

# STEWARDSHIP



MARTIN CURRIE

A Legg Mason Company



INVESTING FOR  
SUSTAINABLE  
OUTCOMES

ANNUAL REPORT 2019

[www.martincurrie.com](http://www.martincurrie.com)

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## REPORT SUMMARY

### HIGHLIGHTS IN 2018

- Highest possible (A+) rating awarded by the PRI\* across all three categories
- Work carried out with International Integrated Reporting Council and UK Financial Reporting Council
- Extensive engagement and voting activity on behalf of our clients
- Continued to develop our work with external consultants on our in-house ESG expertise
- Research and thought leadership shared with clients and industry

### ENGAGEMENT ACTIVITY

**329**  
# companies engaged  
with (private)

**8**  
# companies engaged  
with (collaborative)

### VOTING ACTIVITY

**735**  
shareholder  
meetings

**7,704**  
resolutions

### PRI RATINGS HISTORY

Module				
Year	Strategy	Integration	Active Ownership	Reporting period
2018	A+	A+	A+	1 Jan 17 – 31 Dec 17
2017	A+	A+	A+	1 Jan 16 – 31 Dec 16
2016	A+	A+	A	1 Jan 15 – 31 Dec 15
2015	A+	A	A	1 Jan 14 – 31 Dec 14
2014	A	A	A	1 Jan 13 – 31 Dec 13

### ACTIVE PARTICIPANTS IN COLLABORATIVE ENGAGEMENT INITIATIVES



TAX RESPONSIBILITY



WATER RISK



CYBERSECURITY

\*PRI – Principles for Responsible Investment. Engagement and voting activity is for the period 1 January 2018 to 31 December 2018.

## FOREWORD

As the industry superannuation fund dedicated to Australia's health and community services sector, HESTA aims to make a real difference to the financial future of every one of our members. We believe strongly that having made such an invaluable contribution to society during their working lives, they deserve the best possible financial outcomes in their retirement. Our role as responsible stewards of our members' savings also requires us to think holistically about how we can contribute to a better world for our members to live, work and retire into. For us, these two ambitions are inherently linked. A secure and confident financial future for our members should always be aligned with a healthy economy, society and environment.

As such, Martin Currie's long-standing focus on stewardship has been a natural philosophical fit with our own purpose and motivations. Martin Currie has managed funds on behalf of HESTA members for over six years. During that time, Martin Currie has not only strengthened the depth and commitment of its stewardship activities, it has also become an active voice within the industry advocating for change towards a more sustainable investment environment. For us, this sets an important standard. As references to sustainability issues become increasingly commonplace within the investment industry, Martin Currie can quite rightly claim genuine leadership in this space. In particular, through the integration of ESG analysis in every part of its investment process, its active engagement with investee companies and its numerous long-term collaborative engagements.

I am therefore pleased to introduce Martin Currie's Annual Stewardship Report for 2019.



**Sonya Sawtell-Rickson**

Chief Investment Officer  
HESTA

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AS REFERENCES TO SUSTAINABILITY ISSUES BECOME INCREASINGLY COMMONPLACE WITHIN THE INVESTMENT INDUSTRY, MARTIN CURRIE CAN QUITE RIGHTLY CLAIM GENUINE LEADERSHIP IN THIS SPACE.



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## STEWARDSHIP AND LONG-TERM VALUE CREATION

We view our role in the investment chain with a straightforward clarity of purpose. As asset managers, aligning the long-term investment horizons of our clients' capital with companies that will use that capital to create multi-decade, sustainable value is our ultimate fiduciary duty. We believe stewardship is at the heart of this client proposition.

In our minds, it is inconceivable to approach investment decisions without considering every way a company creates and delivers value for its stakeholders both now, and long into the future. For us, this means not only looking beyond conventional notions of company performance, but importantly, being active participants in defining what a more sustainable investment world looks like.

Our ongoing aim to invest for long-term, sustainable value has, for many years, been materially enriched by our stewardship activities and continues to benefit our clients through three connecting qualities:

### LEADERSHIP

We firmly believe in working towards a more sustainable investment environment that can better deliver long-term value creation for our clients. Stewardship, in this sense encompasses our wider role within the industry to influence change and help define best practice. This will not only benefit investors in the long-term, but materially enhances and informs what we do right now – enabling greater levels of insight, establishing collaborative partnerships and putting us at the forefront of industry change.

### PROCESS

We fully embed ESG analysis into every aspect of our investment process. We make ESG real by using it to build conviction in our investments, as well as a means of identifying risks and opportunities. This analysis forms a core part of our active ownership approach and, as such, is carried out by the people with day-to-day responsibility for investment decisions – our portfolio managers.

### EXPERIENCE

Our commitment to sustainable investing is long-standing. We became signatories to the Principles for Responsible Investment (PRI) back in 2009 and every year since we have built on our capabilities and strengthened our industry involvement. The result is a depth of experience in sustainable investing many will claim, but few will genuinely have.

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## KEY FACTS

- Stewardship at the core of our approach
- ESG analysis integrated into the investment process
- Integration carried out by the analysts and portfolio managers who know the companies best
- Implementation overseen by David Sheasby, Head of Stewardship and ESG
- Highest possible (A+) rating from the PRI across all three categories
- Tier-1 ranking by the FRC for our statement of compliance with the UK Stewardship Code
- Signatory to Principles for Responsible Investment (PRI) since 2009
- Signatory to UK, Japanese and Korean Stewardship Codes
- Member of International Corporate Governance Network (ICGN)
- Supporter of the International Integrated Reporting Council (IIRC)

# STEWARDSHIP YEAR IN REVIEW

## CLIMATE ACTION

From an ESG perspective, climate change was undoubtedly the prominent theme throughout 2018. This was evident in September when the Global Climate Action summit delivered an ambitious 'call to action' for how global leaders can transition towards a low-carbon economy. Another strong signal of the impetus towards decarbonisation was the announcement from six major sovereign wealth funds during the year that they had joined forces to produce a climate-change framework. The joint initiative aims to not only identify climate-related risks and opportunities in their combined US\$3 trillion assets under management, but also to promote standardised reporting methodologies for companies regarding the financial implications of climate change.

