RIDING ESG WAVES ACROSS THE GLOBE
THE CASE OF THE US AND INDIA

ESG Insights
Environment

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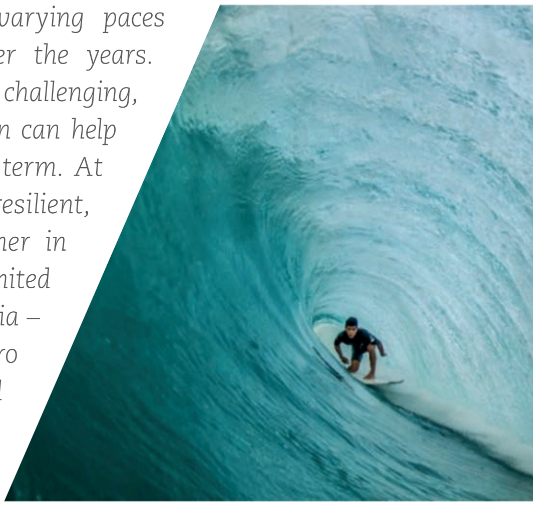
Global markets have evolved at varying paces and under different conditions over the years. Navigating this uncertainty can be challenging, but keeping your eyes on the horizon can help you master the waves over the long term. At Comgest, we choose to invest in resilient, quality growth companies – whether in developed economies, like the United States, or emerging ones, such as India – to try to mitigate unpredictable macro developments. For us, culture and ESG analysis are fundamental in helping us to stay on our board, no matter the waves we face.



At any surf spot in the world, you can observe a cadre of wetsuit-clad individuals scanning the horizon of the sea. Surfing, a sport unlike any other, demands an intricate understanding of the water and weather conditions. The interplay between tides and the underwater terrain determines the height, direction and formation of wave patterns.

At Comgest, we see the parallels between surfing and our own quality growth investment approach. Just as experienced surfers may wait hours before paddling out into the water and selecting a wave, we typically conduct years of fundamental research to determine whether a company meets our quality growth criteria. We seek companies that have exceptional longevity, visible growth, robust free cash flow, formidable barriers to entry, strong corporate culture and ESG credentials.

Environmental, social and governance (ESG) factors are integrated into our research, investment selection and portfolio management process. Like tidal patterns and swell size for surfers, ESG helps us discern what separates these quality companies from the rest. From our perspective, ESG provides us with an enhanced understanding of a company's quality and long-term growth potential.

NO TWO WAVES ARE THE SAME

Markets have faced significant volatility in recent years. Geopolitical tensions[1], anxiety about national elections[2] and monetary policy decisions, particularly around interest rates[3], have created an uncertain environment for businesses and investors alike. Emerging markets, including India, have emerged in recent years as a prominent alternative for investors looking beyond China.[4] In our view, India's strong demographics, developing infrastructure and economic reforms have created an environment for quality growth companies.

Meanwhile, a global patchwork of ESG regulation has taken shape as policymakers attempt to address issues including climate change, human rights or biodiversity. From industry-wide pledges to net zero targets, there has been a tidal wave of new ESG commitments, regulations and rules since the signing of the Paris Agreement in 2015, which aim to prevent global temperatures from rising above 1.5°C and has been signed by nearly every country.[5]

Emerging and developed economies face different challenges in balancing economic development with the pursuit of a more sustainable future. These market-by-market differences are akin to surfing: no two waves are the same, but all surfers should consider the same fundamental elements – wind direction, tide break, water depth and swell size. When confronting markets with different "wave" patterns, we seek companies that possess deep competitive moats, solid ESG foundations and high visibility that have the potential to endure short-term macro developments and grow well into the future. Blocking out the short-term macro noise, we maintain a steadfast commitment to Comgest's long-term quality growth approach.

RIDING THE ESG PIPELINE IN THE US

With towering six metre waves, Hawaii's Banzai Pipeline is a fitting analogy for the ESG landscape in the United States.[6] Renowned for stunning waves and elite surfers, the Pipeline is equally notorious for its extremely complex break points. Similarly, the ESG wave in the US, shaped by a variety of federal and state-specific rules and regulations, presents a formidable challenge for investors.

