exchange rates may adversely affect the value of your investment.

Details of M&G's voting, together with our published voting policy, are on the M&G corporate website within the Responsible Investment section.

Our starting position is to be supportive of the management of the companies in which we invest. However, there are occasions when company boards or shareholders put forward resolutions that we feel unable to support, especially if they are not in line with our public voting policy.

### **Meetings where at least one management recommendation was not supported**



### **Votes cast as against, abstain or withhold by category and region**

	UK	Europe
Directors-related	0%	54%
Remuneration	17%	18%
Capital-related	83%	18%
Corporate activity	0%	0%
Anti-takeover	0%	0%
Routine other business	0%	5%
Shareholder resolutions	0%	5%
	100%	100%

## Engagement

Meeting management teams is an integral part of our investment process. This is not to gain an 'information edge' on the financial development of a company, but rather to get a good grip on the business model, become comfortable with the company's long-term strategy and, not least, to get a sense of how aligned the management is with our values. We look for:

- Alignment of values and time horizons
- Track record of integrity and responsibility
- Cultural strength
- Trustworthiness and transparency.

M&G Investments generally, and the Select team specifically, seeks and promotes long-term thinking from management teams. We place a great deal of emphasis on establishing if a company is run in a responsible manner by trustworthy people with the stakeholders' best interests in mind. Discussions with management, and a deep look into the company's history, disclosure and incentive schemes, can normally provide valuable information.

If we have identified specific corporate responsibility issues, we will present these to the management team. We also offer our help on how to think about targets, disclosure and incentive structures. However, because of our bias towards responsibly run businesses, we do not consider ourselves to be 'ESG-activists'. In most cases, our engagement will not be aimed at solving problems, but rather at getting a good sense of the business culture – we believe that conversations with management teams about corporate responsibility can reveal much more about the business culture than any sustainability report or newspaper headline. We believe that active asset managers can have a significant impact on corporate behaviour, and we hope that, alongside like-minded investors, we will be able to strengthen the corporate responsibility, culture and long-term performance of the companies in which we invest.

## Engagement case studies

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### Nestlé – food and beverage

Nestlé is the world's largest food and beverage company, with more than 2,000 brands in 189 countries around the globe. During the period we met the company's chief executive to discuss, among others, sustainable sourcing and complexity within the business's supply chain. Nestlé highlighted the need for accountability of brand owners, from auditing the supply chain to transparency for end customers, with consumer companies having the scale to make a difference. Nestlé explained that it was working on using technology to help monitor suppliers -- for example using satellite imagery to monitor potential deforestation through palm oil production. It hopes at some point to be able to provide GPS coordinates on the packaging of the product -- linking, for example, the cocoa farm where beans for a chocolate bar were grown and a profile of the farmer who grew them. There is a long way to go before we get to that stage, but we will continue to monitor Nestlé's progress.

### Société Bic – consumer products

Bic is a French consumer products company, best known for producing lighters, pens and razors. We believe that Bic operates under a strong company culture with very little bureaucracy, concentrated on innovation and service delivery for its customers. It benefits from scale advantages, manufacturing expertise and a unique distribution channel, all of which help to protect its competitive advantage. We met the company's chief executive to understand the regulation around product quality in Bic's lighters business, given the ISO standard had been updated in December 2018. The standard is enforced in the US and Latin America, and being able to adhere to the regulation represents a competitive benefit for Bic, and a detriment to cheaper lighter brands generally produced in Asia. However, the standard is not enforced in Europe, where there are some 4,000 deaths per year resulting from the use of sub-par lighters. Bic has been working with the European Commission to improve enforcement, which will ultimately benefit BIC's European operations, reducing competition in this area by eliminating those companies unable to meet adequate standards.

### ALK-Abelló – healthcare

ALK-Abelló specialises in allergy immunotherapy (AIT), a unique treatment that not only reduces allergic symptoms, but also treats the underlying causes by inducing an immune response that provides protection against a particular allergy. The company produces vaccines for major respiratory allergies and focuses on prevention, diagnosis and treatment of respiratory diseases, such as asthma. We met the company to gain a better understanding of the progression of its business

strategy, including its expansion in the US. This, we learned, was progressing better than expected, with the group looking likely to outperform on medium-term targets. ALK is tracking ahead on both cost and pipeline initiatives, its niche competitive advantage in Europe is only increasing, and it is ahead of its competitors in terms of product approvals and innovation. The main task for the company now is to expand the market, reaching an ever-greater percentage of allergy sufferers, which we are confident it can accomplish. We believe that this could be a much larger company in three to four years from now, aided by slow and steady progress in the US.

## 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, 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 M&G's 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:

## KPIs at a glance

KPI	Environmental			Social		Governance		Human Rights
	Total Co2 Eq Emissions to Revenue USD	Total Water Use to Revenue MIn USD	Waste Reduction	Employee Satisfaction	Women Managers	Board Gender Diversity, Percent	Average Board Tenure	Global Compact BMK
M&G Pan European Select	192	748	94.0%	79.0%	35.0%	29.0%	6.7	55.0%
MSCI Europe	151	4,201	92.0%	77.0%	32.0%	33.0%	6.6	76.0%

Source: Eikon Reuters, 25 November 2019

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. For a full explanation of each KPI, please see our KPI report on the M&G website.

## M&G November 2019

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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