This latter point was echoed in the first status report on the Task Force on Climate-related Financial Disclosures (TCFD), released 15 months after the TCFD launched its 2017 landmark recommendations. Encouragingly, over 500 companies, with a combined market capitalisation of US\$7.9 trillion, have so far expressed support for the recommendations, but the update highlighted the need for greater disclosure of firms' climate risks – an area where we have spent increasing amounts of time engaging with companies on during the year. We are, however, pleased to see developments in the area of scenario analysis, specifically with tools such as TPI and PACTA.

## GLOBAL CONSENSUS

Against this backdrop of positive action, there was a reminder of the critical need behind it. A report by the UN Intergovernmental Panel on Climate Change (IPCC) released in October concluded that containing a rise in global temperatures to under 1.5°C, would require 'rapid, far-reaching and unprecedented changes in all aspects of society'.

It was perhaps fitting then that, at the end of the year, global consensus was reached at the COP24 climate negotiations on how to implement the 2015 Paris climate accord. This momentous agreement now paves the way for policy measures which come into effect from 2020. For investors, the historic climate-change initiatives we have seen in 2018, will now place an unmovable focus on the impacts of climate change on companies and on their climate strategies.

2018 has also been notable for the growing societal awareness surrounding many sustainability issues ranging from plastic waste to fast fashion. Regulation and shifts in consumer behaviour regarding these kinds of issues are only likely to intensify in the coming years, increasingly forcing companies to consider the impact of their businesses across a range of different stakeholders.

## EXPANDING OUR ESG CAPABILITIES AND INFLUENCE

With an ever-greater range of ESG issues now becoming materially impactful for companies, it is vital our investors are fully equipped to integrate sustainability analysis into every part of the investment process. During 2018 we have expanded our ESG investor 'toolkit' by launching the ESG knowledge hub, an online directory of all our ESG resources. In addition, we have created two further proprietary tools: a portfolio dashboard to provide a high-level ESG profile of each strategy based on MSCI ESG data and a framework for critically assessing aspects of corporate governance.

We have also continued to place significant emphasis on collaborating towards global standards of sustainability best practice. As committed advocates of a unified approach to the treatment and inclusion of ESG disclosure and reporting, we have worked with various policy makers and standard setters in 2018 to help implement industry change. These have included the International Integrated Reporting Council (IIRC) and the UK Financial Reporting Council (FRC) as well as being part of a global accountancy house's consultation on ESG reporting. Our work in this important area is explored in more detail within our case study.

Elsewhere during 2018, we have maintained our significant involvement in ongoing PRI-led collaborative engagements on corporate taxation and cybersecurity; we also began the second round of collaborative engagement on water in the agricultural supply chain. In terms of company-specific milestones, we launched our inaugural CSR report – with the intention of recognising and disclosing the most material factors to our business – and were one of the first international asset managers to become signatories to the Korean Stewardship Code.

Finally, we were delighted to have once again been awarded the top (A+) rating from the PRI across all categories – Strategy & Governance, Integration and Active Ownership.



**David Sheasby**

Head of Stewardship  
and ESG

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# ESG – AN INTEGRAL ELEMENT OF STEWARDSHIP

## WHAT IS IT?

ESG refers to a set of factors that may impact the ability of companies to generate sustainable returns over the long term. It involves understanding the governance structures and culture of a company (and its broader social and environmental impacts), employing a broad view of changes taking place in the world and assessing the effect these can have on a company's cash flows, balance sheet, reputation and, ultimately, corporate value.

## WHY DO WE DO IT?

As stewards of our clients' capital we take an holistic view of investee companies, looking at all material information, whether quantitative or qualitative. There is compelling evidence that ESG factors influence returns over the long term, and therefore have to be incorporated by fiduciaries when assessing risks and opportunities.

## HOW DO WE DO IT?

As bottom-up investors, our process starts at the company level. Once an idea has been identified, we subject it to rigorous fundamental analysis and peer review to decide whether it merits inclusion in our high-conviction portfolios. ESG analysis is embedded in this assessment, influencing key assumptions such as the cost of capital, revenues or costs and thus our estimate of a company's intrinsic value. Our particular emphasis on governance stems from the belief that this is a fundamental determinant of long-term performance. Problems here are more often than not reflected in a company's environmental and social track record, making it a reliable proxy for wider sustainability. In broad terms, we divide our process into three categories: identification, integration and active ownership.

**OUR PARTICULAR EMPHASIS ON GOVERNANCE STEMS FROM THE BELIEF THAT THIS IS A FUNDAMENTAL DETERMINANT OF LONG-TERM PERFORMANCE.**

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## OUR PROCESS

### IDENTIFICATION

- Identify material ESG factors
- In-house industry frameworks used as a guide
- Understand the potential impact on returns

### INTEGRATION

- Incorporation of key ESG factors into the investment case
- Consideration of business aspects likely to be impacted
- Financial modelling and portfolio construction

### ACTIVE OWNERSHIP

- Monitoring and engagement of investee companies
- Private and collaborative engagement
- Proxy voting
- Disclosures and reporting

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To explain more about our ESG process and rationale, we have written the following papers:

- *The value of ESG*
- *Accessing the true value of ESG*
- *The positive impact of ESG integration*

# IDENTIFICATION

## WHAT WE LOOK AT:

Below is a non-exhaustive list of some of the factors we may consider as part of our fundamental analysis. The level of research and engagement varies depending on region, sector and, critically, the materiality of the issues in question. The overarching aim is to assess the extent to which ESG factors will contribute to/detract from the long-term value of a firm.



### Governance

We value transparency and clear, accountable governance structures, paying considerable attention to the extent to which a company demonstrates alignment with the interests of long-term investors.



