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GENERATION IM GLOBAL EQUITY QUARTERLY INVESTOR LETTER

October 2021

DEAR FELLOW INVESTOR

Thank you to the many of you who took the time to complete our recent client survey. We appreciated your thoughtful comments and reflections and we look forward to sharing and implementing some changes in the coming months that will help us to better serve you, our client community.

A prevailing piece of feedback was your interest in learning more about our investment process and the portfolio companies we invest in on your behalf. One of the ways we're responding to this request is by changing the format and content of the quarterly investor letter. Going forward, you can expect to see a clearer layout. Each letter will start with a reflection on our investment process activity (generally a particular topic or project) and a company example that hopefully brings to life our thinking around the investment thesis in more detail. We will then discuss our engagement activity, portfolio ESG metrics and end with some observations around broader advocacy and sustainability issues, as well as an update about the firm.

As ever when trialling something new, we would be grateful to know if this change actually meets your expectations, so please do reach out to your account manager with any further thoughts on how we can continue to improve our outreach to you.

PORTFOLIO UPDATE

Each quarter, we will continue to include a more specific quarterly commentary regarding the portfolio itself (buys/sells/attribution etc.) in the Global Equity portfolio review report, which is included alongside this letter.

The total assets under management for the Global Equity strategy as at 30 September 2021 are USD 31.67 billion.¹

¹ Includes subscriptions and redemptions received by the last business day of the quarter but applied the first business day after the quarter-end.

IMPLIED TEMPERATURE RISE

What climate future are we aligned with? This is a question we constantly ask ourselves at Generation.

'Implied Temperature Rise' (ITR) tools provide a single 'degrees Celsius' number that indicates whether a portfolio is aligned with the rapid climate action required for a 1.5 degree world – or with the totally unsustainable status quo. The transition to net zero is complicated, and ITR inevitably misses some of the nuance, but the idea is that it will provide a steer for portfolio managers and clients alike.

We have been very active in external discussions on ITR. We work with the COP26 Private Finance Hub and the Portfolio Alignment Team on emerging best practice and the strengths and weaknesses of different methodologies – the latest report will be published by the Task Force on Climate-related Financial Disclosures (TCFD) on 14 October. Our Senior Partner David Blood leads the relevant workstream for the Glasgow Financial Alliance for Net Zero – the umbrella vehicle for finance industry firms of all kinds that are committed to net zero, which of course includes Generation. The goal is to help shape the evolving norms about portfolio alignment tools and how they should be used by investors.

We've also been experimenting with ITR internally for some time. You may recall that we included an analysis in our Q1 2020 letter. This was conducted by Vivid Economics and was based on Scope 1 only (i.e. included only the direct emissions of companies, not their electricity use or indirect emissions in their value chains). It found that our Global Equity Fund was aligned with a 1.5 degree world.

In recent months we have discussed the latest developments in ITR with many different data providers. This led us to explore a new tool being developed by MSCI. We had actually planned to share the results with you last quarter, but – in a sign of how approaches are still evolving – MSCI decided to revise their methodology, in part due to recommendations we had made to them via the processes we mention above.

MSCI are still rolling out their new ITR tool, but they have kindly allowed us to pilot it while it is still in development. Please, therefore, take the findings provided in this discussion with due caution. Indeed, we think these numbers are likely to move around a lot as methodologies are tweaked, and the different approaches used by providers will certainly give quite different results.

Before we turn to the results, here are four lessons that shine through from our experience:

