



# **Quantum's India**

## **Responsible Returns Strategy**

### **Responsible Investment Policy**

## Statement

Quantum Advisor's Q India Responsible Returns Strategy is solely focused on investing in companies that are sustainable as assessed by its proprietary Environmental, Social and Governance ("ESG") framework and thereby banking on sustainability to drive long term returns for its investors.

## Scope

The purpose of the Responsible Investment Policy (also referred to as "ESG Policy") is to describe the framework governing the approach of Quantum Advisors towards ESG investments strategies.

This document defines Quantum Advisor's approach to integrating the ESG risks and value creation opportunities into investments made through our India focused Equity ESG product offering - Q India Responsible Returns Strategy (QIRR). It outlines the firm's investment philosophy, our research process, resources dedicated to ESG integration and our engagement policy.

Our own organizational culture or our DNA emphasizes on values like honesty, integrity and transparency in the way we conduct our operations. As a long-term investor, it is natural for us to look for the same high standards in our investee companies and lead by example as a torch bearer of many of the best ESG practices. The Integration of ESG aspects in our investment process is beneficial for:

- **Our investors:** helps deliver better risk-adjusted returns over the long term while preserving or enhancing the natural and social capital. Along with being invested in top tier rated companies in corporate governance.
- **Our investment research team:** adds value to our overall research process including portfolio-management, risk-management and monitoring and identification of risks and opportunities.
- **For regulators and society:** leads to better functioning of capital markets and minimizes the occurrence of negative externalities. It can also lead to enhancing ESG standard/regulations in India.

# 1. Introduction

Over the years, Quantum Advisors have continued and enhanced its tradition of extensive financial analysis and investing by incorporating the best global practices, as it has evolved as an asset manager. As part of our research process, we had given primary emphasis to governance factors over environmental and social factors. From 2015 onwards, based on the trend of increasing importance of Environmental, Social and Governance (ESG) factors as well as regulations mandating disclosures on ESG metrics, we have developed a proprietary methodology to formally rate companies in our investment universe on their ESG intent and performance. With regulatory push and availability of more data over time, will allow for better evaluation of the impact the companies are likely to have on the environment and society in general.

Quantum Advisors is committed to maintaining an investment approach that ensures continued improvement in environmental and social performance and corporate governance in a comprehensive manner among its portfolio companies. We recognize that a company's ESG practices, whether good or bad, can affect its valuation and financial performance. There have been numerous implicit evidence of the same. As a result, we pledge to exercise independent judgment in identification of ESG risks and opportunities, incorporate ESG information in our investment research, engage with companies on ESG issues and diligently vote proxies on all resolutions.

# 2. Our Approach

Since its inception, Quantum Advisorshas focused on the principles of long-term investing by adhering to a portfolio construction methodology based on "Active Monitoring but not Incessant Churning."

We believe that material environmental, social and governance factors are an important driver of long-term investment returns from both an opportunity and a risk mitigation perspective.

As long-term stewards of our clients' capital, it is imperative for us to assess how companies manage all forms of capital - financial, social, and human and natural resources - and to incorporate the true cost of their business operations by measuring the impact of their actions on the society and the environment. From 2015 onwards, we developed a proprietary methodology to formally rate companies in our investment universe on their E, S, and G metrics. Based on our proprietary ESG research, we manage the Q India Responsible Returns Strategy (QIRR) to provide investors an opportunity to invest in sustainable companies.

Our approach relies on our proprietary "Integrity Screen" focused on Governance as well as our principles-based, qualitative-oriented, ESG framework honed since 2015 to identify best and worst ESG practices.

For inclusion in the portfolio, a company needs to have a rating above the minimum positive benchmark as decided by the ESG team. The rating is based on our proprietary methodology. In addition, there are certain key financial filters that the company needs to comply with. These filters include long-term return on capital employed, leverage and growth rates.

**Our ESG guidelines :** As an active fund manager for our bottom up ESG analysis, apart from sector or company specific material factors, we generally look for below given aspects of E, S and G in our sustainability evaluation of companies

| Environment                                | Social                                         | Governance                                                    |
|--------------------------------------------|------------------------------------------------|---------------------------------------------------------------|
| Climate change and environmental pollution | Human capital development / employee relations | Board independence:                                           |
| Natural resource use                       | Health and safety                              | Executive compensation:                                       |
| Water Stewardship                          | Equal opportunity and workforce diversity      | Treatment of minority shareholders:                           |
| Waste Management                           | Corporate social responsibility                | Functioning of audit, remuneration and nomination committees: |
| Energy Efficiency                          | Human rights / child labour                    | Reputation / regulatory compliance                            |
| Renewable Energy                           | Responsible sourcing                           |                                                               |

### 3. ESG Research and Investment process

We believe that ESG issues will increasingly impact long term shareholder returns for companies. Companies that focus on ESG issues with its multi stakeholders approach will have a relatively lower risk profile and will be better prepared to deal with possible negative externalities.

While the ESG framework and measurement of direct costs to society and the environment are still an imperfect but an evolving science, adopting a sustainable framework for a business positively impacts a company's social license to operate and allows it to deliver superior returns over the long term.