Board leadership, diversity and independence



Management remuneration



Shareholder rights



Succession planning



Accounting and audit standards



### Environmental

Knowing how a company identifies and manages potential environmental issues helps us to understand how it is preparing for changes to regulation and disclosure requirements.



Pollution



Water usage



Climate change (emissions)



Energy efficiency



Resource management



### Social

How a company treats its people, customers and other stakeholders, can give valuable insight into its culture – a good proxy for long-term business success.



Data protection and privacy



Equality and diversity



Community relations



Human capital management



Product safety and liability



Supply-chain management



Human rights

## MATERIAL MATTERS

Materiality is a concept used frequently in this report. In simple terms this refers to the strength of the relationship between an ESG factor and corporate performance. Some of this is common sense. For example, carbon risk is clearly more material to an oil & gas firm than it is to an IT-services business. Similarly, cybersecurity and data protection is likely to be more material to the latter than the former. In other instances, it may be less intuitive. To make the best use of our research time we have created hierarchies of the most material issues industry by industry. This way we can gauge whether managements are focusing on the right areas – an approach that is backed up by research showing a clear link between a firm's integration of material sustainability issues and enhanced shareholder value (versus a less-discriminating approach). Once the most material issues have been isolated and analysed, the challenge is to translate this information into numbers in our modelling of key financial variables such as the cost of capital, cash flow, turnover and capital expenditure.

**THE OVERARCHING AIM IS TO ASSESS THE EXTENT TO WHICH ESG FACTORS WILL CONTRIBUTE TO/ DETRACT FROM THE LONG-TERM VALUE OF A FIRM.**

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## INTEGRATION

ESG factors are integrated into our fundamental analysis and decision-making process. We make both qualitative and quantitative assessments of issues deemed material to long-term performance, leveraging our proprietary industry frameworks to ensure that we focus on the most relevant issues/indicators in each industry.

### EXAMPLES OF ESG INTEGRATION FOR THE REPORTING PERIOD:

#### ANTA SPORTS



Chinese sportswear company

**Issue:** With insiders owning over half of the business, we had concerns that management accountability would be undermined by the ownership structure of the group. This became evident when the group acquired AMER Sports – a deal that had the potential to destroy shareholder value in the long term, with consequent risk to the dividend. Given these potential impacts, we were disappointed by the lack of management engagement to discuss the merits of the deal; this was left instead to the investor relations department. As a result, we were unable to accurately determine whether the motivations of the management team were ‘empire building’, rather than serving shareholders.

**Impact on manager’s decision:** The potential governance issues that we had initially identified proved to be a real issue when the company entered into a material transaction. In essence, this was a concern about capital allocation and our view of the company was impacted by its decision to disengage from its shareholder base in spite of our attempts to address this. As such, although there was a positive view on the company’s products and operational capabilities, we could no longer justify holding the position based on these governance considerations.

#### CHINA GAS



Chinese utility company

**Issue:** China has set some ambitious targets regarding future energy-mix; in particular, a switch from coal to increased gas use from 5% to 10% by 2020. Among the key beneficiaries of this change are the ‘town gas’ companies which build out the networks and supply natural gas to industrial users and end consumers. China gas is one of the leading town gas companies and a key beneficiary of this evolution in the energy mix.

**Impact on manager’s decision:** Through our discussions with the management, we were able to establish the current and future impact on the growth profile of the group, reflecting the opportunity from an increased focus on gas in the mix. As such, we were able to reflect this in the revenue growth of the group.

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## WELSPUN



Indian industrial company

**Issue:** Welspun's water-intensive textile plant in Anjar has historically been heavily reliant on the nearby Narmada River. The company has recently invested in a 30 million litre/day waste-water treatment plant, which treats sewage from the surrounding area. 85% of the recovered water is used in the Anjar plant. This substantially reduces the company's dependence on the Narmada River, minimising availability risk (e.g. during droughts), while increasing fresh water availability for domestic and farm use in the area, and preventing untreated sewage being pumped back into the river.

**Impact on manager's decision:** We were encouraged by Welspun's efforts to conserve water. Investments to address the potential risks presented by its dependence on the river flow provided a positive benefit to the area in which it operates, demonstrating both an awareness of the externalities present in its operating model, as well as an alignment with its wider stakeholders. We view these actions as prudent steps for ensuring the long-term sustainability of the business, thus building further conviction in the investment thesis.

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## DSM



Dutch science company

**Context:** Having engaged with the company, we were able to better understand the most material benefits that the company experiences from its sustainability programme. In particular, we noted the positive impact on:

- **Employees:** although the company headquarters are poorly located, DSM's sustainability credentials have had a material impact on its ability to attract workers.
- **Customers:** the company's supply-chain transparency and sustainability credentials are proving increasingly important in attracting new customers, some of which are keen to name DSM as a supplier based on these credentials.

**Impact on manager's decision:** The company has a well-regarded sustainability programme and reports extensively on its efforts, which we believe contributes to the long-term viability of its business model. This increases our confidence in the long-term sustainability of its margins, as well as reducing the overall risk profile of the business. As such, we reflected both of these positive developments in our modelling of the group.

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# INTEGRATION

## AMP



Australian financial services company

**Issue:** The group was subject to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry's investigation. Facing the prospect of the Royal Commission recommending wholesale changes to vertical integration, further deterioration of the life-insurance industry, and falling market sentiment due to both the wide level of fees charged for no advice and the sales culture in AMP, the business began to unwind in dramatic fashion.

**Impact on manager's decision:** We reflected on the deteriorating view of the management quality and governance as well as the dilutive approach to shareholder value in our quality rating for this group. The impact of this was to decrease conviction and the potential size of the position. However, our main lesson through this has been the need for greater proprietary governance analysis. As a result, we have recently built out an improved internal Governance Assessment rating framework covering our Australian companies. This further analytical tool is designed to help us identify the type of oversight failings that occurred at AMP over recent years as surfaced by the Royal Commission.

