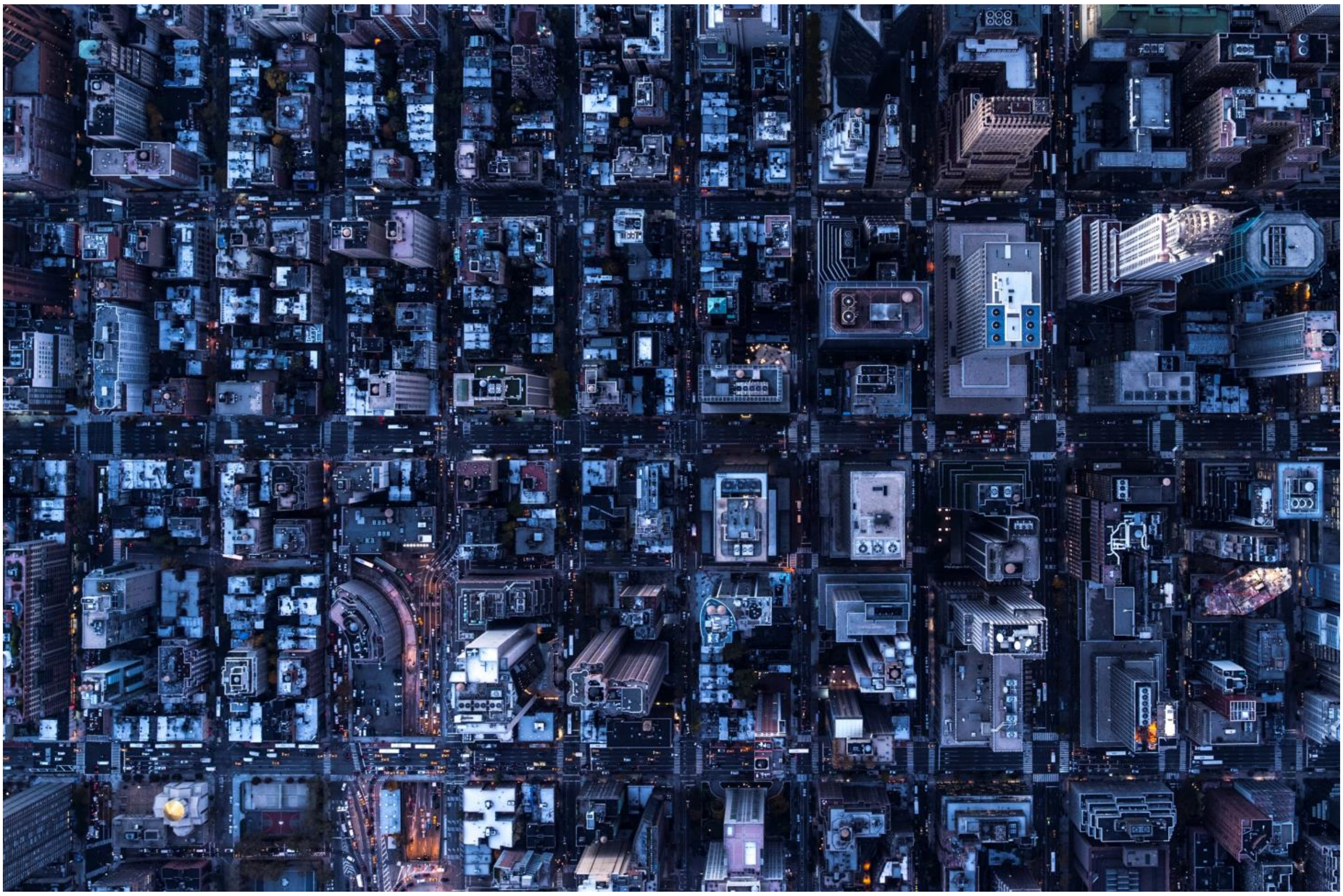
Generation Investment Management Global Equity Quarterly Investor Letter

October 2023



Dear fellow investors

In the past quarter markets were weak. Despite considerable uncertainty we believe this is a great environment for capital allocation.

For many investors the market themes of the past quarter were economic growth and generative artificial intelligence ("AI").

In the past quarter markets were pulled in different directions. On the one hand economic growth in most countries has remained surprisingly strong. There were numerous technological breakthroughs, in particular those linked to generative AI.[1] On the other hand central bankers insist that they have not yet defeated inflation, while in the US bond yields continue to rise.[2] In our view this creates a good environment for capital allocation.

Companies linked to the generative AI revolution have made a substantial contribution to overall returns this year. Other companies in your portfolio have also done well, including some linked to the continued strength in consumer spending across the world – even in the face of high inflation and fears of recession.

