



Response to ESG Questionnaire

Cerno Capital

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Introduction

The issue of defining ESG and how individual companies express their specific values is now at the forefront of many of our clients' minds. We have researched SRI funds for many years now and have a separate rating category, but we acknowledge that this is now a mainstream strategy for an increasing number of investors and ESG issues are impacting all funds, not just those designated responsible or SRI.

In order to understand each company's stance on ESG factors at the corporate level, and how this is built into the investment managers' research and process we ask all our rated fund managers four questions:

- Please provide an overview of any Responsible Ownership/Stewardship strategy that your business follows.
- Please provide an overview of how ESG is integrated into your business.
- Does your business have a policy of excluding any companies or sectors from all strategies managed? If yes, please provide further details.
- What improvements (if any) have been made over the past 12 months within your business to the points highlighted in the previous questions?

The responses given by [Cerno Capital](#) are shown here.

1. Please provide an overview of any Responsible Ownership/Stewardship strategy that your business follows.

Portfolios managed by Cerno Capital are run in accordance with the UN Principles of Responsible Investment (UNPRI). We have been signatories since 2020. Responsibility for setting objectives resides with the partners of the firm. Responsibility for implementation is with the partners and all members of the investment team. In our minds, the discipline of long-term investment entails two distinct modes of thinking. The first is the absorption of relevant information with respect to a company's historical path and current conditions. The second is the imaginative exercise of developing theses as to the possible future paths to growth and challenges on these paths. This requires agility in relating historic and current trends with possible future trends - a process that is as much qualitative as quantitative.

For us, the central mode of measurement of corporate return is Return on Capital Employed or Return on Invested Capital (ROCE/ROIC) which summarises levels of economic returns at the company level. Whilst we engage with a large range of aggregations which give meaning to global, regional, country and sector fundamentals, ultimately our returns to our investors are more predicated on the fundamentals of the securities of individual companies, or, if we are investing through a manager, their portfolio of securities than country or sector level returns. It would therefore be true to state that Cerno Capital is predominantly a bottom-up manager.

When we think about investment returns, it is the combination of growth and the security of that growth in relation to economic returns that truly matter in the long run. We define long term as being periods in excess

of 5 years. Environmental, Social and Governance (ESG) factors are intrinsic to underpinning the security of returns for all future periods and most relevant in the time frames we spend most time thinking about - those which extend beyond 5 years.

Exclusions - and we do employ exclusions - are helpful in winnowing out sectors and companies that have unresolved conflicts with respect to ESG but exclusions are not ultimately enough, in our opinion, to meet the standards of good stewardship. The great advantage in making ESG considerations material within the investment decision making process is the formalisation it brings to considerations which were active in our thought process but could, on occasion, be devolved within other matters relevant to the security of returns. The firm's investment model aims to bring together direct manager responsibility for decisions within each portfolio of which they are responsible, with collective responsibility for authorised investments. Portfolio Managers are only able to add internally authorised investments to a portfolio. All members of the investment team are engaged in the authorisation of investments and this process culminates in a vote. Each member of the investment team holds a veto. This means, in practice, that no person or group of people can drive an investment approval when met with critical opposition.

The process of authorisation is multi-step and summarised as follows:

- 1) Discussion of a possible investment at the Weekly Investment Meeting attended by investment staff.
- 2) Following interchange of ideas and debate a decision will be made as to whether to perform research.
- 3) One or more members of the team will undertake that research and report back at subsequent Investment Meetings.
- 4) A written report will be produced and discussed, issues raised will be taken away for further analysis and then reported back.
- 5) Confirmation of eligibility for the target fund will be sought from the firm's Compliance Officer.
- 6) The team will vote as to whether to adopt an investment as an authorised investment.
- 7) Once the security, manager or instrument is added to the approved list, it can be added to portfolios at the discretion of the approved manager or managers.

Stewardship

Stewardship connotes several things.

First, it describes our role as agents, actively allocating capital within a global system. We are empowered to make decisions on behalf of our investors and these decisions potentially have impacts beyond the range of financial outcomes for our investors.

We are expected to engage with the companies in which we invest and, if this investment is via another specialist investor, understand and engage with their processes.

Stewardship also entails doing the work to understand both the present and distant consequences of strategies and decisions made by companies or managers in which we invest. This requires our investment professionals to maintain broad, not narrow interests, to read widely and to be willing recipients of input and opinion from a wide array of people and organisations.

This work, which should come as second nature to people who are drawn to investment for reasons that extend beyond their own self-interest, requires us to seek to expand our curious minds into the realms of politics, society, science and culture.

Stewardship also involves being alert to possible conflicts of interest and dealing with them in an equitable and ethical manner when they arise.

