MAY 2021

ESG Philosophy

OVERVIEW

Eagle's main competitive advantage has always been our willingness and desire to think over a long time horizon. As we celebrated our 30th anniversary in 2018, we reflected upon our business and discovered an old Eagle marketing brochure from the late 1980s stating our purpose: To achieve superior returns over the long-term with a best-in-class team that shares core values and provides the highest quality client servicing to our partners. That remains our purpose, *our why*, to this day.

This long-term framework applies to everything we seek to do, from hiring the right people and partnering with the right clients to finding the best management teams with whom to invest. We have always considered how our investments are impacted by various factors. We believe environmental, social, and governance (ESG) issues will undoubtedly impact value for investors in the future and become increasingly important to long-term value creation.

In this paper, we review our investment philosophy and how we have incorporated ESG related issues and awareness into our investment approach. As we are committed to providing our investors with superior returns, our Research team continues to integrate material ESG considerations into our research process.

INVESTMENT PHILOSOPHY

As our investors know, Eagle Capital focuses intensely on the drivers of long-term value creation. We use a fundamental, bottom-up research approach to seek to identify undervalued companies with unrecognized long-term growth potential and stocks that are inexpensive relative to their core earnings power and long-term prospects. Our time horizon uniquely positions us to think differently about what drives and influences industries and companies.

Our Research team seeks to build a portfolio of businesses with two primary characteristics. The first is that, even in times of stress, the underlying assets are strong enough to generate cash flow and maintain a value floor for the investment. In other words, the company is a good value based on what we can be fairly certain of now.

The second characteristic we look for is some change afoot that is unrecognized by the market and in our view likely to be very valuable in the out years. If we get those two pieces correct, the value part of our work should defend the portfolio when times are bad, while the eventual realization of the change should generate extra returns when things go right.

These two timeless principles of Eagle are where we focus our energy and where we believe we can gain a sustainable competitive investment advantage. And this is the reason that our philosophy and process have been consistent since our firm's inception, enabling us to significantly outperform the market since 1988.

ESG SUMMARY

Sustainable investing is a framework in which an investment adviser seeks to maximize long-term value creation while considering ESG criteria. However, sustainable investing can be a confusing landscape to navigate when the terminology has varied widely to include: ESG, Socially Responsible Investing (SRI), Impact Investing (II), Conscious Capitalism, Mission Related Investing (MRI), Screening and Exclusion. Before describing how we incorporate ESG into our research process, we think it is helpful to clarify how we view each of these three broad categories:

- Environmental: How a company incorporates its views on the natural environment. Examples include climate change, energy consumption, fossil fuels, pollution standards, waste, and hazardous materials.

- Social: How a company manages its relationships with people, including its employees, customers, suppliers and community. Examples include corporate philanthropy, diversity issues, human rights, product quality and safety, responsible R&D and working conditions.

- Governance: How a company deals with leadership. Examples include executive compensation, board structure, audits, internal controls, shareholder rights, and tax strategy.

With the proliferation of new ESG products coming to market, what has become clear is the lack of universal reporting standards. MSCI and Sustainalytics are two of the most widely used ESG data providers, but their correlation is only 0.53 among their scores, meaning that their ratings of companies are only consistent for about half of the coverage universe.[1] Additionally, the MIT Sloan School of Management released a working paper focusing on the divergence of ESG ratings, and in its data set of five different ESG raters, the correlations between their ratings were on average 0.61 (and a range from 0.42 to 0.73).[2] It is important for both investors and investment managers to understand the differences in service providers as this selection may align with a different ESG philosophy, materiality or scoring profile.

EAGLE'S ESG APPROACH

Eagle has created an ESG Advisory Council to reflect the growing importance of advancing ESG tenets in our firm and investment portfolio. To find undervalued companies, we must understand the drivers of return. Using a sustainability lens within our investment process to view ESG issues – such as corporate governance, tax strategies and diversity measures – may impact the growth potential in a positive or negative way in the long term. Good governance should, by definition, lead to better corporate financial performance.[3]

Our eight member Council includes Eagle's Founder and CIO, Ravenel Curry, as well as senior partners and members from many areas of our firm, including investment research, operations, finance, and client services and also an external ESG advisor (Mark Sloss, Founder and CEO of Regenerative Investment Strategies). Our Council is led by Yinh Hinh, who leads our ESG activities as a member of our Research team. We view ESG as a material theme for all business functions to promote long term thinking with the aim of positively impacting our firm, portfolio and returns.