Other companies have detracted from returns so far this year. Charles Schwab has dragged, in part as the market continues to deal with the fallout from the collapse of Silicon Valley Bank in the spring, and in part because of worries that clients will move their money from deposits to money-market funds. Some real-estate stocks have also suffered; this is in part because offices in many cities remain underutilised as people continue to spend a large chunk of the working week at home.[3]

In the past year, other stock prices have performed less well than expected for an idiosyncratic reason: the comedown from the COVID-19 pandemic. From 2020 to mid-2022, demand soared for goods and services such as e-commerce, vaccine supplies and diagnostic tests. In our opinion companies gaining from that surge – including portfolio companies such as Amazon, Henry Schein (which makes healthcare products) and Thermo Fisher (which supplies lab equipment) – were always going to face slower revenue growth as the world moved on from the pandemic.

Yet the market focuses largely on year-on-year growth, and in many cases has marked down the share prices of companies facing this 'Covid whiplash' – even if their long-term prospects remain good. In many cases we have spotted opportunities and bought accordingly. In the past year we have added to our holdings in companies that we have followed for years, but where the price was never right.

[1] Consider, for instance, the fact that ChatGPT can now accept images, not just text.

[2] Ten-year rates are currently at their highest since 2007.

[3] Barrero José María, Bloom Nicholas, Davis Stephen J. "The Evolution of Work from Home." Journal of Economic Perspectives (2023)

THE INVESTMENT PROCESS

We believe strongly in the quality of the companies in your portfolio. Our proprietary quantitative measure of Business Quality, derived from our intensive internal research process, is close to an all-time high (60% of the portfolio by weight is marked as "BQ1," the highest possible score). We believe your companies provide goods and services that others find difficult to replicate – and, as a result, are able where necessary to pass on higher costs to their customers. Expressed as a single entity, your portfolio trades at an average of 22 times earnings,[4] with revenue growth in the teens, even stronger earnings growth and an operating free-cash-flow yield of 4.6%. And, importantly from the perspective of sustainability, your portfolio emits carbon emissions at around a quarter of the rate of the benchmark.[5]

In our last letter to you, we said that the second quarter of 2023 would be "remembered as the period when AI truly entered the public consciousness." In the third quarter of 2023, public interest faded somewhat. The press writes about generative AI less than before; Google searches for "artificial intelligence" are 10% off their peak in June.[6] Doubters are, as they always do, raising doubts.[7] It is all part of the classic 'hype cycle' that accompanies new technologies.

We, however, are ramping up our research efforts to understand generative AI. We continue to have (often robust) discussions about the pros and cons of the technology. We are talking daily with your portfolio companies about the risks and opportunities. And we are exploring use cases internally, for instance in terms of helping us understand company earnings calls. We were delighted to host many of you at a roundtable on AI in September, at which we discussed our research process.

SHARPENING OUR RESEARCH FRAMEWORK

We continue to work together to look for new opportunities, and to test and re-test the case for existing investments. We have reduced our Focus List to ~120 names, down from the peak of ~145 names. This has facilitated a deeper focus on our research.

We are proud of our research capabilities – indeed it is the foundation of our investment decisions. A few examples of the type of work we have done over the past quarter are highlighted below.

In August we conducted a large internal exercise on sportswear companies, thinking about what enables brands to stay relevant as consumer tastes change.

We also thought deeply about company culture: is it something you can invest behind? We reviewed academic literature and debated potential definitions of culture as part of a research project. Our broad conclusion from our research is that it is hard to boil culture down to quantitative measures. At the same time, however, we believe companies with a truly great culture – names such as Danaher, MercadoLibre and Henry Schein spring to mind – make for great investments. The only way to identify these companies is to get your hands dirty: knowing the management for years and understanding how they respond to challenges. As long-term investors, this is exactly what we try to do.

In a separate exercise, we analysed our investments over the long run. We were inspired by a paper on long-term shareholder returns, published earlier this year by Hendrik Bessembinder of Arizona State University and colleagues.[8] The paper has some striking results. It found that the majority of stocks underperformed the market from 1990 to 2020. About 2.5% of firms accounted for all of the net increase in stock market wealth.

[4] Earnings refers to T+1 earnings and therefore 2024 figures.

[5] MSCI as at 29 September 2023. Based on carbon intensity, Scope 1 & 2 (tCO2e/$m), weighted average calculation.

[6] Google Trends. See report here.

[7] For instance, see this article here.