- **ITR is a work in progress, and tools continue to evolve.** As we have already noted, the ITR tool is still being refined by MSCI and other providers are in a similar process of updating and refining their approaches as experience is gained across the market. In practical terms, we've had to work through some challenges like missing datapoints and updates to numbers, which meaningfully change the results. We will continue to explore different tools and engage in methodology development.
- **It's an indicative result, not a precision tool.** The MSCI method is simple and transparent – two benefits that encouraged us to work with them for this analysis – but it is a pretty crude depiction of how emissions will evolve in future. For instance, it assumes that company emissions grow by 1% per year, unless the company sets targets. Under the hood, you can find some quirky results. For diverse portfolios this will come out in the wash, but we believe it will lead to bias for concentrated portfolios.
- **Coverage and resolution is limited.** The quality of Scope 3 data and the ability to model the future using this data is currently very challenging. There is also limited sectoral detail. As a consequence, for example, semiconductor companies score very poorly. This is because the calculation imagines what would happen to temperatures if the entire global economy was as carbon-intensive as a semiconductor company (the upshot is that capital-light companies get much better scores than industrials, for instance).
- **Targets make a big impact.** MSCI take account of company GHG targets. This has a large impact on the results, meaning that target-setting is the quickest way to improve the temperature score. This will place significant focus on target-setting in the engagement strategies of any firms that use ITR to report progress on climate. We'll need to make sure that there is also sufficient focus on near-term emissions cuts.

Now to the results for your Global Equity portfolio. These are the headline numbers, providing a calculation for different scopes:

SCOPE	ITR
S1	3.03
S2	1.81
S3	2.01
S1+2	2.04
S1+2+3	2.01

The Science Based Targets initiative recommends reporting both 'Scope 1+2' and 'Scope 1+2+3' results, which we show in bold, as well as calculations for the separate Scopes 1, 2 and 3.

This is how we interpret these figures:

- **Using this method, your portfolio is aligned with 2 degrees, meaningfully better than benchmark.** Both aggregate figures are just above 2 degrees for your portfolio. In contrast, for the benchmark MSCI World, the figure for S1+2+3 is 2.84 degrees. This suggests that MSCI World is aligned with the Climate Action Tracker 'current policies' scenario (2.7 - 3.1 degrees), although the methodologies used are different. Needless to say, 3 degrees of warming would be devastating for the planet.
- **We need to go further and faster.** Generation is committed to net zero-aligned portfolios by 2040. Globally, moving to 1.5 degrees is consistent with net zero in 2050. There is a lot of work to do to move your portfolio from 2 degrees to 1.5 degrees and to meet our own commitment. Later in October, we will release the approach we are taking for disclosing on and tracking towards our 2040 commitment, under the Net Zero Asset Managers initiative. The emissions intensity of your portfolio is one quarter that of the benchmark, as you can see on page 9. That Generation still needs to go further and faster on emissions reduction highlights the scale of the global challenge.
- **The results for S1 are disappointing.** We think the methodology is harsh on some companies manufacturing hardware in particular. Semiconductor companies and several industrials companies score poorly for instance. Some companies' Science Based Targets appear not to have been incorporated by MSCI, so the scores will come down when this is updated. But whichever way you cut it, it's uncomfortable that the result is above 3 degrees. It's also striking that the figure is so much higher than the Vivid calculation. This simply reflects different assumptions and methods, highlighting how much these tools are still evolving.
- **For the S1+2+3 score, Scope 3 largely shapes the final outcome.** The vast majority of emissions for portfolio companies lie in Scope 3 and the methodology is weighted accordingly. While companies also need to decarbonise their own operations, what happens in the value chain will determine the success or failure of companies in the portfolio, from a climate action perspective. At the same time, we have less confidence in the quality of Scope 3 data at present.

All said, we are not satisfied with this result and will make lowering the ITR of your portfolio the critical thrust of our future engagement with companies.

COMPANY EXAMPLE

In each quarterly letter, we aim to share portfolio examples that bring our investment process to life, across our five sector teams: Consumer, Financials, Healthcare, Industrials and Technology. This quarter we focus on the healthcare space, specifically the diversified hospital supplies businesses Becton, Dickinson and Company (BD) and Baxter International (Baxter). We will usually aim to highlight one company per letter, but given the affinity of BD and Baxter, we thought it worth discussing them together.

The healthcare sector has historically had high exposure in the Global Equity Fund. What determines our focus areas within healthcare? As with all our coverage, there are two key factors: evidence of providing products or services that society needs more of, and overall system positive effects. We believe companies with sustainable business models, which offer solutions to creating a more equitable, efficient and effective society, are more likely to thrive in the long term. We first explored these two dimensions within a healthcare context in a 2004 roadmap early in our firm's history. While we continue to iterate our thinking and stay close to developments, this fundamental 'Healthcare Roadmap' is largely unchanged, continuing to shape where we focus our time.