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1 Darbyshire, Madison, Nicholas Megaw, and James Fontanella-Khan. "How the Investment World Is Trying to Navigate Geopolitics." *Financial Times*, 5-Jul-2024.
2 Buchwald, Elisabeth. "US Businesses Are Suffering from Election Uncertainty - and It Could Be Hurting the Economy." *CNN*, 24-Oct-2024
3 Sorkin, Andrew Ross, Ravi Mattu, Bernhard Warner, Sarah Kessler, Michael J. De La Merced, Lauren Hirsch, and Ephrat Livni. "Why Uncertainty Still Hangs over the Fed's Big Decision." *The New York Times*, 18-Sept-2024.
4 Kumar, Amit. "India Is Well Placed to Become the 'next China' and Drive Global Growth." *Nikkei Asia*, 8-Aug-2024.
5 "Paris Agreement." United Nations, 22-Apr-2016.
6 Shute, Megan. "A Closer Look at Hawaii's Legendary Banzai Pipeline." Only In Your State: Discover Magic In Your Own Backyard, 12-Oct-2020.

We believe that the US offers an attractive mix of qualities that make its companies appealing to investors, including its efficiency and productivity-oriented corporate culture. Given its highly competitive market environment, we consider that strong US performers typically possess quality business models leveraging on their cutting-edge innovation, scale or unique brand image. Based on our experience, the sustainability strategy of companies can either reinforce or weaken their quality.

In our view, recognising the unique regulatory, economic, sustainability-related or even cultural features of the US market can help distinguish the ESG quality of companies. The US election outcome may contribute to what shape the country's existing ESG legislation – such as the Inflation Reduction Act – will take in the future.[7] Meanwhile, the International Energy Agency (IEA) estimates that energy consumption from data centres is projected to double 2020-levels by 2026 due to the rise of artificial intelligence.[8] This increase in electricity usage could lead to an uptick in emissions, especially in the US, where only 20% of the power grid is currently supplied by renewable energy sources.[9]

Fundamentally, we believe that the US market is not only about the "Environment" in ESG, but also (and perhaps more importantly) about "Social" and "Governance." In our view, growth is fuelled by an abundant, diverse and skilled workforce, with innovation and efficiency gains being driven by strong leadership. However, navigating an environment where competition for talent is intense and cost optimisation is pushed to the maximum can be challenging. This dynamic could in some cases lead to social tensions and human capital challenges as US companies try to balance these trends.

The absence of stringent governance codes and intense competition for top business leaders – which drives up executive pay – can weaken trust with shareholders.[10] Less restrictive governance practices specific to the US market may also contribute to a weaker power balance between the Board of Directors and CEO.[11] Despite this "bigger, stronger, faster" business culture, we try to identify US companies that have managed to achieve consistent quality growth while maintaining strong sustainability credentials.

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7 Milman, Oliver, and Dharna Noor. "Swing States in US Election Are Biggest Winners in Democrats' Landmark Climate Bill." *The Guardian*, 24-Sept-2024.
8 Rozite, Vida, Jack Miller, and Sungjin Oh. "Why AI and Energy Are the New Power Couple – Analysis." *IEA*, 2-Nov-2023.
9 U.S. Department of Energy. "Renewable Energy". Accessed 20-Oct-2024.
10 Temple-West, Patrick. "Shareholders Raise Heat on US Companies over Executive Pay." *Financial Times*, 14-Dec-2023.
11 Kim, Hyunseob, John Graham, and Mark Leary. "CEO Power and Board Dynamics." The Harvard Law School Forum on Corporate Governance, 3-Apr-2017.

Copart, the leading US salvage car auction marketplace, exemplifies how a company's ESG approach can result in consistent long-term growth. The company collects and stocks vehicles deemed "non-repairable" by insurance companies and auctions them online. Copart customers then typically repair and reuse the cars with about 30% of auctioned cars hitting the road again.[12]

We believe that Copart benefits from several competitive advantages that are key to its long-term growth, including its network size and relationship with insurance companies. Copart's marketplace is the largest in the world with over 200,000 cars and buyers in over 190 countries.[13] The company operates a wide range of stockyards with over 200 locations across 11 countries, which means that it can efficiently pick up vehicles and add them to its stockyards.[14]

In addition, the company's collect-store-reuse model contributes to increase the useful life of vehicles as about 30% auctioned cars hit the road again, while others can be used to extract and reuse the car parts. The company also anticipates the arrival of EV vehicles to the market – according to some insurance data EVs represent 1.9% of reparable appraisals in 2022 (+200% vs 2021).[15] To prepare for this new trend, all yard employees of Copart receive enhancement training on hybrid & electric vehicles.[15]

The health and safety of Copart's 10,000+ employees are a top priority for the company. From razor tool awareness to vehicle receiving safety, Copart's Safety Training Awareness team hosts a wide variety of specialised trainings throughout the year to enhance safety of all yard employees.[15] In 2023, the company invested over $1 million in training and education programs for employees aimed at career growth and continuous learning.[15] From our perspective, these efforts have helped the company maintain strong employee motivation, with 74% of US employees agreeing they have "opportunities to learn and grow at work".[15] As Copart grows, we expect the company to continue developing its human capital policies.

