

DIFFERENTIAL
CAPITAL



Differential Capital (PTY) LTD

ESG POLICY

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1. Why do we ascribe importance to ESG?

Differential Capital's purpose is to improve people's *lives* through superior asset management. The Anthropocene era is already responsible for the Sixth Great Extinction. Global inequality levels are rising or remaining stubbornly high in most countries. A spate of recent governance failures in South Africa has severely dented the country's reputation for having ethical management teams. Core to Differential is the desire to leverage our privileged position as custodians of capital to effect positive change.

It is morally *and financially* the right way to invest

Sustainable investing does not impede returns. Evidence continues to grow which shows that helping society and generating superior risk-adjusted returns are not mutually exclusive.

The Anthropocene is arguably the biggest challenge we face

The decisions we make today will echo in the lives of our descendants for generations.

Bad governance has major social ramifications

The Global Financial Crisis clarified the need for capital allocators to be more vigilant of moral hazard and general corporate governance failures. Closer to home, South Africa has been rocked by scandals both in the public and private sectors, both of which have been hugely detrimental to society.

Social inequality is a global systemic risk

According to the United Nations, in-country inequality has risen dramatically since the 1970s. This has no doubt fuelled global populism, intolerance, and increased the spectre of potential conflict globally.

Ultimately, we will achieve our purpose if our actions result in positive financial outcomes for clients, create a more equal society for all South Africans, and a more hospitable planet for our descendants – one investment at a time.

2. How do we define ESG?

- **(E)nvironmental**
 - **Being mindful of the natural environment and making economic choices that are not harmful to the earth.** By considering factors such as global warming, greenhouse gas emissions, water use, energy use, food supply etc., we endeavour to ensure that companies conduct business in a manner that is either positive for the environment, or at least minimally impactful
- **(S)ocial**
 - **Companies should have pro-social utility. We consider a company's net impact on inequality, growth and job creation.** We also consider if a company promotes responsible consumption and if its core activities create economic or physical dependency. We further consider the impacts on poverty, hunger, health and education
- **(G)overnance**
 - We expect the board, management teams and indeed the entire organisation to exemplify the highest standards of ethics.

We view ESG as a separate risk factor. ESG failings, aside from potentially destroying shareholder value in a particular company, also have the potential to destroy value in *other* companies.

$$FV = \frac{D_1}{(RFR + ERP + ESGP) - Growth}$$

ESG integration incorporates the risk associated with non-adherence to ESG practices as it relates to both the moral (effect on society) and capitalist (effect on shareholder return) imperatives.

3. What do we do?

Differential Capital is a signatory to the UNPRI. A cornerstone of our philosophy is the expectation that all companies in which we invest conduct business in a manner that has positive social utility.

1. ESG is the responsibility of all staff members

All staff members understand the purpose of the company, are empowered to further it, and are required to adhere to it. The responsibility of monitoring of the investment universe with regards to ESG considerations is the duty of all analysts, with ultimate responsibility devolving to the directors.

2. Our first screen is an ESG screen

We exclude companies based on exhibiting strong ESG disutility. We employ a dispassionate scorecard which determines whether a company is considered for inclusion into the portfolio. Where a company is excluded, we still comment on the detriment it causes to society. Simply not investing is not good enough. Inaction is action.

3. We conduct thorough analysis on ESG factors.

Our ESG process is as detailed as our bottom-up fundamental analysis. We score companies independently on adherence to the United Nations Sustainable Development Goals. We consider 63 environmental factors, 105 social assessments on factors and 111 factors on governance.

4. We will set the benchmark for activism and social commentary

We aspire to be the industry leader with regards to advocacy of ESG considerations. Voting on resolutions for all holdings is a minimum requirement. We are guided by our Proxy Voting Policy. Constant engagement with the board of directors on ESG failings is routine. We will make public commentary on issues where society is being harmed by certain industries or companies. In instances where Differential votes against resolutions, Differential will communicate this formally to the board of directors and may opt to make the reasons public.

5. Company engagement is ongoing

As shareholders of a company, we see ourselves as collaborators. Our engagements with management are considered a routine part of our ownership.

6. Promote ESG best practices

It will benefit society if we share our ESG insights with management teams and broader society. It will strengthen corporate governance as it relates to both the moral and capitalist imperative, resulting in a better society and better shareholder returns. Our overarching goal is to benefit society, and therefore, there may be instances where it is appropriate to collaborate with other stakeholders.

4. How AI enables ESG

The use of Artificial Intelligence and Data Science pervades Differential Capital. Mundane tasks are carried out by machines, freeing up humans to apply their minds to matters such as ESG – which are more nuanced and not easily automated. We track many data sets that allow us to independently assess a company's prospects, removing any reliance on management access or rapport, which frees us up to ask the difficult questions.

This policy guides Differential's ethos towards ESG. However, all team members constantly evaluate and interrogate ESG aspects as is relevant. A policy can never be all inclusive. Our philosophy is clear and we wholly embrace it. By doing this, our processes are iteratively enhanced, resulting in continuous improvement.