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## CRODA



UK chemical company

**Issue:** The UK-based speciality chemical company's products often form critical components to brands where sustainability is the key selling point. Croda views its sustainability programmes as helping customers manage their risk in terms of achieving their own sustainability objectives. For us, a crucial part of understanding the investment case was calculating the competitive advantage that came from its sustainability operations.

**Impact on manager's decision:** A large proportion of Croda's raw materials come from renewable sources – around 60%, compared with less than 16% among its main competitors, which have their roots in the carbon economy of the 19th and 20th centuries. Through our discussions with the company we were encouraged that this renewables mix will be a major source of differentiation for the company, especially with the carbon price predicted to rise in the future.

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## ACTIVE OWNERSHIP

As an active manager of long-term concentrated portfolios, we place a significant emphasis on stewardship. Engagement is a key element of this. We are motivated by a firm belief that this both helps protect and enhance the risk-adjusted return on our clients' capital. We build strong relationships with investee companies and engage in a constructive manner. Our focus will always be on issues that are most material and thus could have an impact on long-term shareholder value, such as strategy, capital structure, governance and wider sustainability matters. While we typically engage in private, we will continue to join collaborative efforts, particularly when deemed likely to be more effective than acting alone. Our decision to pursue the latter will, among other things, be a function of: the specific nature of the issue; the likely efficacy against acting privately; and the degree of alignment with the other investors.

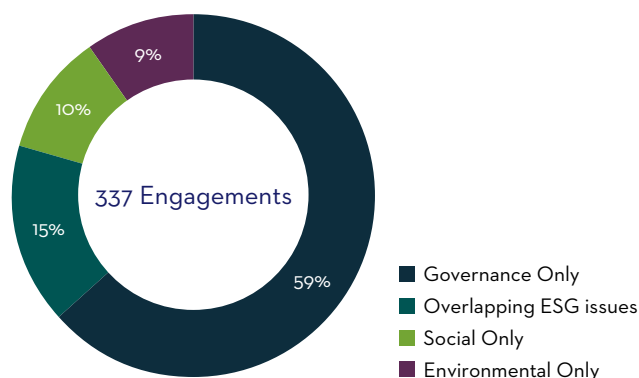
**WE BUILD STRONG RELATIONSHIPS WITH INVESTEE COMPANIES AND ENGAGE IN A CONSTRUCTIVE MANNER. OUR FOCUS WILL ALWAYS BE ON ISSUES THAT ARE MOST MATERIAL AND THUS COULD HAVE AN IMPACT ON LONG-TERM SHAREHOLDER VALUE, SUCH AS STRATEGY, CAPITAL STRUCTURE, GOVERNANCE AND WIDER SUSTAINABILITY MATTERS.**

### NUMBER OF ENGAGEMENTS

**329:** NUMBER OF COMPANIES PRIVATELY ENGAGED

**8:** NUMBER OF COMPANIES ENGAGED VIA COLLABORATIVE INITIATIVES

### ENGAGEMENTS BY THEME



Source: Martin Currie. Engagement activity is for the period 1 January 2018 – 31 December 2018.

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# ACTIVE OWNERSHIP

## ENGAGEMENT ACTIVITY EXAMPLES: \*



### Dutch financial company

**Reason for engagement:** Concerns about lack of board diversity.

**Objectives:** The company, which has only been quoted for three years, is a provider of liquidity for exchange traded products (ETPs) via its technology platform. The Dutch civil code states companies should have a minimum 30% female (or male) representation on the supervisory board. The firm's supervisory and management boards are all male. Our objectives focused on understanding the process by which this lack of diversity would be addressed.

**Scope and process:** We initially contacted investor relations to express our concerns. We then requested a call with the chair of the nomination committee to provide more insight into the nomination process – we were apparently the first investors to ask to speak to the supervisory board. This proved to be insightful and outlined the challenges the group is facing in recruiting female Non-Executive Directors (NEDs). The conversation covered the current perception of gender within the finance industry and the attendant lack of diversity. As such, it highlighted the challenge the company has had with recruiting and retaining talented female candidates.

**Engagement outcome:** The company understands the challenges it faces and is clearly looking at how it can address these issues. We will continue to monitor the progress on this over the coming year.



### Unilever – Anglo-Dutch consumer goods company

**Reason for engagement:** Announcement to simplify its corporate structure.

**Objectives:** In March 2018, the company announced its intention to simplify its corporate structure by moving from two legal entities into a single legal entity incorporated in the Netherlands. In the framework of the proposed simplification, the company had committed to continuing with existing core corporate governance features and proposed to create for the first time, a 'one share, one vote' principle for all shareholders. Shareholders were initially asked to approve the simplification at the special meeting of the company which was due to take place in October 2018. While we could see some apparent advantages of the simplification, we were also concerned about the impact on shareholders in the UK and wanted to express this view to the company.

**Scope and process:** Having analysed the proposal, we spoke to the CFO and outlined our concerns. We noted that the proposal would require 75% support from UK-based shareholders and we indicated that we would not support the proposal as it stood. Part of this process was also to engage with other shareholders who held some of our concerns.

**Engagement outcome:** The company withdrew the proposal in October 2018.

\*We have chosen not to name some of the companies in this section.





#### Korean manufacturer of water purifiers, air cleaners, and water softeners

**Reason for engagement:** Concerns about board and audit committee independence.

**Objectives:** Historically, the board of this Korean consumer good company has not had an independent majority. Having faced some serious issues regarding product quality, we have engaged with the company over the last few years to address a lack of board independence and, in particular, the failure to establish an independent audit committee.

**Scope and process:** We contacted the company regarding its board make-up in March 2017, and followed this up in March 2018 with a call to the company's investor relations team – noting that as the company's total assets had topped 2 trillion won, we expected changes to be made, consistent with Korean commercial law. A review of the board and its committee is also a standard part of our annual review process of stocks we hold.