The healthcare sector benefits from several secular tailwinds that lead to increased spending on health in many countries.² For instance, societies are ageing rapidly and chronic diseases like diabetes and obesity are rising in the mix.³ On average, human life expectancy globally has increased by three to four months every year over the last several decades.⁴ Furthermore, the amazing pace of innovation has led to increased spending in certain categories (e.g. on immuno-oncology medicines to treat cancers) while also creating pressures in other parts of the system.

While these tailwinds offer a positive investment backdrop, we also need to consider the complex realities of today's healthcare systems. The US healthcare system, in particular, is an interesting example of the complicated interplay of incentives, business dynamics and government influence/regulation that lead to often puzzling outcomes. On the one hand, the leading academic medical centres in the US offer the latest technologies and the very best care in the world. On the other hand, the country as a whole often fails to offer basic healthcare services for much of its population. For instance, the US is among a handful of countries where maternal mortality has increased in the last 25 years, bucking an almost universal trend of improvement everywhere in the world,⁵ while life expectancy has actually gone down in the last five years.⁶ To sum up, the US spends a lot on healthcare but in return gets very poor outcomes.

There are many factors to blame for this paradox. The lack of universal healthcare access, the misaligned incentives of physicians and hospitals, as well as the vested interests of incumbent healthcare systems and insurance companies, are some of the factors that are often cited. In our comparison of various Western healthcare systems, we see that the US does consume slightly more in healthcare products and services per capita than much of the rich world, but the real difference is in the prices paid for those products and services. The most striking factor that distinguishes the US healthcare system is the bloated and complex administration layer required to stitch together a fragmented network of providers and payers of healthcare, which naturally pushes up the cost of healthcare delivery. There are about 35 million people employed in healthcare but only five million of them are doctors and nurses directly involved in clinical care.⁷

The cost malaise afflicting the US healthcare system, in economic parlance, is dubbed 'Baumol's cost disease'. This theory suggests that growth in labour productivity in certain parts of the economy (like what we have experienced with many manufacturing-oriented sectors over the past several decades) inevitably pushes up the cost of more labour-intensive, services-heavy sectors that experience much lower levels of productivity increases (see Figure 1). In simple terms, a world of rapid technological progress leads to falling costs of manufactured goods like cars, smartphones and T-shirts while simultaneously pushing up the cost of labour-intensive services like schooling, childcare, fitness trainers and, importantly for this discussion, healthcare.

² [Health spending, OECD data](#)

³ [Nature paper, 2020](#)

⁴ [Our World in Data](#)

⁵ Harvard Business Review, 2019. ['The Rising U.S. Maternal Mortality Rate Demands Action from Employers'](#)

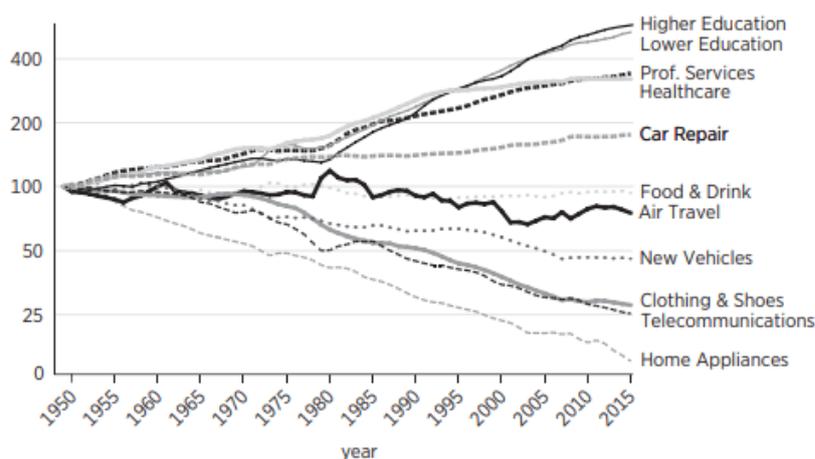
⁶ [Our World in Data](#)