In short, good stewardship requires an ethical mind set with a regard to outcomes beyond immediate investment returns.

ESG & Engagement

As managers of liquid financial assets, when issues arise that are dissonant with our preferred outcomes, we always have the practical sanction of selling those assets in the market although perhaps not at the best prices we would wish.

That may give the sense of erasing a mistake and the feeling of resolution. However, we need to bear in mind that the issues which caused us discomfort may persist and be harmful to others and some of those others may not have all the benefits of our training, information sources, access and organisation. It is therefore necessary to engage on the issues that have caused a change in our evaluation.

For us, there are three courses of action:

- 1) sell the asset and communicate the reasons for sale to relevant persons of responsibility.
- 2) retain the asset and engage on the issue, stating our reservations and assessing the responses we receive.
- 3) 3) retain the asset and engage with other stewards of capital and policymakers to form a joint or combined approach.

Sustainability is a priority

Cerno Capital is a discretionary asset manager. At its core this means that we make investment decisions at the granular and portfolio level on behalf of individuals, families, trusts, charities, foundations and institutions that place their capital with us.

Cerno Capital addresses a global opportunity set of liquid investments but ultimately only invests in a selection of these. The firm needs therefore to have well thought out processes for reducing the large possible list to smaller potential lists and to be able to undertake deep research on chosen candidates and then monitor those when invested.

Cerno Capital has a long-term investment mind set. This is the least crowded zone in global investment due to the endemic short-termism that bedevils financial markets.

The interaction between these definitions determines the priorities whereby sustainability concerns need to be shared across all our activities, wherever we operate and meriting the trust of our investors.

Climate - risks and opportunities

The planet is experiencing stress and there are a range of possible outcomes. At its worst, we will experience devastating droughts and floods at significant loss of life and opportunity, rendering parts of the planet near to uninhabitable. The consequent geopolitical pressures would lead to further devastating secondary consequences.

The most optimistic prognosis suggests that by the combination of the application of technologies and modification of human behaviour, the planet will continue to warm for a period of time but the worst-case scenario will be averted.

Obviously, there are many possible outcomes between these two poles.

Currently, there are grounds for optimism and pessimism. Sales of electric vehicles are beginning to outstrip the more optimistic forecasts as tipping points in consumer attitudes are reached. On the other hand, some countries continue to put coal-fired power stations into commission.

One of the most disappointing facets of the climate "debate" is the unholy union of some economic libertarians with climate sceptics. Economic libertarianism has much to commend it even if full adoption may lead to sub-

optimal outcomes for societies. At its heart is the notion that government and government-led regulation should be curbed to maximise growth and therefore employment and profit.

With regard to the climate, this logic defeats itself. Planetary warming and the attendant consequences, left unchecked, will ultimately destroy growth and opportunity.

Where do opportunities lie?

New technologies offer a spectrum of venture and public capital opportunities. Alternative energy has progressed from niche to essential in some advanced economies, initially helped by subsidies but now largely standing on their own. Fantastical things may be possible such as plastic eating bacteria.

New industries come with considerable risks. Most obviously risk of failure but also from the crowding of capital into niches that ultimately fail to build an economic moat around themselves.

At Cerno Capital, we are particularly interested in and invest in established companies (therefore companies with the cash flows to fund change) that are providing material assistance on energy efficiency within the carbon complex and leveraging change outside the carbon complex.

Examples include Atlas Copco which manufactures the world's most efficient compressors, Murata which are the leading manufacturer of the brushless DC motors required and capacitors required for Electric Vehicles, companies within the PPG group that manufacture the world's most advanced coating for reducing drag and maintenance and Linde's investment in green hydrogen.

In addition to these, TSMC demonstrates market leading standards of disclosure and conduct. TSMC targets net-zero emissions by 2050 and 40% renewable energy use by 2030, tracking progress via regular esg disclosure reports. Moreover, their global impact is more significant in the downstream than in their own operations. In 2020, TSMC facilitated the global conservation of 4kWh of energy for each 1kWh utilised in production, due to increased efficiency of products which use their leading edge chips.

Furthermore, Keysight technologies has developed leading risk management systems, ESG targets, disclosure and implementation. For example, Keysight has committed to the Science Based Targets initiative, through which it has certified it's 2040 net-zero and 2025 50% landfill reduction strategies. The business already uses 100% renewable energy in all operations and design products with energy efficiency as a key feature,

Resources available to us

Cerno Capital undertakes its own research on candidate investments and the use of external research services and service providers are critical in allowing us to access data, alerts and arguments in all aspects of our stewardship activities. We are active consumers of the deep sectoral research undertaken by global investment banks whose research we pay for. These include UBS, Goldman Sachs and JP Morgan. We subscribe to Sustainalytics for detailed input on ESG issues. With respect to our voting, we utilise ProxyEdge which provides timely systematic alerts on all matters tabled to shareholders.