**Engagement outcome:** Following our engagement, the company has made changes to the board to ensure that there is now a majority of independents. In addition, the company has now put an independent audit committee in place. Both of these address the original issues that we had identified.



#### Hong Kong-based insurance group

**Reason for engagement:** Disclosure on potential gaps in existing accounts and understanding willingness to engage.

**Objectives:** Following an annual update to our accounting diagnostic report on the company, we had a number of technical questions about disclosure – specifically, where we couldn't quite draw the conclusions we thought were likely from the existing accounts. We also had some governance questions on the board composition and remuneration where we think the company scores highly, but also where improvement is still possible.

**Scope and process:** The accounting diagnostic reports for holdings is updated annually to take account of the latest annual report. As a result, we were keen to follow up on some technical questions prompted by the updated information. We set out our questions in advance to ensure that there was an opportunity for the company to gather the information required. We then set up a dedicated meeting to address each issue in turn.

**Engagement outcome:** In this case we had a very successful update from the company. We had helpful engagement on disclosure, governance and remuneration, with the clarifications given generally helping resolve the questions we had. The process reconfirmed our assessment that the company scores highly in terms of disclosure, but improvement is still possible.

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# ACTIVE OWNERSHIP

## ENGAGEMENT ACTIVITY EXAMPLES:



### Chinese utility company

**Reason for engagement:** Concerns about increasing turnover in senior management.

**Objectives:** This successful and fast-growing Chinese gas distribution company had seen a number of management changes. We were keen to understand the reasons behind this and what impact the appointment of the new CEO might have. We noticed, in particular, increased turnover at senior management level, specifically where external appointments are made who then depart after a short tenure. The company has grown significantly during our holding period, but we were concerned that the culture was perhaps still insular and resistant to external ideas.

**Scope and process:** The matter was brought to our attention from both regulatory announcements and through our annual accounting diagnostic update. As long-term holders of the shares, we are in regular contact with the group and were able to use these interactions to raise our concerns. We targeted a specific meeting early in 2018 to address these issues, discussing the management changes both via email and in person. We used publicly available materials and the information directly received from the company to review the management team's experience and duties.

**Engagement outcome:** The company provided strong reassurance on the background and role of the new executive chairman. The company also clearly improved its broader investor engagement which helped build confidence in management overall. These have been good steps forward, but this is a topic we continue to monitor.



### Vietnamese dairy producer

**Reason for engagement:** To understand the future structure of the board following a change in ownership and find out more about its supply chain management.

**Objectives:** Our objectives were to clarify the implications on future strategy. We also wanted to understand its approach to small farmers (who are its main suppliers). For us, this aspect of supply chain management is key for the sustainability of the business longer term, and we needed greater reassurance around the risks associated with this operating model.

**Scope and process:** We held a conference call with the senior finance manager, corporate secretariat and head of investor relations.

**Engagement outcome:** We achieved greater clarity on the future structure of the board following the change in ownership. There was also evidence of strong support offered to small farmers, which provided comfort around the supply chain. However, it was clear this support also impacts near-term financial returns.



## Chinese pharmaceutical

**Reason for engagement:** To understand the impact of changing drug procurement practices in China.

**Objectives:** We wanted to achieve a better understanding of the recent policy developments in drug procurement and pricing, what this impact is likely to have on the industry, and specifically, the company's strategic response to the policy and the changing market structure.

**Scope and process:** We met the company and separately, the largest drug distributor in China, in September. We subsequently also met a number of competitors who were able to provide additional colour on the process including how the number of drugs covered under the new procurement policy could evolve.

**Engagement outcome:** It is clear that the Chinese government is trying to improve the drug procurement process throughout the commercial chain, reduce oversubscription of drugs, improve access to innovative medicines and lower costs of drug procurement. Our conclusion is that the policy changes, although disruptive in the short term, will continue to be supportive of the large, high-quality drug manufacturers with a focus on innovation.



## IOOF – Australian financial services company

**Reason for engagement:** A need for board and management change.

**Objectives:** Under the spotlight of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry's investigation, and with deteriorating relations with the main superannuation regulator, the Australian Prudential Regulation Authority (APRA), it became clear that there needed to be changes at senior level in the company. This led APRA to take action in December to disqualify five executives from the board for failure to act in the best interest of superannuation members.

**Scope and process:** Through one-on-one engagement with key company management individuals and board members, and even interactions in the press, we made it clear to the company that we were disappointed that it had been unable to manage relations with a key regulator. We consistently petitioned the firm to make material change to the board and management. We called for the removal of the CEO and chair, and requested that the company complies with APRA's 'Managed Action Plan' as this was a necessary step in the interests of all stakeholders to place the company on a sustainable course.

**Engagement outcome:** The company removed the CEO & chairman in response to APRA's 'show cause' notice and proposed conditions. It has acted decisively, and providing that it follows through with meeting APRA's demands, we believe that the revised leadership can forge a better regulatory relationship and set the company back on a more sustainable path. The recent financial results and presentation illustrates a significantly improved tone coming from the board and management.

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# ACTIVE OWNERSHIP

## COLLABORATIVE ENGAGEMENT ACTIVITY

Although most of our engagement is private, we have participated in a number of collaborative efforts to address specific issues at companies held in our portfolios. Finding a coalition of like-minded shareholders is a good way of sharing knowledge and can generate more tangible results than acting alone. The following are a few examples of activities we are, or have been, involved in:



Cybersecurity	<p>An initiative aimed at companies in the financial, healthcare, and retail sectors and is based on work we did as members of the original advisory committee. The project commenced in 2017, with letters sent out to the target companies. We are leading the engagement with five of the businesses included.</p> <p><b>Status: ongoing.</b></p>
Tax responsibility	<p>This effort concerns corporate tax responsibility, notably in the IT and healthcare sectors. It focuses particularly on tax policy disclosures, governance and risk management, as well as broader transparency around tax strategies. We are lead managers for two of the technology companies targeted.</p> <p><b>Status: ongoing.</b></p>
Water risk	<p>Improving disclosure and encouraging the adoption of best practice from food, beverage, apparel, retail and agricultural companies, based on their exposure to water risks.</p> <p><b>Status: second round.</b></p>

\*The trademark shown is that of the respective owner and is used for descriptive and illustrative purposes only. The company trademark shown is not in any way associated, or to be deemed to be associated, with Martin Currie or its group companies.

