M&G Global Listed Infrastructure Fund

Understanding our ESG approach

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The M&G Global Listed Infrastructure Fund is not explicitly labelled as an ESG fund, but environmental, social and governance (ESG) considerations are central to our investment process. As investors in long-life, immovable infrastructure assets, we endeavour to ensure asset and business sustainability by incorporating ESG factors in our fundamental analysis.

The importance of ESG

By their nature, infrastructure assets can be inherently impactful on the environment and communities in and around where they operate. Capital allocation decisions by an infrastructure company's management and board also tend to have long-term consequences. These businesses can also face ongoing exposure to often-shifting environmental, regulatory, and development challenges. As such, an ever-present risk to any infrastructure business is the potential loss of its licence to operate, whether for a single asset, business segment, or indeed at a corporate level. We therefore believe that effective ESG analysis is essential to mitigating risk with the potential to grow the value of our investments.

The value and income from the fund's assets will go down as well as up. This will cause the value of your investment to fall as well as rise and you may get back less than you originally invested.

Our ESG process

We employ a four-step approach to integrating ESG in our investment process (see Figure 1).

Pre-screening

We begin by screening potential investments for exposures necessitating hard exclusions: companies that generate over 30% of their revenues from coal-fired power and nuclear power are automatically excluded. We place these limits on nuclear and coal-fired power generation for economic reasons, under the belief that stranded asset risk is prominent in these activities. Other exclusions and restrictions include alcohol, tobacco, adult entertainment, gambling, controversial weapons and cluster munitions.

Figure 1. Four-step ESG investment process

Stage 1

Pre-screening

Hard exclusions
- Cluster munitions and anti-personnel mines
- Coal-fired power
- Nuclear energy
- No material exposure to alcohol, tobacco, adult entertainment, gambling and controversial weapons

Third-party rankings
- Ethical considerations:
  - ISS-Ethix UN Global Compact
- ESG considerations:
  - MSCI

Stage 2

Quality scorecard

Independent analysis of ESG and related issues
- Assessment of material risks specific to infrastructure: Climate change
  - Physical footprint
  - Age of asset base and stranding risk
  - Regulatory risk

Stage 3

Quantification of ESG risks

Evaluation of risk vs return potential
- Stock level:
  - Scenario analysis
  - Revenue modelling
  - Cost modelling
  - Discount rate
  - Terminal asset value/growth rate
- Portfolio level:
  - Greenhouse gas (GHG) exposure

Stage 4

Monitoring of ESG issues

The ongoing process
- Hard exclusions
- Voting on ESG issues
- Quarterly oversight with Corporate Finance and Stewardship team
  - Downgrade to RED in UNGC
  - Downgrade to B or CCC in MSCI ESG ratings

Source: M&G, 2020.

Figure 2. Most significant ESG considerations for infrastructure companies

Environmental	Social	Governance
• Water usage	• Health and safety	• Shareholder rights
• Resource scarcity	• Working conditions	• Board independence
• Waste and pollution	• Supply chains	• Dividend policy
• Compliance and regulation	• Community relations	• Remuneration and incentives
• Carbon/GHG	• Stakeholder management	• Audit and internal control
• Climate change		• Cyber security
• Energy efficiency		• Bribery and corruption

Source: M&G, 2020.

We also screen potential investments for any warning flags received from the UN Global Compact (UNGC) principles (according to data from ISS-Ethix), and for third-party rankings provided by MSCI ESG. If an investment candidate screens RED under UNGC and/or is ranked CCC by MSCI ESG:

- An exhaustive due diligence is performed, encompassing independent analysis and engagement with the company.
- The investment candidate is referred to an internal forum where ESG-related findings will be presented and the investment case challenged.

Quality scorecard

Next, we conduct detailed independent research, often involving company engagement, and create a quality scorecard for every investment candidate. This scorecard assesses potential investments against a number of ESG considerations that we believe to be specifically pertinent to infrastructure assets and businesses. At all times, our analysis of ESG factors is performed on both a relative and absolute basis, and any given company's direction of travel is paramount.

Quantification of ESG risks

Having assessed these factors, we attempt to quantify ESG risks in the investment case in order to evaluate whether the return potential outweighs the risks. If we believe the risks to be sufficiently accounted for, the stock will be allowed into the portfolio.