From a governance perspective, we believe that Copart demonstrates the leadership continuity seen in many of the quality growth companies that we choose to invest in. The recent appointment of Jeff Liaw as CEO, who previously worked under former CEO Aaron Adair and founder Willis Johnson, underscores this consistency of management. Both Adair and Johnson still serve on Copart's Board of Directors. Moreover, the recent creation of a Chief Product Officer as part of the top executive team aligns with Copart's continuous goal of preparing the company's leadership for changing business challenges.[16] Our experience suggests that strong and

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12 Source: Tognini, Giacomo. "How Copart Is Making a Billion Dollars from a Junkyard." *Forbes*, 18-Nov-2020.
13 Source: Copart website. Accessed 20-Oct-2024.
14 Source: Copart website. Accessed 20-Oct-2024.
15 Copart. Moving Forward Responsibly & Sustainably, December 2023.
16 Cueto, Jonalyn. "Copart Announces New Additions to Leadership Team." Insurance Business America, 16-Jan-2024.

skilful leadership, stable management and clear succession planning are crucial for companies seeking to foster long-term strategic thinking and smooth execution.

PADDLING TOWARD GREATER TRANSPARENCY IN INDIA

Across the globe, India's ESG landscape is comparable to surf spots along its Goa coast where the sport is still in its early stages but growing in popularity. Goa, a province bordering the Indian Ocean, has 100 kilometres of largely sand-covered beaches. Unlike the Banzai Pipeline's towering waves, Goa is known for having more manageable beginner waves. However, with patience, quality waves can still be found.

While Indian equities have demonstrated strong performance in recent years, the market's embrace of ESG is still in its early stages compared to more mature markets, such as the European Union. The country has taken steps to improve its ESG regulations, including implementing the Business Responsibility and Sustainability Reporting, a framework under which the top 1,000 listed companies in India are required to disclose their ESG performance.[17] In our view, this signals a growing emphasis on ESG transparency and improving quality of disclosure.

From an environmental perspective, India's push for energy transition is key to its ESG landscape. In particular, the country has pledged to achieve net-zero carbon emissions by 2070, with plans to reach 500 GW of renewable energy by 2030.[18] While carbon emissions and the energy transition are key focus areas, we believe that broader environmental concerns, including biodiversity, have received less attention.

In terms of governance, India is shaped by a substantial portion of influential family-owned businesses and state-owned enterprises (SOEs). Reform in corporate governance is gradually improving, as retail ownership rises, and regulatory bodies push for more transparency and board independence.[19] However, despite these advancements, we believe that India's entrenched business structure and culture can present governance challenges. As bottom-up stock pickers, we believe that our research approach enables us to build a more detailed and reliable understanding of the governance profile of a particular company. On the social front, we believe that growing international investment will likely, over time, bring improved working conditions and safety standards to sectors like construction, manufacturing and IT.

[17] Deloitte India. "Business Responsibility and Sustainability Report", 3-Jan-2024.
[18] "COP26: India PM Narendra Modi pledges net zero by 2070." *BBC News*, 2-Nov-2021.
[19] Mundy, Simon. "India Proposes Board Rules to Challenge Tycoons." *Financial Times*, 16-Oct-2017.

Power Grid Corporation of India, India's largest power transmission company is contributing to the country's growing power demand and renewable energy transition. More than 80% of its work-in-hand projects are focused on renewable energy transmission, helping to address the country's grid limitations.[20] There are already signs that India's energy access has strained the country's unstable grid network.[21] In our view, India is likely to experience further disruptions due to rising energy consumption in the coming years. Between 2000 and 2022, India's electricity consumption increased by 223% with factors like urbanisation, construction and industrialisation fuelling growing power demand.[22] We believe that Power Grid's transmission lines are crucial to meeting this increased energy demand and facilitating the connection of India's renewable energy resources to the grid.