FINDING A COALITION OF LIKE-MINDED SHAREHOLDERS IS A GOOD WAY OF SHARING KNOWLEDGE AND CAN GENERATE MORE TANGIBLE RESULTS THAN ACTING ALONE.



# CASE STUDY: THE ESG REPORTING CONUNDRUM

## ESG IN THE MAINSTREAM

ESG analysis has well and truly moved into the investment mainstream. However, the increased focus on ESG issues has yet to be matched by an adequate method of identifying and communicating these to investors and other stakeholders. Put bluntly, while there are well-established ways of reporting, analysing and understanding the financial performance of companies, there is still a considerable lack of coherency on how (and indeed, what) non-financial metrics should be quantified.

That's not to say that there isn't a huge amount of ESG data out there. In recent years we've witnessed a surge in not only companies disclosing more ESG-related information, but also data providers (such as MSCI and Bloomberg) collating and disseminating this information. While this is to be welcomed, it has also proved somewhat of a smokescreen – giving the appearance that the current state of company-level ESG information can provide a sufficient framework for accurately incorporating non-balance sheet value.

## DATA FALLS SHORT

One of the most common criticisms from investors and wider stakeholders is a lack of consistency. An absence of standardised, recognisable metrics provided from both companies and data providers inevitably makes any kind of inter-company comparisons less meaningful and less objective. Data quality is also often questioned, with a lack of transparency on ESG scoring methodologies as well as differing levels of data integrity, accuracy, disclosure and timeliness.

Collaboratively addressing these issues, with the aim of establishing a unified approach to the treatment and inclusion of ESG disclosure and reporting, has been a considerable focus for Martin Currie in recent years. We were one of the early signatories to the International Integrated Reporting Council (IIRC)'s statement on integrated reporting, and in 2018 we were delighted to work with the IIRC providing feedback on three companies as a member of an investor panel.

Similarly, in 2018, we participated in a project with the Financial Reporting Council's Financial Reporting Lab to look at how companies can best report on their performance metrics. Specifically, we were asked to provide our assessment on the current state of reporting by UK companies, identify areas of best practice and critically review report examples cited by the FRC.

## ESG REPORTING BECOMES VITAL

Efforts such as these are gathering increasing importance. Not least because of greater levels of regulatory change on reporting in recent years, but also because there is a growing expectation for companies to be addressing and reporting on far more non-financial aspects of their activity. This, in our view, is only likely to generate more momentum in the coming years – in particular, as investors look to companies to respond to the UN Sustainable Development Goals and climate-related change.

We have certainly noticed an increased awareness and willingness from companies to now voluntarily move beyond the conventions of traditional financial-only reporting. For instance, in the past 18 months we have worked with several companies (including a global consumer goods company and two Japanese firms) who have requested our guidance on the state of their current reporting and how this could be improved and evolved.

In our view, it's important not to underestimate the mindset-shifting impact of these kinds of individual interactions, or the power of collaborative engagements to effect positive change. Which is why we have been keen to lend our industry knowledge to recent projects run by Ceres (looking at sustainability reporting, with a particular focus on effectiveness and materiality) and a broad-spanning report by accountancy firm EY (focusing on how integrated reports can better define notions of corporate value).

## TIME TO CHANGE

Direction of travel in all these areas is therefore positive, but there is much more still to do. Traditional reporting models are being increasingly challenged to keep pace with an evolving definition of what constitutes a company's value in the 21st Century. Inevitably, these descriptions need to develop beyond existing financial data. In our view, the steps to reaching this need to progress in three consecutive stages of development.



1. Standardisation



2. Auditing/  
assurance



3. Materiality

Firstly, through standardisation – globally recognised metrics to ensure consistency across a range of non-financial measures. Secondly, with auditing/assurance – the enabling of objective, comparative analysis of companies' non-financial activities, and finally, via materiality – a meaningful interpretation of these measures against long-term value creation.

The other pressing issue is time. Awareness of corporate ESG issues has come a long way fast. It's now vital we have the frameworks quickly in place to effectively measure them.

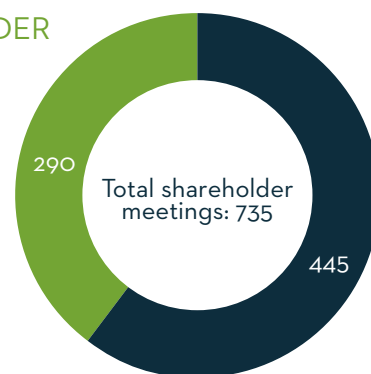
## VOTING ACTIVITY

Proxy voting is a key component of stewardship. When voting on behalf of our clients, we consider the long-term economic impact of our voting decisions. 2018 saw a continuation of many of the themes we have seen in recent years, including remuneration where there is a broad push to increase transparency and bring incentive plans in greater alignment with the long-term interests of shareholders.

'Overboarding' has been another common concern, with many directors still taking on unrealistic numbers of commitments. Meanwhile, the long-standing issue of board structure has kept cropping up, particularly regarding independence and diversity. Finally, as we mentioned last year, the pressure around climate change ('carbon risk') disclosure is increasing – with an unsurprising focus on the fossil fuel sector – and we remain supportive of many initiatives on this front. As always, we review all meeting proposals on a case-by-case basis, with our clients' best interests at the heart of all our decisions.