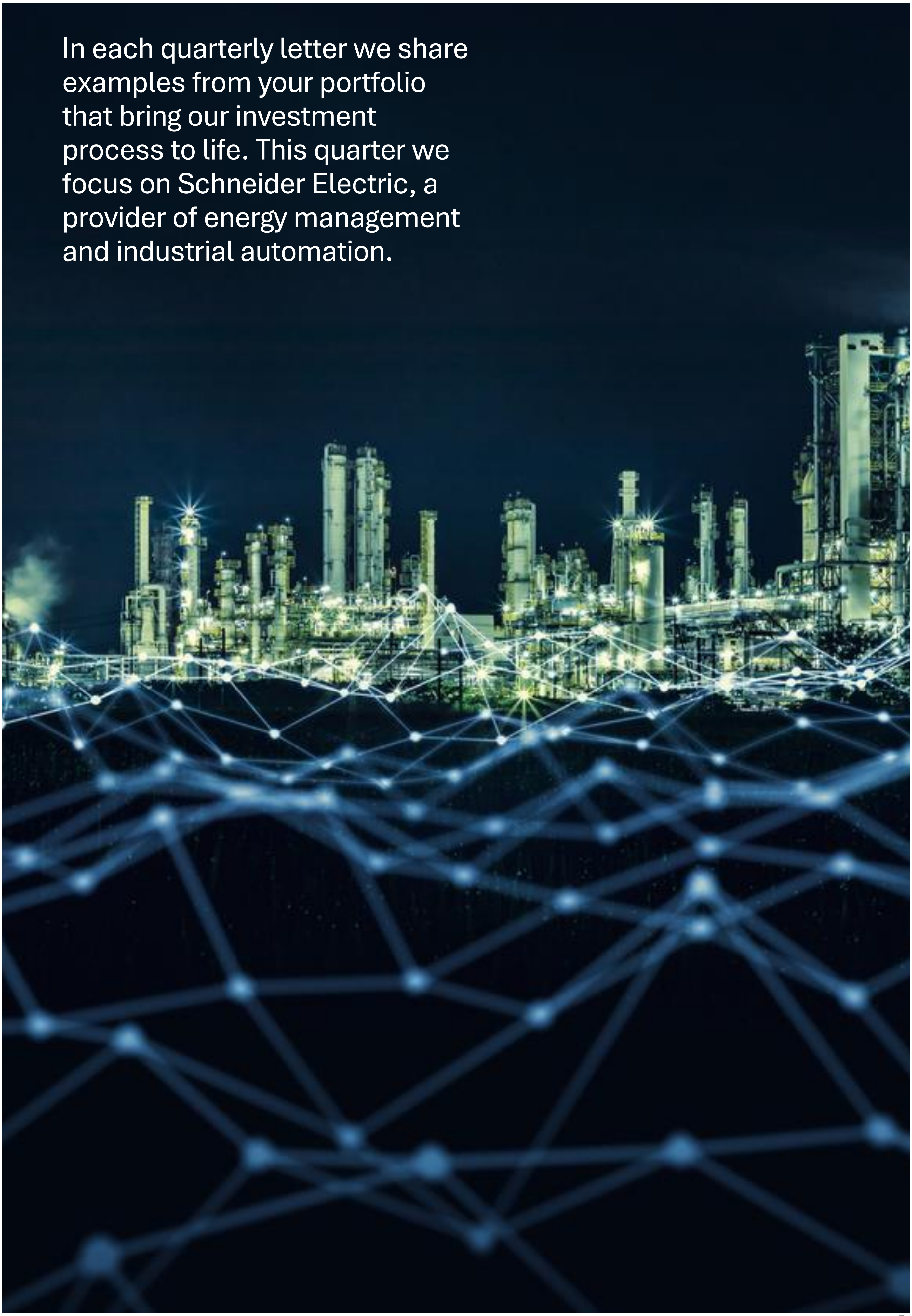
[8] Bessembinder, Hendrik, Te-Feng Chen, Goeun Choi, and KC John Wei. "Long-term shareholder returns: Evidence from 64,000 global stocks." Financial Analysts Journal (2023): 1–31.

The results, according to the authors, “highlight the degree to which successful stock selection can enhance wealth.”

We conducted a similar analysis looking at the period since the inception of the fund in 2005. We found similar results. Happily, we found that 33 Generation assets were in the top 100 stocks as measured by returns, while no Generation stocks were in the bottom 100. Stock-picking, it seems, matters. And that is why our research process is so important.

Thank you for the trust you have placed in us. The total assets under management for the Global Equity strategy as at 30 September 2023 are USD 25.0 billion.

In each quarterly letter we share examples from your portfolio that bring our investment process to life. This quarter we focus on Schneider Electric, a provider of energy management and industrial automation.



Company example

Decarbonisation of the built environment is a crucial step towards achieving net zero. The energy used to operate buildings accounts for 27% of global greenhouse gas emissions.[9] A variety of tools is needed to reduce the world's carbon footprint, including better insulation, electrification, higher efficiency heating and cooling solutions, smarter lighting and electricity controls. Many of your portfolio companies, including Carlisle, Trane and Legrand, offer products and services that facilitate this vital transition.