Fundamental Analysis

Our investors have come to know that Eagle's "North Star" is buying undervalued companies with what we consider to be unrecognized long-term growth potential. We are value-oriented investors with a long-term horizon which in our view has proven to be a structural advantage as we are able to focus on years 5 and beyond. The typical holding period for stocks is shorter today (approximately nine months) than any other time period in the last century.[4] The quarterly earnings cycle promotes short-term focus in the investment community, creating a dearth of long-term thinking.

We have focused on underlying businesses that in our view are durable enough to generate cash flow and maintain a value floor to our investment, and Eagle has always recognized a core tenant of an ESG mindset – strong corporate governance provides greater confidence in projections of cash flows and the stability of earnings. This mindset has consistently provided investors with strong financial returns. Applying a fitting materiality framework further enhances our long-term value creation objectives.

We tend to agree with "The Investor Revolution," a 2019 *Harvard Business Review* article by Robert Eccles and Svetlana Klimenko, that sustainable investing is about materiality. A company that spends vast sums of money trying to address every conceivable environmental, social, and governance issue will likely see its financial performance suffer; however, companies that focus on material issues tend to outperform those that don't.[5] Professor Eccles, a tenured professor at Harvard Business School and a leader on how companies can create sustainable strategies, also argues that materiality varies by industry.

There is no set playbook on how to apply ESG factors to an investment portfolio. Given the lack of uniformity around ESG reporting, it helps to understand materiality issues and reporting trends. At Eagle, our ESG Advisory Council and Research team bring a specific ESG awareness to analyze issues that may have a material impact on a company's future performance. Our ESG approach relies on consideration and deliberation, not objective standards or metrics, which can make it challenging for investors to assess the effectiveness or results of our ESG process versus other managers who may have their own distinct approaches.

After much research with a materiality lens, we identified SASB as a strong partner to work with and now have been an Alliance Member since 2019. SASB is an independent nonprofit founded to establish a much clearer understanding of material sustainability risks and opportunities facing companies, and to create industry-based performance statistics suitable for disclosure in standard SEC filings. SASB has identified the material ESG issues for all 77 industries in its classification system. For example, material issues for companies in food retail and distribution include greenhouse gas emissions, energy management, access and affordability, fair labor practices, and fair marketing and advertising. For internet and media services, the list includes energy management, water and wastewater management, data security and customer privacy, diversity and inclusion, and competitive behavior.

In addition to our deep fundamental work and SASB's materiality framework, Eagle's research team utilizes third-party research and ratings to gain a deeper understanding of the issues faced by each of our companies regarding material ESG factors. As there is no single common definition, approach, or implementation process around ESG investing, in a similar fashion third-party data also varies widely. Eagle evaluates ESG factors raised by third-party research in the context of our internal analysis of a company's long-term growth strategy, competitive positioning and financial longevity. Using third-party data, Eagle is able to view a company's external ESG rating, ESG rating history, benchmark against peers and key ESG-related issues affecting individual companies.

Decision Making Process

Eagle's approach to ESG is predicated on the meaningful link between sustainability and long-term value creation. With the combination of Eagle's fundamental research, the SASB framework, and third-party research and ratings, our Research team examines the value of the companies while reviewing material risk factors, including ESG considerations. Our ESG Advisory Council meets regularly with our Analysts to review each portfolio company, generally undertaking the following four-part ESG review to further evaluate our analysts' conviction level in each investment:

1. Identification: Identify major ESG risks that could potentially have a material impact on the company's future performance
2. Assessment: Assess the level of concern for each of the key ESG issues
3. Monitoring: Review effective ways to monitor key ESG issues
4. Engagement: Outline questions and engagement (proxy activity) to focus on in future meetings with management

Every company in the portfolio has its own documented ESG specific analysis, as one of the factors in our research process that is used to evaluate investment decisions. Companies with more meaningful risks, including ESG factors, will be sized appropriately in the portfolio. It is essential to monitor if these sustainability factors will affect a company's long-term performance and have a material impact to their returns over the long term. We anticipate our ESG process and review will further evolve in context to the burgeoning sustainability communication, transparency and data from companies.