⁷ Generation internal research

We have long been aware of this dynamic influencing the world of healthcare, and it has guided how we invest in the space. If the problem is the ‘price’ of healthcare, businesses that rely on or are perceived to be reliant on pushing up healthcare costs are unlikely to be the solution. That is why we have stayed away from hospitals and healthcare services organisations as well as insurance companies, as we think their interests are misaligned with a healthcare system that offers high-quality, cost-effective healthcare that is accessible by all. In a similar vein, we have historically stayed away from most pharmaceutical companies due to the risk of regulation and patent cliffs that often cause these businesses to run hard to stay still. Furthermore, we have not been keen to accept the binary risk in your portfolio that often surrounds the outcome of clinical trials, as we have had no edge in that regard.

In recent years, our thinking has also been refined by collaboration with our colleagues in Growth Equity, who have used the same mindset to look for smaller, private businesses that are changing the current healthcare landscape. These growth-stage businesses offer new business models and leverage technology to improve productivity and increase efficiency in healthcare delivery. Recent private market investments include AlayaCare, Sophia Genetics (prior to its IPO) and Elation Health. Genomics, in particular, is an area where we see opportunities in which the Global Equity Fund can invest – a field transforming preventative and tailored medicine.

Figure 1. The Real Price of Selected Goods and Services, 1950-2016



Note: Prices normalized to 100 in 1950. Ratio scale.
Source: Bureau of Economic Analysis (BEA), "National Income and Product Accounts."

BAXTER AND BD

Two businesses we believe exemplify our thinking around healthcare are Baxter and BD. These are businesses with long histories, which provide essential healthcare products and services used by every hospital around the world, and do it in a manner that is not a burden on the system. Baxter’s main forte is manufacturing sterile fluids in large quantities for intravenous injections (such as a bag of intravenous saline), which the company has leveraged to branch into adjacent product categories. BD, on the other hand, focuses on ‘dry’ consumables and produces everyday supplies like needles and syringes in large quantities. BD has diversified outside of this core medical supplies category into life science instruments and reagents as well as other medical devices.

Healthcare supplies is a space we know well, due to our original roadmap work highlighting its potential to yield high-quality businesses. In our view, Baxter and BD, similar to several medical device companies we also cover, are attractive businesses offering steady, predictable growth. There are significant barriers to entry for new competitors which struggle to replicate the scale, breadth and reach of these companies. We also like the fact that these businesses are less impacted by changing regulation and shifting reimbursement patterns on the one hand and rapid technological change on the other — all factors that keep us away from the pharmaceutical space, as we discussed above. The products offered by these companies are, in a nutshell, humble, low-cost items without which modern

medicine cannot be practised. On the few occasions that these products have been in short supply, it has required a major effort on the part of industry, government, hospitals and clinicians to overcome the problem, illustrating the critical role that these products play in the world of healthcare.⁸

The importance of both companies has also been clear during the COVID-19 pandemic. BD rapidly scaled up the production of tens of millions of rapid antigen tests that detect the presence of the COVID virus in fifteen minutes. It has also been instrumental in producing over two billion needles that have been used by all the vaccine manufacturers.⁹ Baxter, on the other hand, has made an essential contribution by rapidly scaling up the production and deployment of equipment used to treat the acute kidney disease that seriously ill COVID patients often suffer from, thereby directly saving tens of thousands of lives. In addition, Baxter has provided its expertise in filling and packaging COVID vaccines in vials to several manufacturers, helping these vaccines get to market faster.

We have been investors in BD for some time. Baxter was interesting for Generation from an investment perspective more recently due to its impressive turnaround following the company's split, under a new, energised management team driven by a more aligned set of incentives. The decline in both businesses' stock prices during the pandemic offered an opportunity to increase our exposure to them. As hospitals were busy treating COVID patients, they had to reduce routine hospital admissions and surgical procedures, thereby affecting demand for these two companies' products. Trends in hospital admissions are improving and, as the pandemic recedes, we believe much of the care that has been deferred will come back and the demand environment for these businesses will normalise.¹⁰

From an engagement perspective, we have had productive conversations with both companies, covering climate disclosures and action, diversity and several other topics. We have been supportive of Baxter's efforts to improve product quality and rekindle innovation in its product categories. We have also had productive conversations with the company on diversity, where, despite gender parity for the business overall, there is scope for improvement in its senior ranks. We discuss our diversity engagement programme in the following section.