One of the recent additions in this regard is Schneider Electric (Schneider). A French company, Schneider has expanded globally and is now organised around four hubs: Europe, the Americas, India and China. More than 75% of the company's revenue comes from electrical products – primarily 'low-voltage' (switchboards, circuit breakers, surge protectors, power meters, etc.), supplemented by 'medium-voltage' (substations, transformers, industrial power meters, etc.) and specialist equipment for niche sectors such as data centres (uninterruptible power supply, cooling, specialised surge protection, etc.). The remainder comes from industrial automation hardware, software and systems where Schneider helps clients improve the efficiency of their manufacturing processes.

Electrification of the built environment is both an enabler and a beneficiary of the transition to net zero. For example, heat pumps have a smaller carbon footprint than the gas boilers they replace.[10] Smart controls for domestic appliances, lights, heating and cooling allow more efficient use of energy. Companies like Schneider provide the upgrades of the electrical installations required to enable these appliances and controls. The company also benefits from electrification of other sectors. Higher penetration of electric vehicles, for instance, requires not only the rollout of charging infrastructure but also an upgrade of the electrical infrastructure in most buildings.

OUR INVESTMENT THESIS

We added Schneider to our Focus List in September 2021. Our investment thesis was underpinned by three key considerations.

First, we believe Schneider is a global leader in electrification. The company has a ~30% market share in low-voltage equipment – twice the size of the number two player. Schneider's customers tend to show significant brand loyalty. Low-voltage equipment is often recommended by the electricians who install it, and is typically a low-priced but critical item where the cost of failure is high. In turn, electricians prefer to use products they already know and trust, allowing them to complete more installations per day and reducing the risk of customer complaints. We know these dynamics well through our position in Legrand, which competes against Schneider in certain markets.

Second, the company is well positioned in a number of fast-growth areas. For example, through several acquisitions in the 2000s and early 2010s, Schneider established a robust presence in supplying equipment to data centres, which today represents just under 20% of the company's revenue. Similarly, the company has also built up a strong portfolio of smart products and software offerings, from home automation controls to building management systems and standalone industrial software.

[9] IEA. See report here. The energy used to operate buildings accounts for 27% of carbon emissions related to final energy demand globally.

[10] IEA. See report here.

Finally, we believe that Schneider's end markets will see rapid, sustained growth in the future. Electrification of buildings and industry, more than ever, makes economic sense: it lowers operating costs and results in good returns on investment. Government-supported initiatives are now providing serious incentives for this transition. For example, the EU wants to triple the deep renovation rate of buildings, from 1% to 3% per annum.[11] In the US, the Infrastructure Investment and Jobs Act, the CHIPS and Science Act as well as the Inflation Reduction Act all support significant growth in Schneider's end markets.

We think these changes are likely to have disproportionate benefits for a company like Schneider. For example, a newly built home with rooftop solar panels and battery storage, electrified heating and cooking, as well as home automation for lighting and temperature control has an addressable market for Schneider that is five times bigger than a standard gas-powered home.[12] We believe that the company can more than double its organic growth rate, from ~3% per annum historically to more than 6% per annum for the foreseeable future.

SUSTAINABILITY

Schneider has a long-standing best-in-class sustainability approach that informs its strategy and resource allocation. In the past two decades the company has focused its investments in areas that facilitate a transition to a lower-carbon world, and that benefit significantly from a stronger societal focus on sustainability.

It also focuses on sustainability internally. Schneider tracks a detailed list of sustainability metrics related to its core operations. Crucially, 20% of management's annual bonus and 25% of their long-term compensation are linked to achieving the related targets – a best-in-class approach, in our view. Since 2019, the company has tracked the proportion of revenue that comes from products bringing environmental efficiency to customers. In 2022 this was 72% of group sales. Schneider also aims to reduce global carbon emissions by 800 million tonnes of CO_2 through the use of its products – one of the most significant commitments of this nature amongst companies on our Focus List.

Schneider has taken a leadership role in decarbonising its own operations, along with those of its suppliers. The company has set near- and long-term science based targets consistent with a 1.5°C trajectory. It is one of the companies on our Focus List that is most involved with reducing the carbon footprint of its supply chain, setting ambitious targets for its key suppliers.

MANAGEMENT QUALITY

A key driver behind the company's focus on sustainability was prior CEO and current Chairman Jean-Pascal Tricoire ("JPT"). He led the company between 2006 and 2023, where he laid the foundations for today's Schneider. An active period of portfolio shaping resulted in more than EUR 28 billion spent on more than 30 acquisitions. While not every one of them has been an unqualified success, we believe the net result has left Schneider in an ideal position to benefit from secular growth within its industries. As the portfolio shaping is now largely complete, new CEO and Schneider veteran Peter Herweck is rightly focused on organic growth, harvesting the results of JPT's active M&A work before him.