Monitoring of ESG issues

After a stock enters the portfolio, there is a robust process in place – comprising company engagement, voting, and oversight with our Corporate Finance and Stewardship team – to ensure the ongoing monitoring of ESG issues.

Our ESG process in practice: Republic Services

We invest in a number of businesses with indisputable ESG credentials, for example, companies dedicated to the production of renewable energy. But rather than showcase these holdings here, we provide a more nuanced case study that gives a better sense of how we balance ESG risks while aiming to add value to our investment process.

Republic Services is a US-based, industry-leading waste management company with strategic physical assets in its network. An ESG-oriented study of this company provides insight into our ESG process, our use of independent research and company engagement.

As a company engaged in waste management, Republic Services is inevitably associated with its landfill assets and related greenhouse gas (GHG) production, and thereby scores poorly with many third-party ESG providers. This type of assessment is simplistic, in our view: the provision of waste management services is essential for society, and landfill is an unfortunate but inevitable consequence of humans' creation of non-recyclable waste. However, where assets are well managed, and where companies make use of technology and waste-reducing initiatives such as recycling, the impact can be diminished.

In this regard, waste management companies' attitude towards their corporate social responsibility is fundamental, as it plays an instrumental role in ensuring that these regulated businesses and their associated assets remain licensed and indeed appreciated over the long term. As such, we performed thorough ESG due diligence on Republic Services, which encompassed both detailed independent research and specific ESG-focused meetings involving our investment team, M&G's Head of Corporate Finance and Stewardship team and the company.

In studying Republic Services's ESG exposures, a specific focus was on its landfill sites, which, as immovable physical infrastructure, face potential stranded asset risk. Our due diligence process provided comfort that the company works effectively to manage and mitigate these risks. It carefully monitors geophysical threats to its landfill sites and develops infrastructure where necessary, for example, by fortifying sites to protect against seismic activity. Additionally, it has designed pioneering technologies for the capture of liquids and gases, two potentially impactful by-products of the decomposition of waste. Rather than just disposing of these liquids and gases, the company attempts to reuse them – treating the liquids and returning them to watersheds, and harvesting the gases and repurposing them as energy.

Outside of landfill, the company is investing further in its recycling capabilities, generating a return on capital by developing a business unit that is increasingly significant as demand for recycling increases. In addition to generating a healthy return, this investment enhances the sustainability of the company's business model, improving the likelihood that Republic Services will remain relevant over the long term.

The company's promising direction of travel is also reflected in its commitment to clearly defined sustainability goals.[1] Having achieved its 2018 targets, Republic Services has embarked on a more ambitious strategy with seven sustainability goals aligned with the United Nations' Sustainable Development Goals (SDGs).

[1]https://www.republicservices.com/cms/documents/sustainability_reports/2019SustainabilityReport.pdf

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The fund invests mainly in company shares and is therefore likely to experience larger price fluctuations than funds that invest in bonds and/or cash.

The 'Blue Planet' initiative aims to deliver on the following goals by 2030:

- **Safety Amplified**
  - Zero employee fatalities
  - Reduce OSHA (Occupational Safety and Health Administration) Total Recordable Incident Rate (TRIR) to 2.0 or less
- **Engaged Workforce** Achieve and maintain employee engagement scores at or above 88%
- **Climate Leadership** Reduce absolute Scope 1 and 2 GHG emissions by 35% (2017 as baseline year), aligned with Science-Based Targets initiative (SBTi)
- **Circular Economy** Increase recovery of key materials by 40% on a combined basis (2017 as baseline year)
- **Regenerative Landfills** Increase biogas sent to beneficial reuse by 50% (2017 as baseline year)
- **Charitable Giving** Seeking to have a positive impact on 20 million people

These 2030 sustainability goals are designed to address the key risks and opportunities for the business, including those associated with climate change, in recognition of the inextricable link between sustainability performance and financial return. The benefit to the environment and society will strengthen the business over the long term, in the company's view.

Republic Services is also committed to transparency with the publication of an annual sustainability report to demonstrate progress in supporting the circular economy. As long-term shareholders, we will continue to discuss sustainability developments with the management team to ensure that the investment case remains robust.

In all, we believe that Republic Services provides an essential service for society in a responsible manner, giving us comfort that the business will remain relevant in the future.

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