In the case of BD, over fifteen years of dialogue has fostered a relationship such that we believe the company considers us as a critical thought partner on sustainability. For example, we encouraged management to sign the Science Based Targets initiative's Business Ambition for 1.5 degrees pledge, which commits the company to reduce its Scope 3 emissions in line with 1.5 degree scenarios by 2050.¹¹ BD signed last month, building on its existing commitment to a 46% reduction of its Scope 1 and 2 GHG emissions by 2030, and to be carbon neutral across its direct operations by 2040. One point of feedback from BD we find most encouraging is how our support has been used over the years as an internal push to add new critical-needs products to its portfolio. This includes a device that helps childbirth in the developing world and a rapid HIV testing system.^{12,13}

⁸ [FDA release, 2018](#)

⁹ [BD press release, 2021](#)

¹⁰ [Trends in Overall and Non Covid Hospital Admissions, KFF](#)

¹¹ [BD Signs Business Ambition For 1.5°C To Reach Net Zero Emissions, 2021](#)

¹² [BD press article](#)

¹³ [BD press release, 2018](#)

STEWARDSHIP AND ENGAGEMENT

DIVERSITY ENGAGEMENT FRAMEWORK

The team had extensive discussions over the summer about how we can further step up our engagement on diversity. Alongside climate change, this has long been an engagement issue we have pursued systematically across the Focus List. While we have seen some companies make significant progress, in aggregate the pace of change has not been adequate. The unequal impacts of the COVID-19 pandemic, the murder of George Floyd and the ever-growing sense of urgency about addressing structural inequalities have created a moment where we can, and should, push our dialogue with companies further.

We believe the business case for diversity, equity and inclusion (DEI) is now unequivocal. While it is challenging to isolate diversity as a performance factor and to prove that diversity leads to better financial performance, there are a number of studies that give us confidence this case can be made. The research we find particularly compelling is on *how* diversity benefits decision-making. Work by Professor Scott Page at the University of Michigan has shown that, for complex tasks, a diverse group displaying different perspectives outperforms a group composed of experts who are non-diverse and like-minded.¹⁴ James Surowiecki, author of 'The Wisdom of Crowds', has shown that diversity contributes not only by adding different perspectives to the group, but also by making it easier for individuals to say what they really think, thereby facilitating collectively wise decisions.¹⁵

Following our review of the latest research, conversations with experts and team discussions, we constructed a new DEI engagement framework that we will deploy with our Focus List companies. We rejected adopting an engagement framework based on a one-size-fits-all approach, because we did not want to foster a compliance mentality. We decided our core ask should be that, alongside disclosing comprehensive DEI data, companies should publish their own ambitious plans for improvement.

We will engage with companies on the basis of clear ideas about what disclosures and plans should include. We believe disclosure should cover the gender and racial/ethnic diversity of the board, executive committee, key managerial and professional populations and the workforce as a whole, as well as information on DEI policies and programmes in operation. We expect DEI plans to be championed by the CEO and each company to set out a long-term vision for diversity, covering at least gender and racial diversity, and a date by which this is to be realised.

Specifically, DEI plans should:

- include shorter-term targets for gender and racial diversity, linked to compensation and/or performance reviews
- address with utmost urgency any glaring deficiencies in basic diversity at governance and senior leadership level (i.e. board and executive committee), which we define as a minimum of a one-third representation of women, and including at least one person from a minority racial or ethnic group (interpreted according to geography and company context)
- include the collection of hiring, promotion and attrition data; the examination of pay equity and pay ratios, and the establishment via employee surveys of the employee experience of DEI
- include a comprehensive suite of interventions covering, at a minimum: programmes for the sponsorship of diverse talent; training on inclusive behaviour; anti-discrimination, abuse and harassment policies; initiatives to grow the pipeline of diverse talent in industries and professions that lack diversity, and policies and benefits to enable all employees to combine careers and parenting/caring responsibilities
- be resourced with sufficient dedicated headcount.