[11] Buildings Performance Institute Europe. See report here.

[12] Schneider Electric.

Stewardship and engagement

This quarter we signed up to the Science Based Targets initiative. We want our transition plan to be validated in the same manner we expect of our companies. Below we outline what this means for your portfolio, sharing a real-world example of how our expectations around science based targets can affect individual holdings.

COMMITMENT TO THE SCIENCE BASED TARGETS INITIATIVE

In 2020 Generation committed to align your portfolio with net-zero greenhouse gas (GHG) emissions by 2040 or sooner, in line with the goals of the Paris Agreement. We formalised our commitment the following year by submitting this target to the Net Zero Asset Managers initiative, alongside interim targets of achieving 60% science based target (SBT) coverage across the firm's investments by 2025 and 100% coverage by 2030.

This quarter we took a further step in our net-zero commitment. We signed up to the Science Based Targets initiative (SBTi) and now have two years to validate our targets using SBTi's methodology for financial institutions. These targets will cover the emissions associated with Generation's investments and the emissions associated with our business operations.

We joined SBTi in part because we would like our plans to be validated by the gold-standard verification body. However, we also believe that it will be invaluable to go through the same validation process that we expect of our companies. This will, in our view, make our climate engagement stronger and better. We will keep you informed of our progress.

AMAZON AND CLIMATE CHANGE

This is not the only important SBTi-related news of the past quarter. At the end of July, SBTi delisted from the initiative a number of companies that had formally committed to set SBTs but had failed to agree validated targets within the two-year period the initiative allows as well as an additional grace period. One of the companies delisted was Amazon, a portfolio company.

Amazon's journey on climate change – and indeed Generation's journey with them on the issue – is long. Part of our investment thesis, from the inception of our coverage of the company, is that Amazon's e-commerce service is more carbon-efficient than traditional 'bricks and mortar' retail. This was the subject of a Generation Insights piece in 2020.[13] In addition, we have always felt the company's scale offered huge potential for positive, systemic impact on the climate.

Our early experience of Amazon on climate, however, was frustrating. The company did not disclose the information we wanted to see on its climate impact, nor did it articulate a plan to reduce emissions.

2019 saw change. Amazon committed to reach net-zero emissions by 2040 – ten years earlier than the 2050 date for global net-zero emissions implied by the Paris Agreement. The commitment was developed together with Christiana Figueres, who was executive secretary of the United Nations Framework Convention on Climate Change at the time the Paris Agreement was negotiated. In addition, Amazon worked to build a movement of companies also committed to net-zero emissions by 2040 called The Climate Pledge. Generation itself became a signatory in 2021.

Amazon's implementation work began straight away. The company rapidly became the world's largest corporate purchaser of renewable energy – an essential step for the decarbonisation of Amazon's cloud business, AWS – and is on track to power its entire operations with 100% renewable energy by 2025. For its retail business, Amazon formed a partnership with Rivian to put 100,000 electric delivery vehicles on the road by 2030.[14] It is also working on harder areas of decarbonisation – including heavy-duty trucking and the steel and cement that go into building its fulfilment centres.

[13] See Insights here.

[14] Amazon. See article here.

Generation has always argued, however, that Amazon needed to supplement its own Climate Pledge with near- and long-term targets independently validated by SBTi. This would provide assurance that Amazon's decarbonisation plan was indeed aligned with a 1.5°C pathway and encompassed the appropriate categories of emissions.

It is therefore a matter of significant concern that Amazon has not managed to set a science based target with SBTi. We are also concerned that, despite sustained engagement, Amazon still does not disclose emissions associated with the production of the goods it purchases and sells on its platform (its 'first-party' sales as opposed to 'third-party' sales made by other sellers on the platform). We escalated our engagement on this disclosure requirement earlier in the year, voting against the re-election of Jamie Gorelick, the non-executive director on Amazon's Board who chairs the Board committee responsible for sustainability. Our confidence in what Amazon could be – a leading driver of the net-zero transition – remains intact. But we need to see the proof.

CLIMATE WEEK NYC

Our Director of Engagement, Edward Mason, attended Climate Week NYC this year for the first time alongside our Chairman, Al Gore. It was a heady week, with a number of set-piece events, including the Bloomberg Transition Finance Action Forum, The Climate Pledge Summit and the launch of the final recommendations of the Taskforce on Nature-related Financial Disclosures (TNFD). We were encouraged to see the point repeatedly made that the world will not meet its climate targets unless we halt nature loss this decade, and that climate and nature are two sides of the same coin.

Such is the draw of Climate Week that it offers a productive opportunity for private discussion. For the first time, Generation organised an event itself – a convening of chief sustainability officers from our network, from both inside and beyond the Global Equity Focus List, organised in conjunction with our Growth Equity colleagues. This was a chance to hear what is going well and not so well in the Sustainability Revolution, and to deepen the relationships through which these obstacles can be overcome. The event felt integral to our mission. We have no doubt that it will be repeated.