COLLABORATION WITH THE ESG COMMUNITY

As a member of the SASB Alliance, Eagle gains access to a global network of institutional investors and ESG experts to compare materiality issues and reporting trends for our investors. Along with other SASB Alliance Members, we share the belief that the industry needs a more consistent and standardized approach to sustainability disclosures for the benefit of both investors and companies. Eagle has participated in SASB's industry specific research projects in order to share insights from an investment manager's perspective; we believe our level of transparency may further improve SASB's materiality research and standard setting practices.

Eagle is also a Signatory to the United Nations-supported Principles for Responsible Investment (PRI). PRI defines sustainable investing and ESG integration as "the explicit and systematic inclusion of environmental, social and governance issues in investment analysis and investment decisions. Put another way, ESG integration is the analysis of all material factors in investment analysis and investment decisions, including environmental, social, and governance factors."[6] The PRI has become a leading global network for investors who demonstrate their commitment to responsible investing. Eagle became a Signatory largely as a reflection of the work we were already doing related to ESG investing. With over 3,500 Signatories globally in over 60 countries, we look forward to collaborating further with this community of like-minded investors. Our team can learn from and share with SASB, PRI and other notable institutional investors focused on ESG issues.

Most importantly, we always put our clients' interests first. We pride ourselves on open communication, transparency and trust with our partners. We have had many conversations with various investor types including endowments, foundations, sovereign wealth funds, pensions, family offices, and investment consultants to gain a unique opportunity to learn as to which ESG concerns are important to them. Through these conversations, we can support and incorporate our clients' portfolio demands and explore their sustainability goals.

EAGLE CULTURE

Our ESG principles are embedded throughout our organization and help us ensure that our business model will be sustainable well into the future. Eagle Capital is committed to creating and fostering a culture of diversity and inclusion. We believe that our human capital is our most valuable asset, and Eagle investors have come to know our low employee turnover and high talent retention is attributed to a unique culture centered on staying humble, staying curious, and staying focused for our clients. We deeply appreciate the diverse life experiences and backgrounds each team member brings to our firm. Eagle's diversity and inclusion initiative begins with the hiring process, where we look to recruit the best person for the role regardless of their age, race, ethnicity, sexual orientation, parental/marital status, or disability.

Eagle recognizes that progress is critical and is committed to continuing to improve our diversity, especially on our investment team. We strongly believe a diversity of backgrounds, experiences and ways of thinking among our colleagues leads to better investments and business insights.

In addition to working with traditional recruiters to identify underrepresented talent, we partnered with the Toigo Foundation to benefit from their talent management services to enhance our internship model and to source candidates for an investment team internship program in summer 2020. The success of the program has led to an expanded relationship with Toigo to assist in our education and awareness in framing our long-term D&I strategies.

Our diversity and inclusion initiative is led by senior members at Eagle including Anne Maffei (Partner, Client Team) and Chip Robie (COO). Eagle works closely with recruiters and with external compensation consultants to ensure fairness in compensation as well as to maintain internal policies that incorporate anti-discrimination, anti-harassment, anti-sexual harassment and anti-racism guidelines.

Teamwork is integral to every part of our organization and approach to our business. As a flat and lean organization, we believe that a collegial and non-bureaucratic culture helps employees thrive and work most productively.

EAGLE ESG SUMMARY

Eagle continues to pursue its original purpose: to seek to achieve superior returns over the long-term with a best-in-class team that shares core values and provides the highest quality client servicing to our partners. We believe that Eagle's practice of incorporating ESG awareness within our firm and into our research process should continue to improve our returns, not necessarily in the short term over the next few quarters, but over a longer time horizon that is granted by and expected from our clients.

For more than 32 years, Eagle has worked closely with our clients to understand their missions and risk and return objectives. Many of our endowments, foundations and family offices were early adopters in the sustainable investing space. Today, we have clients pursuing ESG-related investments, and even more considering it. We welcome the opportunity to work with you on developing or expanding your sustainable investment program. Please contact us to discuss your objectives and how we can be of service to your organization.

REFERENCES

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[3] Research Affiliates – Unlocking the Performance Potential in ESG Investing. March 2018.

[4] Barrons, IDC, as of December 31, 2018.

[5] The Investor Revolution. Harvard Business Review. Robert G. Eccles, Svetlana Klimenko May-June 2019.

[6] "What is ESG Integration", *PRI,* last modified April 25, 2018, https://www.unpri.org/fixed-income/what-is-esg-integration/3052.article

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