¹⁴ Scott E. Page, *The Diversity Bonus*, 2017

¹⁵ James Surowiecki, *The Wisdom of Crowds*, 2005

On climate change, we have a clear definition of ‘good’: net zero emissions no later than 2040. On DEI our vision of good is a plan that includes targets to achieve, by 2030 or sooner:

- gender parity on the board, executive committee and throughout the organisation
- racial and ethnic representation on the board, executive committee and throughout the organisation that reflects the societies from which the company recruits and the customers that the company serves
- no structural differences in the roles performed by women and minority candidates.

The leading companies in DEI on the Focus List are already showing this level of ambition:

- Recruit Holdings has committed to achieve approximately 50% representation of women on the board, in senior executive roles, in managerial positions, and of total employees in the company by 2030.¹⁶
- Trane has set the following goals for 2030: (a) to attain gender parity in leadership, and (b) to achieve workforce diversity reflective of the company’s communities, including increasing the racial and ethnic diversity of its salaried population in the US to 26%.¹⁷
- Twilio has a goal that women should make up 50% of its employee population by 2023 and that, in the US, under-represented populations should make up 30% of its workforce.¹⁸

As we did with climate change, we will produce a booklet that explains to Focus List companies in more detail why Generation thinks diversity is important and what leading companies are doing about it, as well as to provide support and resources.

While in 2022 we will continue to take egregious DEI shortcomings into account in our proxy voting decisions on director elections, from 2023 we will step up our voting practices, so that where companies do not meet our new expectations, this will generally be reflected in our voting on the re-election of the appropriate director. We look forward to reporting on the progress of our engagement in investor letters to come.

¹⁶ [Recruit Holdings press release](#)

¹⁷ [Trane website](#)

¹⁸ [TechCrunch article](#)

PORTFOLIO METRICS¹⁹

We provide select Environmental, Social and Governance (ESG) as well as financial 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.

	FACTOR	PORTFOLIO	BENCHMARK
E	Carbon footprint - (tonnes) CO ₂ equivalent/\$m (revs) ²⁰	58	246
	Greenhouse gas - imputed cost (% of revenues) ²⁰	0.5%	1.4%
	Water & resource use - imputed cost (% of revenues) ²⁰	0.6%	1.5%
	Waste & pollution - imputed cost (% of revenues) ²⁰	0.4%	0.9%
	Percentage of companies that disclose GHG emissions ²⁰	73%	76%
	Percentage of companies in SBT initiative ²¹	35%	25%
S	Human capital development score ²²	5.7	5.3
	Data security score ²²	5.8	5.3
	% of employees would recommend company to friend ²³	76%	73%
G	Firm tenure of executive team ²⁴	13.0 years	N/A
	Fewer than 10% shareholder votes against executive pay ²²	64%	76%
	Equal shareholder voting rights ²²	93%	88%
	CEO total pay less than 3x of median executive officer ²²	73%	74%
	Percentage of shares owned by executives ²⁵	0.21%	0.10%
	Female board directors ²²	30%	29%
	Board not entrenched ²²	69%	82%
	All non-executive board members on less than 4 boards ²²	47%	55%
	Independent compensation committee ²²	82%	70%
	Independent board ²²	76%	73%
	Independent chairman or lead non-executive director ²²	78%	66%
F	Three-year revenue growth (annualised) ²⁵	11%	9%
	Gross margin ²⁵	51%	49%
	Cash flow return on invested capital (CFROI) ²⁶	13%	6%

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

¹⁹ As at 9 September 2021. Portfolio referenced is the Generation IM Global Equity Fund and may not be representative of all client portfolios within the strategy. Referenced data may not be available across all portfolio companies and it is limited to the data received from the source provider. 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 at the end of this letter.