If you would like to raise any points with respect to responsible investment, sustainability or ESG please email us at stewardship@cernocapital.com.

Internal communication

The partners of the firm undertake briefings of the whole firm which detail our responsibilities with respect to ongoing stewardship activity. Stewardship and ESG are standing items on the firm's agenda for the following quora: Management Committee, Investment Advisory Committee, Advisory Board and at all Investment Meetings. The firm has its own Sustainability Committee of four staff members who meet no less than monthly to discuss initiatives and make recommendations with respect to the firm's own activities, resource use and outreach programs.

2. Please provide an overview of how ESG is integrated into your business.

With respect to the E in ESG, we recognise that the global economy, of its nature, requires energy expenditure and resource utilisation. The majority of companies we invest in manufacture products and these products begin in either raw or component form that are either refined or combined. Companies are part of complex ecosystems of suppliers and customers.

We monitor resource usage and environmental impact the companies that we invest in and assess their own targets, relating these to best practice in the industries in which they operate.

To help with this aspect of our work, we subscribe to relevant research provided by Sustainalytics, a private sector research and data organisation that collate and interpret ESG data and risks on 13,000 companies worldwide. <https://www.sustainalytics.com/esg-data/>

With respect to the S in ESG, we recognise that, for both historical and current reasons of prejudice, opportunities are not even by income group, ethnic group or gender. We expect the companies that we invest in to make tangible progress on these matters, provide information on their objectives, progress toward these objectives and be open to consultation and challenge. We acknowledge that diversity of thought, points of reference, and cultural background are supportive factors in helping organisations adapt and innovate.

Furthermore, such is the force of the dominant strain of capitalism in the world today, we expect companies to increase their openness in communicating their struggle to find an appropriate balance between the profit imperative ("if we don't make money, we can't employ people") and their wider impact on society. The strength of the corporate lobby in the corridors of power is matched only by the narrowness of their sets of interests. Consequently, there needs to be active redress from many other sources, for the overall benefit of society. We monitor and evaluate companies' behaviour when such issues arise.

In the assessment of the G in ESG, or Governance of listed companies, we are aided by the existence of requirements laid out by stock exchanges globally. These represent a minimum as governance is assessed through the behaviours of all stakeholders in addition to the confirmation of clear policies and procedures. Our approach to governance looks to assess the ability of an appropriately experienced Board to act independently in the interests of long-term shareholders. We look for clearly documented procedures and a prudent approach with regards to management of financial matters and for governance to promote openness and a culture that commits the long-term success of both businesses and industries.

Where we allocate to third party asset managers, we align ourselves with governance requirements that resonate with our own. This fosters an emphasis on long term ownership and development of assets. Our own activities are governed by documented policies which ensure consistency across accounts and emphasis on positive long-term outcomes. Oversight rests with the Management Committee comprising Partners of the firm alongside the Financial Director. With regards to our own governance and that of invested entities, we do not tolerate malfeasance.

3. Does your business have a policy of excluding any companies or sectors from all strategies managed? If yes, please provide further details.

Cerno Capital is predominantly a generalist bottom-up manager, meaning that apart from a few extraordinary exclusions which are Airlines, Defense, Banks, Tobacco, Oil & Gas, Basic Materials, we are largely sector and country agnostic. Instead, our investments are carried out on the fundamentals of the securities of individual companies or a manager's portfolio of securities, meaning that there are no SDG 'themes' present across our portfolios.

As responsible investors, it is material to the investment process if one company is aligned to, or working to further its impact according to a particular SDG. Therefore, such a finding would be presented and discussed in the weekly investment meeting and recorded on the due diligence reports. However, it is not a pre-requisite for a holding to be aligned to the SDGs in a particular fashion and as a result, we do not map against them.

4. What improvements (if any) have been made over the past 12 months within your business to the points highlighted in the previous questions?

No structural changes have been made; however stewardship responsibilities have been designated to a specific member of the investment team to facilitate more effective analysis.

The committee continue to meet monthly to improve the working environment and team habits. It is currently working on initiatives to help with climate change, reducing plastic consumption and feeding the homeless.

Important Notice

This document is aimed at Investment Professionals only and should not be relied upon by Private Investors.

Our comments and opinion are intended as general information only and do not constitute advice or recommendation. Information is sourced directly from fund managers and websites. Therefore, this information is as current as is available at the time of production.

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