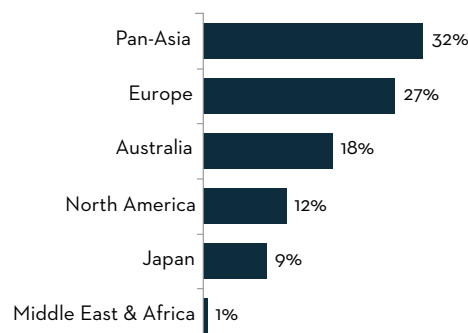
**PROXY VOTING IS A KEY COMPONENT OF STEWARDSHIP. WHEN VOTING ON BEHALF OF OUR CLIENTS, WE CONSIDER THE LONG-TERM ECONOMIC IMPACT OF OUR VOTING DECISIONS.**

### SHAREHOLDER MEETINGS

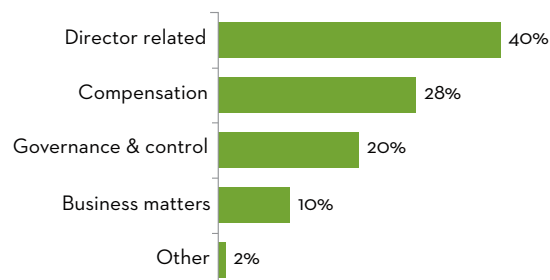


- Number of shareholder meetings at which we voted in line with management
- Number of shareholder meetings at which we voted against management on at least one resolution

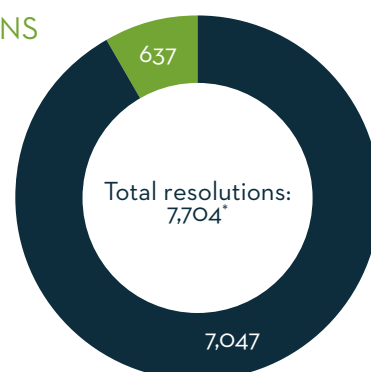
### GEOGRAPHICAL BREAKDOWN OF VOTES AGAINST MANAGEMENT



### CATEGORIES FOR VOTES AGAINST MANAGEMENT



### RESOLUTIONS



- Number of resolutions voted in line with management
- Number of resolutions voted against management

\*Number of non-voting resolutions equals 20

## VOTING EXAMPLES\*



### Indonesian retailer

**Issue:** Lack of disclosure on board candidates ahead of AGM.

**Objectives:** In order to be able to make a decision on whether to support candidates seeking nomination to the board of directors and commissioners, it is important that investors are able to make an informed assessment of the candidates. In this case, the company had not released sufficient details in the initial proxy to enable this.

**Scope and process:** We engaged with the company initially by email and followed this up with a phone call to the head of investor relations to explain our concerns about the lack of disclosure and the implications this had for being able to make an informed decision.

**Outcome:** After our initial contact, the company issued a revised proxy, but this still lacked biographical details. The company then published biographies for the new board members. With this additional information we were able to make an informed decision on our support for the board nominees.



### Hong Kong-listed luggage manufacturer

**Issue:** Concerns about structure of long-term incentives.

**Objectives:** The company proposed a share-award scheme for senior executives ahead of its AGM. We were concerned, however, that the structure was not aligned with the strategic goals of the group and raised issues of potentially excessive dilution. In particular, we noted the significant element of the award based on time vesting with no performance criteria attached. For the remaining portion, where performance requirements were in place, the focus was on earnings per share (EPS) and relative total share-holder return (RTSR) with no inclusion of a return-on-capital-based metric. Given the acquisitive nature of this business, the lack of return-based metrics was of particular concern.

**Scope and process:** We outlined our position to the company and requested further information on the structure of incentive plans and the strategic consideration behind these awards. We weighed the company's explanation that time-vesting plans aid retention and that simple EPS measures are easily understood against our preference for performance measures (rather than simple time vesting) and belief that return-on-capital-based measures give a better understanding of acquisitive businesses. We believe that simple earnings per share criteria allows management to game targets by 'buying' EPS through acquisitions, even if it overpays for the companies it buys. We were pleased that the company provided prompt and clear answers. However, after we analysed the replies, we did not find that they adequately addressed our concerns.

**Outcome:** As the structure of the share-award remained unchanged at the time of the AGM, and because our analysis suggested this was not in line with strong practice, we decided to vote against this award. In this case, although the resolution passed, there was a significant (27%) vote against the resolution.

\*We have chosen not to name some of the companies in this section.

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# VOTING ACTIVITY

## VOTING EXAMPLES



### South African internet investment company

**Issue:** Misaligned remuneration policy and skewed shareholder structure.

**Objectives:** We had concerns about the structure and time period of the long-term incentive plan (LTIP), where we believed that the alignment with the objectives of the business and with shareholders could be improved. In particular, the short vesting period for elements of the LTIP were problematic. In addition, the protections offered by the dual-class structure and the lack of potential controls we perceived around future share issuance were a cause for concern. Our engagement with the company has sought to address both of these issues.

**Scope and process:** We have consistently engaged with the company on both remuneration and shareholder structure over the last few years. We corresponded with the group ahead of its annual general meetings outlining our thoughts and reasons for the position that we have taken. We also had the opportunity to raise these issues in our face-to-face meetings to progress this issue.

**Outcome:** We have been consistent in our approach over the last few years and have noted incremental improvements to date. In response to our concerns, the company has brought the group chief people officer to discuss these issues in more detail. Pleasingly, we were asked to provide guidance on the detail of the key changes we would like to see on the remuneration structure. This engagement is ongoing.



### Malaysian gaming company

**Issue:** Concerns around independence on long-tenured directors and succession planning.

**Objectives:** We do not believe that long tenure necessarily precludes independence. However, in this case the senior independent director, who plays a key role as representative of minority shareholders, had been working with the CEO for so long that it raised concerns regarding his ability to remain independent. In addition, the length of tenure of board members raised concerns regarding succession planning. While the company made some reference to this in its disclosures it appeared to be 'boiler-plate' rather than insightful disclosure.