Portfolio metrics[15]

We provide select Environmental, Social and Governance (ESG) as well as Financial (F) metrics, which we believe best represent the data we use to inform our Business and Management Quality process, out of those currently available for the majority of the portfolio and benchmark. While they are best viewed as an output of our process rather than direct inputs, they also provide us with an additional lens to view the portfolio and stimulate internal discussion.

As well as measuring the portfolio against a benchmark, we are starting to measure it against thresholds too. This is because your portfolio might beat its benchmark in regard to one of the criteria below, but this still might not achieve what is needed for a truly sustainable society. For example: your portfolio has a lower gender pay gap score than the benchmark, but really we want the portfolio, and society more broadly, to move towards eliminating the gender pay gap completely. Therefore, in this situation, our threshold for success would be zero.

E

	Portfolio	Benchmark	Threshold
Carbon intensity, Scope 1 & 2 (tCO_2e/\$m)[16]	**23**	114	
Carbon intensity, Scopes 1–3 (tCO_2e/Eur m)[17]	**489**	870	
SBTi target validated (portfolio weight %)[18]	**43%**	40%	100%
SBTi committed but target not set (portfolio weight %)[17]	**23%**	13%	
Implied temperature rise (Scopes 1–3, degrees Celsius)[18]	**1.7**	2.5	1.5

S

	Portfolio	Benchmark	Threshold
Percentage of employees would recommend the company to friend[19]	**73%**	72%	
Effective tax rate[20]	**20%**	23%	
Commitment to a living wage[21]	**26%**		100%
Gender – female Board % (weighted average)[22]	**34%**	33%	40–60%
Gender – female executives % (weighted average)[23]	**24%**	24%	40–60%
Gender pay gap (simple average)[24]	**14%**	18%	0%
Advanced total race/ethnicity score (weighted average)[25]	**49**	43	
Pay linked to diversity targets (simple average)[17]	**11%**	6%	

[15] As at 18 September 2023. This information may no longer be current. To the extent not sourced from Generation, it is from sources believed reliable. However, Generation does not represent that it is accurate or complete and it should not be relied upon. It should not be deemed representative of future characteristics for the portfolio. For definitions of each metric, please refer to the appendix.
[16] Source: MSCI, weighted average calculation. As at 29 September 2023.
[17] Generation analysis based on data from the Science Based Targets initiative.
[18] Source: MSCI. As at 29 September 2023.
[19] Source: Glassdoor.
[20] Source: CapIQ. This metric is not shown as above or below benchmark, as one cannot deduce from the number alone whether a company's effective tax rate is a positive or negative; company profits are taxed in a range of jurisdictions with a range of tax rates and permissible deductions. For comparison, the global average Effective Average Tax Rate (EATR) published by the OECD in November 2022 was 20.2%. This was calculated on the basis of data for 2021 from 77 jurisdictions.
[21] Source: Denominator. Coverage is poor for this metric and not adequately representative of the benchmark, therefore no comparison is made.
[22] Source: Denominator.
[23] Source: Denominator. This is a Denominator calculated data point because there is no universally agreed definition of an 'executive' and therefore without a standard method one company's disclosure might represent something significantly different to another's.
[24] Source: Denominator. This metric is a simple average of gender pay gap data disclosed by companies. Coverage is poor and pay gaps are not measured in a consistent way. Nonetheless, we think it is important to show the data available on this metric.
[25] Source: Denominator. This metric is a score out of 100 that measures the company's total performance on racial/ethnic diversity across the Board, executive, and company as a whole. Comparison to background race/ethnicity is calibrated to the country of operations: a company with 100% Caucasian leadership in the US scores less than a company with same ratio in Denmark, due to the different race/ethnicity composition of the background population (higher % of Caucasian in Denmark).

G

	Portfolio	Benchmark
Percentage of shares owned by executives (median)[26]	**0.19%**	0.09%
Independent Board (weighted average)[27]	**77%**	79%
Independent chairman or lead non-executive director (simple average)[28]	**93%**	72%
Board not entrenched (simple average)[28]	**79%**	82%
All non-executive Board members on no more than four public company Boards (simple average)[28]	**98%**	92%
Equal shareholder voting rights (simple average)[28]	**90%**	90%
Independent compensation committee (simple average)[28]	**88%**	71%
Companies with regular 'say on pay' votes (simple average)[28]	**98%**	79%
Fewer than 10% votes against executive pay (simple average)[28]	**57%**	73%
Pay linked to sustainability targets (simple average)[28]	**60%**	39%

F

Three-year revenue growth (weighted average) [27]	**17%**	13%
Gross margin (weighted average)[27]	**54%**	50%
Cash flow return on invested capital[28]	**13%**	8%

Data in green: relative performance above benchmark. Data in red: relative performance below benchmark.