²⁰ Trucost data

²¹ Generation analysis based on data from the Science Based Targets initiative and MSCI as at September 2021

²² MSCI ESG data

²³ Glassdoor data

²⁴ Generation in-house analysis prepared in September 2021

²⁵ CapIQ

²⁶ Credit Suisse Holt

THE FIRM

ADVOCACY UPDATE

As you know, we have been running several initiatives in the run up to COP26. These are set out in full in David Blood's [Senior Partner Letter](#) from earlier in the year.

In this letter we discuss our work on portfolio alignment for net zero, and our engagement work on climate change and diversity and inclusion. Other recent advocacy initiatives this quarter included:

1. Finance at Countdown
2. Work on deforestation-free supply chains and investment portfolios
3. Our latest Insights piece on the emissions of listed companies.

We provide a short update on each below.

Finance at Countdown

We co-organised the 'Finance at Countdown' event with TED on 12 October, which precedes their major Countdown Summit designed to catalyse action in the run-up to COP26. This was a day-long, virtual event to address how capital markets can help lead the drive towards a just transition to net zero. We had some incredible speakers including Jacinda Ardern, Kristalina Georgieva, Mark Carney, Janet Yellen, Christine Lagarde and our Chairman, Al Gore. We will share some highlights from this event in our Q4 letter.

Deforestation

As you know, Generation has had a long-standing interest in tackling deforestation. We have recently been stepping up our activities in this area. Achieving deforestation-free supply chains was one of the priorities set out in our Senior Partner Letter.

It's clear that we cannot get to net zero without fundamentally reimagining our relationship with nature to support its carbon sequestration, biodiversity and community-building capacities. We must work urgently to halt the ongoing degradation of nature, specifically deforestation, and investors and companies have an important role to play.

We are working actively with other stakeholders on this issue, including through the PRI Investor Working Group on Sustainable Commodities. We'll provide more updates in future letters as this work evolves.

Listed Company Emissions – Insights piece

Earlier this year at one of our morning meetings, someone asked the question: "What proportion of greenhouse gas emissions are listed companies responsible for?" We realised the answer to this question, which is surely a critical one for investors in listed equities to know, was less than obvious.

A look back through previous research showed that the typical estimate is around 20% of emissions, once we adjust for different denominators. MSCI published analysis earlier last year consistent with this. All these previous analyses have been based on 'Scope 1' emissions, which cover only the direct emissions by a company – for instance, using fuels to heat a building or in an industrial process.

There are two other scopes to consider. 'Scope 2' comprises purchases of electricity, heat or cooling services while 'Scope 3' covers all other indirect emissions such as the energy used by a supplier, the use of equipment by customers or the transportation of goods by a third party. Scope 3 is notoriously complicated, involving 15 subcategories and going up the supply chain to the source of minerals or food production, and all the way down to the end use by consumers and what happens at a product's end-of-life.

We worked with an external expert, John Ward, to conduct our own analysis over the summer. The findings from this exercise are the subject of our latest [Insights piece](#).

Our analysis explores Scope 3 in particular. The challenge here is avoiding double counting, since, for example, the Scope 2 emissions of one company are another company's Scope 1 emissions. The following questions will give you a sense of how we approached the double counting challenge: What share of global steel production by listed companies is fuelled by state-owned coal suppliers? What proportion of a company's Scope 2 emissions overlap with the Scope 1 emissions of a listed utility? What proportion of household energy consumption is provided by listed companies? What share of global food production passes through listed companies at key stages in the value chain?

We find that listed companies account for 40% of greenhouse gas emissions, as a conservative estimate. This underscores the importance of investor action on climate change through our engagement and capital allocation choices. As you know, listed equities come with opportunities to engage that are less available in private companies.

FIRM UPDATE

As at 30 September 2021, the Generation team is 108 and assets under management total approximately USD 36.1 billion.²⁷ There were no joiners and leavers from our Global and Asia investment team.

We would like to take this opportunity to advise you of a change to the firm's auditors. As a result of a competitive tender process, Generation appointed KPMG LLP as new external auditors of the group, effective September 2021, replacing PwC. Although we were not required to review the firm's audit arrangements, we recognise auditor rotation as a good governance practice.