**Scope and process:** This was an issue that we first raised with the company in detail last year. We outlined our concerns about both the long tenure and the succession planning and noted the limited disclosure around both of these. We indicated that we could not support re-electing all the directors without further disclosure on these issues. We appreciate the skills and experience that the directors have brought to the board; however, in our conversations with the group we continued to have concerns about the processes in place.

**Outcome:** We decided to vote against the election of two members of the board and we continue to engage on this specific topic with the company.





#### Telstra – Australian telecoms company

**Issue:** Concerns about remuneration structure.

**Objectives:** We believed that there was a material misalignment between executive pay, the company's economic performance and shareholders' outcomes for a second year in a row. Notably the CEO's fixed remuneration increased leaving it above median, and the variable remuneration remained static, in spite of a material decline in both economic results and the share price indicating a significant misalignment between pay and performance.

**Scope and process:** This is a company that we engaged with extensively over time and have been able, through that process, to outline our concerns.

**Outcome:** Our concerns on the remuneration outcomes were sufficient for us to vote against the remuneration report. We noted that in this case there were clearly a significant number of shareholders that held the same view as ourselves and the remuneration report received 62% votes against. In Australia this is significant because the 'two-strikes' law holds directors accountable for executive salaries and bonuses – as in this case, where more than 25% of votes are cast against a remuneration resolution this counts as a 'first strike'. In response to this we expect that the company will engage extensively with shareholders like ourselves to address the concerns raised. As such, this will be an interesting area to monitor.



#### Tabcorp – Australian gaming company

**Issue:** An over-boarded director, poor track record on capital allocation and inappropriate remuneration structure.

**Objectives:** We were particularly concerned about the time commitments of one of the external directors in relation to other roles. An additional concern was this individual's limited industry experience at a time when the company has been subject to a money laundering breach and a poorly structured external venture.

**Scope and process:** Through our engagement programme, we had a number of separate discussions with board members and outlined our concerns about the record on capital allocation and the oversight risks presented by time-poor directors at a period when scrutiny on the company is heightened. We therefore wanted to prompt the company to take a frank appraisal of its governance structure and shortcomings.

**Outcome:** We believe that informed voting can send a strong signal to a company. In this case, our engagement did not lead to signs of change so we voted against the re-election of the director in question. We also voted against the remuneration report on inappropriate structure, as in our view, short-term incentives should have been forfeited given losses from the poorly structured external venture.

## OUR VISION

In recent years, there have been fundamental shifts in the perception and accountability of companies – a growing acknowledgement that value can either be created or impacted by factors far beyond the traditional boundaries of financial capital. However, we believe that both the scale of factors likely to affect corporate sustainability in the future and the need to meaningfully analyse these are still hugely underappreciated.

Indeed, more often companies are being challenged to understand and preserve the implicit social contract they hold with their stakeholders – from employees and investors, to local communities and global consumers. We believe the growing focus on companies to maintain their ‘licence to operate’ will be increasingly material to corporate successes and lifespans over the next decades, and is therefore impossible to ignore from an investment perspective.



Climate-change



Millennials



Disruptive  
Technologies

In our opinion, there are several exogenous forces irreversibly driving this trend. Firstly, climate-related change has now reached a tipping point. Companies now not only have to consider the practical sustainability of their operations in light of a whole range of climate-change scenarios, such as water scarcity and resource limitations, but will also be forced to abide by, and report on, increasing climate-related regulations. Specifically, in the next few years, we expect to see policy outcomes from COP24 very quickly filter into national-level and industry-specific regulations on green-house gas emissions. What's more, in a far more climate-focused world, companies will need to have sufficient transparency and rigour around their individual climate strategies merely to preserve their licence to operate.

We see shifting demographic values as also being hugely impactful in this regard. As with issues such as climate change, the growing influence of Millennials as consumers, investors and decision-makers will have significant impact on business practice, brand perception and ultimately end demand. The effect of this generational change will see a far greater demand for corporate sustainability, which in turn will be a key determinant of economic relevance. Likewise, we envisage that disruptive technologies will also have profound effects on society in the near future. The rise of collaborative robots, drones, artificial intelligence, autonomous vehicles and machine-learning algorithms will simultaneously raise productivity levels and challenge human capital, creating varying periods of adjustment, risk and opportunity for companies.

In this sense, the evolving role of the corporate will be a crucial dynamic for investors to understand. We believe companies will soon need to have a much clearer way of articulating their purpose and values. They will increasingly need to demonstrate how they create (or preserve) value for all their stakeholders through, for example, integrated reporting – something we have been early and active supporters of within the investment industry. In particular, there is likely to be specific attention paid to corporate responses to Sustainable Development Goals in the coming years. The role of boards will also have to evolve. Greater alignment with the interests of long-term investors will be crucial, and improvements in accountability, governance structures, diversity and transparency will be the hallmarks of successful companies.

Similarly, in our view, asset managers need to work much harder to instil a sustainability imperative in what they do. Stewardship should be the pathway for this, a means of earning back trust by focusing on achieving sustainable investment outcomes for clients. Expectation is building in this regard – through increasing regulation on asset owners to integrate sustainability factors in their mandates as well as beneficiaries progressively demanding this. Asset managers would therefore be unwise to consider stewardship as just a short-term fad or a box-ticking exercise. As we have demonstrated in this year's report, we believe it must exist as a fundamental part of the investment philosophy, inextricably linked to a long-term view of companies' financial and non-financial performance.

But we believe there's still much more we can do. We continue to evolve our analytical frameworks to incorporate increasingly pertinent sustainability issues such as cybersecurity, taxation and, of course, climate change. Importantly, we will engage with companies, both on a one-on-one and collaborative basis to encourage them on this journey. And finally, in light of improving disclosure by companies, we will be evolving how we can more effectively report on outcomes to our clients.

For access to some of our insights on stewardship and ESG, visit our website [www.martincurrie.com](http://www.martincurrie.com)

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