[26] Source: CapIQ.
[27] Source: MSCI. As at 29 September 2023.
[28] Source: Credit Suisse Holt.

The firm

Generation has ambitious impact initiatives in addition to our core investment work. We know that to bring about the transformative change required over this decade, we must also motivate others.

THE SUSTAINABILITY TRENDS REPORT

This quarter Generation published its seventh annual Sustainability Trends Report. The report is meant to answer a simple question with complex implications: In the transition to a low-emissions economy, where do we stand? Across eight chapters, the report demonstrates the reasons for hope and progress made whilst underlining the need for ever larger and faster change to achieve the transition needed to reach a net-zero society. We encourage you to take a look.

One of the chapters, Land & Food, highlights the interlinked crises of climate and nature. Generation believes the case for investing in nature is clear. Agriculture, forestry and other land use (AFOLU) account for 23% of GHG emissions today, according to the Intergovernmental Panel on Climate Change. Natural climate solutions can deliver close to 7 gigatons of CO_2 abatement per year, enough to achieve around one third of the 2030 net emissions reduction targets required by the Paris Agreement.[29]

NATURAL CLIMATE SOLUTIONS STRATEGY

In September, Just Climate, an investment business established by Generation to address the net-zero challenge at scale, announced its expansion to natural climate solutions by establishing a dedicated investment strategy and opening an office in Brazil. Just Climate's Natural Climate Solutions (NCS) strategy will focus on avoiding emissions from AFOLU, as well as sequestering emissions through restoration of soil, forests and wetlands.

Eduardo Mufarej will become the leader of this global strategy in the role of Co-Chief Investment Officer and Head of Natural Climate Solutions at Just Climate. He has more than 25 years of experience as an investor, executive and entrepreneur, including in private equity and climate solutions. The NCS strategy complements Just Climate's existing Industrial Climate Solutions (ICS) strategy, led by Co-Chief Investment Officer and Head of ICS, Shaun Kingsbury CBE.

[29] "Why investing in nature is key to climate mitigation." McKinsey Sustainability (2021). Available here.

FIRM AND TEAM UPDATE

As at 30 September 2023, the Generation team is 131 and assets under management and supervision total approximately USD 42.6 billion.[30,31] The Just Climate team comprises 31 people.

Kaushik Suresh has been invited to become the co-Portfolio Manager of our Asia Equity strategy. Kaushik has been a part of the Asia Equity team since 2019 and has worked closely with Michael McBrinn, his co-Portfolio Manager, during this time. The transition of Kaushik to the co-Portfolio Manager role happened over the summer and is now complete. Vikas Jain, the former co-Portfolio Manager of our Asia Equity strategy, now leads our consumer sector coverage as part of the Global Equity team.

Ruth Kent joined Generation as a Partner in April, taking on the role of Head of Control, Technology and Finance. The heads of each of these departments now report to Ruth. We are pleased to announce that as of 5 September 2023, Ruth has joined our Management Committee. We look forward to Ruth's contributions to our Management Committee and Generation more broadly.

Thank you for the trust you have placed in us.

Miguel Nogales,
co-CIO

Mark Ferguson,
co-CIO

[30] Includes subscriptions and redemptions received by the last business day of the quarter but applied the first business day after the quarter-end.

[31] Assets under management as at 30 September 2023 are USD 32.1 billion and assets under supervision ("AUS") as at 30 June 2023 are USD 10.5 billion. AUS form part of our Private Equity strategy and include assets where Generation sourced, structured and/or negotiated the investment and in relation to which it provides certain ongoing advisory services for a fee.