Thank you for the trust you have placed in us.

Miguel Nogales and Mark Ferguson, Co-CIOs

²⁷ In addition, the firm has USD 2.2 billion assets under supervision as part of its Long-term Equity strategy as at 30 June 2021.

IMPORTANT INFORMATION

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If you require more information, please contact Generation Client Service (clientservice@generationim.com or +44 (0)207 537 4700).

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FACTOR	METRIC	SUMMARY DESCRIPTION
Firm tenure of executive team	Median	Average tenure of the current executives at the company. In our view, longer is considered better.
Fewer than 10% shareholder votes against executive pay	Percentage	Percentage of companies that received less than 10% shareholder votes against executives pay (most recently reported shareholder meeting). Only applies to companies that have 'say on pay' vote.
Equal shareholder voting rights	Percentage	Percentage of companies that have equal voting rights. In our view, a higher number is considered positive.
CEO total pay less than 3x of median executive officer	Percentage	Percentage of companies where the CEO's total pay for the last reported period was no more than 3x the median pay for other named executives. In our view, a higher number is considered better.
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.
Female board directors	Average	Percentage of female board directors. In our view, a higher percentage is positive.
Board not entrenched	Percentage	Percentage of companies without an Entrenched Board. The Board Not Entrenchment is inferred only; it is assumed and based on the following criteria from MSCI where board tenure is long and/or there are a significant proportion of older board members. The criteria includes >35% board tenure >15 years, 5 or more directors tenure >15 years, 5 or more directors >70 years old.
All non-executive board members on less than four boards	Percentage	Percentage of companies with no overboarded non-executives. The threshold is where a board member serves on four or more public company boards.
Independent compensation committee	Percentage	Percentage of companies with independent compensation committee, where such a committee has been established. Please see below for the independence criteria used.
Independent Board	Average	The Independent Board is inferred only; it is assumed and based on the following criteria from MSCI where it excludes current & 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 provided services to a senior executive or company within the last 3 years. Non executive compensation must be proportionate with other non executives and less than half of the named executives. Where information is insufficient the director is assumed Non-Independent.
Independent chairman or lead non-executive director	Percentage	Percentage of companies which have an independent chair, or where the chair is not independent, an independent lead director. In our view, a higher proportion is considered better. As defined by MSCI, Independence is classified as independent of both management and other interests (employees, Government or major owners).
Human capital development score	Average	MSCI score (0-10) for motivating and engaging employees through variable compensation, work/life balance, training and Employee Share Ownership Programs (ESOPs). MSCI differentiates between labour management and human capital development based on educational attainment, but we aggregate.
Data security score	Average	MSCI score (0-10) for companies attempting to control and protect data through policies, audits, training and other programs.
% of employees would recommend company to friend	Average	Percentage of participating employees who would recommend company to a friend. This metric may warrant caution where a small percentage of the work force report.
Carbon footprint - (tonnes) CO ₂ equivalent/\$m (revs)	Weighted Average	Aggregate tonnes of carbon dioxide (CO ₂ equivalent) per \$USDm revenue (not restricted to CO ₂ , includes a basket of emissions).
Green house gas - imputed cost (% of revenues)	Weighted Average	Aggregate green house gas cost (to society) of direct and indirect emissions, based either on disclosed or modelled emissions. Calculated as a percentage of revenues.
Water & resource use - imputed cost (% revenues)	Weighted Average	Aggregate waste and pollution cost, both direct and indirect, either disclosed or modelled. Calculated as a percentage of revenues.
Waste & pollution - imputed cost (% revenues)	Weighted Average	Aggregate water and resource use cost, both direct and indirect, either disclosed or modelled. Calculated as a percentage of revenues.
Percentage of companies that disclose GHG emissions	Percentage	Percentage of companies reporting GHG emissions data including in sustainability reports or via the CDP.
Percentage of companies in Science-based targets initiative (SBTi)	Percentage	Percentage of companies that have joined the Science Based Targets initiative. Please refer to the Science Based Target initiative website for further information.
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.