From our perspective, Power Grid's main environmental challenge lies in the impact of its transmission networks on biodiversity. To address these concerns, the company conducts environmental assessments and, where possible, seeks to reduce the corridors around their transmission lines – known as Right-of-Way – to minimise deforestation.[23] In our view, Power Grid has taken steps to take local considerations into account by seeking less populated places to lay their power evacuation lines and providing compensation to residents.[24]

Despite its status as a state-owned enterprise, we believe that Power Grid benefits from a disciplined management style and strong culture. In a similar manner to Copart, Power Grid's leadership team has risen through the ranks over the years, demonstrating its ability to retain talent and create a culture of invested employees: four members of Power Grid's Board of Directors are veterans of the company and three employees, including Chairman and Managing Director Ravindra Kumar Tyagi, worked as engineers. In our view, this transcends down throughout the culture of the company, which is very focused on engineering. At Comgest, we also believe that this culture of internal promotion can send a clear signal to employees that their work is valued. We believe that leaders who have devoted much of their career to the company are more likely to be invested in its long-term success.

When managing projects, Power Grid oversees health and safety standards and monitors contractor practices. Based on our research, the company has demonstrated a strong safety track record with no reported labour-related incidents or controversies.[25] Despite India's comparatively slow embrace of ESG standards, we believe that there are examples of companies, like Power Grid, that possess the qualities that we seek and like as long-term growth investors.

20 Power Grid. FY24 Investor Presentation. 24-May-2024.
21 Kemp, John. "India's Grid Strained by Burgeoning Power Demand." *Reuters*, 30-Mar-2023.
22 Source: IEA. "India." Accessed 18-Oct-2024.
23 Power Grid, Integrated Annual Report FY2023-24
24 Power Grid, Integrated Annual Report FY2023-24
25 Comgest, RepRisk

QUALITY IS THE KEY TO STAYING ON YOUR BOARD

Global markets have been battered by waves of uncertainty in recent years, including the COVID-19 pandemic, natural disasters, rising geopolitical rivalries and trade tensions. Elections have also contributed to market jitters with nearly half the world heading to the polls in 2024 to vote in critical presidential and legislative races, including in the US.[26]

As long-term bottom-up stock pickers, however, we tend to look past short-term macro developments and keep our sights on company-specific drivers of growth. We seek companies with competitive advantages, high barriers to entry and pricing power that we believe makes them capable of potentially growing their earnings over the long term. We also focus on identifying companies that possess strong ESG credentials and are committed to continuous improvement. In our view, these "all-weather" performers could face swells of macro headwinds and economic uncertainty – and still emerge on the other side.

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- Investing involves risk including possible loss of principal.
- The value of all investments and the income derived therefrom can decrease as well as increase.
- Changes in exchange rates can negatively impact both the value of your investment and the level of income received.
- Comgest portfolios invest in limited number of securities and may therefore entail higher risks than those which hold a very broad spread of investments.

[26] Visit your local Comgest website to read our investment letter on the upcoming US elections.

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ESG Analyst

Liudmila Strakodonskaya joined Comgest in 2024 and is an ESG Analyst covering the US. Prior to joining Comgest, Liudmila worked as an ESG Analyst at AXA IM, where she developed thematic research, analysis and shareholder engagement on ESG topics with a specific focus on biodiversity and gender diversity. She represented AXA IM at the Finance for Biodiversity Foundation (FfBF) and co-chaired the FfBF's Impact Assessment Working Group with the goal of building and sharing knowledge on biodiversity metrics among investors. She was also actively involved in the creation of the Nature Action 100 initiative as a member of the launching investor group. Liudmila previously worked at Eleva Capital as an ESG/SRI Analyst in 2019 where she contributed to the development and implementation of the company's ESG strategy. She began her career at EthiFinance in 2016 as a Sustainable Investment Analyst specialising in ESG research and reporting. Liudmila holds a PhD in Economics with expertise in sustainable finance from Paris II Panthéon-Assas University (France), for which she received a grant from FIR-UN PRI in 2016.

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Xing Xu joined Comgest in 2020 and is an ESG Analyst and Portfolio Manager responsible for ESG coverage of Asian and Global Emerging Markets. Xing co-leads the management of the GEM Plus equity strategy. She meets and engages with company management alongside members of Comgest's investment team and prepares in-depth ESG reports. Xing was an intern at Comgest prior to joining the firm. She has also undertaken internships in China at Fosun Group, working on strategic investment deals in the technology and financial sectors, and at GF Securities, a leading financial services company in China, within their equity research department. Xing is fluent in Mandarin, holds Master's degrees in Management and Financial Markets from EDHEC Business School (France) as well as a Bachelor of Science degree in International Economics and Trade from the University of Nottingham (UK & China).

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