Appendix

Portfolio metrics: definitions

FACTOR	METRIC	SUMMARY DESCRIPTION
Carbon intensity, Scope 1 & 2 (tCO_2e/$m)	Weighted average	Aggregate tonnes of GHG emissions (expressed as CO_2 equivalent) per USDm of company revenue.
Carbon intensity, Scopes 1–3 (tCO_2e/Eur m)	Weighted average	Aggregate tonnes of GHG emissions (expressed as CO_2 equivalent) relative to the company's most recent sales in million Euro. Scope 3 emissions are estimated.
SBTi target validated (portfolio weight %)	Percentage	The percentage of companies in the portfolio with a validated science based target.
SBTi committed but target not set (portfolio weight %)	Percentage	The percentage of companies in the portfolio that have committed to setting a science based target with the Science Based Targets initiative but have not yet had their target validated.
Implied temperature rise (Scopes 1–3, degrees Celsius)	Degrees Celsius	A portfolio level number in degrees Celsius demonstrating how aligned the companies in the portfolio are to global temperature goals. This metric uses an aggregated budget approach: it compares the sum of 'owned' projected GHG emissions on a Scope 1–3 basis against the sum of 'owned' carbon budgets for underlying holdings. Scope 3 emissions are estimated.
Percentage of employees would recommend company to friend	Average	Percentage of participating employees who would recommend the company to a friend. This metric may warrant caution where a small percentage of the workforce report.
Effective tax rate	Weighted average	The effective tax rate is calculated as the company income tax expense divided by earnings before interest and tax (EBIT) including unusual items. We show a three-year average for smoothing purposes and exclude significant outliers.
Commitment to a living wage	Percentage	The percentage of companies in the portfolio that have committed to a living wage. A living wage is defined by the Global Living Wage Coalition as the remuneration received for a standard workweek by a worker in a particular place sufficient to afford a decent standard of living for the worker and their family. Elements of a decent standard of living include food, water, housing, education, health care, transportation, clothing and other essential needs including provision for unexpected events.
Gender – female Board	Weighted average	A weighted average calculation of the percentage of female Board directors on each of the Boards in the portfolio.
Gender – female executives	Weighted average	A weighted average calculation of the percentage of female executives at each of the companies in the portfolio. There is no standard definition of an executive and companies can define the executive level in many different ways. Denominator, our data provider, works to calculate the data point based on standard definitions.
Gender pay gap	Average	The average salary gender pay gap across companies that disclose this metric within the portfolio. The pay gap data used is calculated by each company without any modifications applied. Calculation methods can vary between companies and jurisdictions.
Advanced total race/ethnicity score	Weighted average	This metric is a score out of 100 calculated by our data provider that measures the company's total performance on racial/ethnic diversity across the Board, executive and company as a whole. Comparison to background race/ethnicity is calibrated to the country of operations: a company with 100% Caucasian leadership in the US scores less than a company with same ratio in Denmark, due to the different race/ethnicity composition of the background population (higher % of Caucasian in Denmark).
Pay linked to diversity targets	Percentage	The percentage of companies where there is evidence of a commitment to linking executive pay to diversity and inclusion targets. The metric is calculated as: number of companies where evidence exists divided by the total number of companies in the portfolio.
Percentage of shares owned by executive	Median	Executive share holdings as a percentage of shares outstanding. We show the median for portfolio and benchmark, as the average may be impacted by some companies (often founder run) with large executive ownership stakes.
Independent Board	Weighted average	Board independence is inferred by MSCI. The following categories of director are not regarded as independent: current and prior employees, those employed by predecessor companies, founders, those with family ties or close relationships to an executive, employees of an entity owned by an executive and those who have provided services to a senior executive or the company within the last three years. The compensation of a non-executive chair must not be excessive in comparison to that of other non-executives and must be less than half that of the named executives. Where information is insufficient, the director is assumed to be non-independent. For the Board to be classified as independent, a majority of the Board members must be classified as independent.

FACTOR	METRIC	SUMMARY DESCRIPTION
Independent chairman or lead non-executive director	Percentage	Percentage of companies that have an independent chair or, where the chair is not independent, an independent lead director.
Board not entrenched	Percentage	Percentage of companies without an entrenched Board. Board entrenchment is inferred by MSCI using a range of criteria including: >35% Board tenure of >15 years, five or more directors with tenure of >15 years, five or more directors >70 years old.
All non-executive Board members on no more than four public company Boards	Percentage	Percentage of companies with no over-boarded non-executives. The threshold is where a Board member serves on five or more public company Boards.
Equal shareholder voting rights	Percentage	Percentage of companies that have equal voting rights.
Independent compensation committee	Percentage	Percentage of companies with independent compensation committee. Please see above for the independence criteria used.
Companies with a regular 'say on pay' vote	Percentage	The percentage of companies in the portfolio that have a policy in place to ensure that a firm's shareholders have the right to vote on the remuneration of executives on a regular basis.
Fewer than 10% shareholder votes against executive pay	Percentage	Percentage of companies that received less than 10% shareholder votes against executive pay at the most recently reported annual shareholder meeting. Only applies to companies that have a 'say on pay' vote.
Pay linked to sustainability targets	Percentage	The percentage of companies where executive remuneration is linked to sustainability targets. This metric is based on the company's own reporting. It considers whether one or more sustainability metrics are used to determine annual and/or long-term incentive pay and does not consider the effectiveness of those metrics.
Three-year revenue growth (annualised)	Weighted average	Aggregate (weighted) three-year revenue growth rate to the last reported fiscal year. Revenue growth is not adjusted for acquisitions and disposals.
Gross margin	Weighted average	Aggregate (weighted) gross margin for the last fiscal year. Gross margin is the difference between revenue and cost of goods sold divided by revenue.
Cash flow return on invested capital (CFROI)	Weighted average	CFROI (cash flow return on investment), a (trademarked) valuation metric.

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