Quantum Advisors has developed policies and procedures to ensure that the companies we invest in meet our expectations of ESG performance and that ESG risk/sustainability risk is managed in our investment process.



### 3.1 Team Structure

We have established a team dedicated for ESG analysis. Each ESG analyst has a sector focus and is responsible for identifying material ESG aspects relevant to the companies within the sector. The ESG analysts interact with our primary financial analysts and portfolio managers to identify and assess ESG risks and opportunities. ESG analyst is also responsible for engaging with the companies under coverage and flagging off any potential qualitative risks and controversies which are often missed out in financial statements. These factors are subsequently incorporated into the company models where appropriate.

### 3.2 ESG Research Process

#### **Bottom up approach :**

Identifying and mapping materiality is the foundation of our ESG analysis. The company analysis includes enhanced due diligence on environmental, social and governance risks material to the investee company and considers how companies manage the identified ESG risks.

The ESG research process typically involves the following steps -

- **Identification of material aspects:** the ESG analyst gathers information from various sources (sustainability reports, annual reports, CDP Reports, Regulatory Filings, SASB publications) to identify key material aspects relevant to the industry.
- **Report preparation:** Based on company disclosures and qualitative aspects and after an internal discussion in the ESG team, the companies are scored on their ESG performance. For details on our scoring methodology, please refer **Annexure I**
- **Presentation to research team:** The ESG analyst presents the report to the entire research team for comments / feedback or clarifications.
- **Portfolio construction:** Once agreed, the ESG scores and inputs are integrated into the equity research report of that company and used in future for the portfolio construction process. For details on our portfolio construction, please refer **Annexure II**

Once an ESG score is assigned to a company it is the responsibility of the ESG analyst to work with the sector financial analyst on updating and reviewing the data to refresh the scores. Generally, ESG scores are reviewed and recalibrated every six months or if triggered by relevant negative or positive engagement results or news flows.

### 3.3 Evaluation of ESG factors

Our scoring methodology has been internally developed and is evolving. We have formulated an internal framework to score the ESG performance of every company in our coverage. Our ESG analysis is based on a Positive Screening & Best-in-Class approach subject to adherence of the company incorporating favorable ESG practices in core / material within each of the E, S and G dimensions.

The methodology consists of scoring companies on their ESG practices on over 150-200 parameters related to a firm's disclosures on environmental, social and governance initiatives and aims at assessing its compliance as well as pro-active readiness for ESG issues. The scores are assigned based on data available through primary and secondary sources.

We evaluate the ESG performance of the company on two broad parameters.

- 1) **Disclosures (30% weight):** Companies are judged on their levels of disclosures based on inputs provided in their sustainability reports / business responsibility reports / annual reports. Companies with higher disclosures get higher scores. Our disclosure scores are based on a binary scoring system (+1 for disclosure, 0 for non-disclosure). The total disclosure score is then standardized and ranges from 0 (least score) to 100 (highest score).
- 2) **Qualitative checks (70% weight):** We check for any past violations / red flags of certain E&S metrics and corporate governance regulations. Depending on the severity of the violation, negative points are given ranging from **-10 (most severe violation) to 0 (no violation / no red flags)**. The total qualitative score ranges from 0 (highest score) to -100 (least score).

Within **disclosures** and **qualitative checks**, **Governance** is given a **50%** weight; **Environmental and Social** have a weight of **25%** each. **For further details on our scoring methodology, refer to Annexure I.**

### 3.4 Monitoring of ESG risks and opportunities and company engagement Monitoring:

Monitoring of ESG risks and opportunities, and periodic updating of scores is the primary responsibility of the ESG analyst. The ESG analyst proactively updates the company research under their coverage every six months where all the primary assumptions of the company and sector are reviewed. During the course of his / her research he / she is expected to interact with the company management and be informed of the latest industry and company specific developments.

**Engagement:**

Active ownership through engagement and voting gives us an opportunity to influence positively and to encourage transparency. Our active ownership involves engagements with our portfolio companies, where we believe it will create better long-term outcomes on ESG matters and, in turn, generate more sustainable value for our investors. Our ESG engagement efforts are tailored to connect on the issues that are most material to the companies long-term value creation and preservation.

We engage with companies on a proactive and reactive basis, when appropriate.

The main purpose of our engagement efforts with a company is to -

- gain a better understanding of the overall sustainability strategy
- seek clarification on their long-term targets and goals
- understand some of the challenges faced in the execution of their strategy and keep ourselves informed of their preparedness to any upcoming change in regulation, future risks, and evolving technologies that could impact or assist the issues they face on the ESG front.

Generally, the engagement and monitoring will cover aspects material to the investee company and may include at least one or all the points enumerated below –

- The operational and financial performance of the company
- Management's execution of the company's long-term strategy
- Industry developments and competitive environment
- Corporate governance practices
- Risk including ESG risks and opportunities relevant to the company

The research and ESG analysts also visit the manufacturing plants of companies to get a better understanding of the production process, health and safety practices and quality control measures. Research Team also engages with suppliers / vendors of the company to gain deeper understanding of their supply chain practices. We also try and engage with local communities and NGOs to help us understand ground reality of corporates.

In addition to the above, when a particular project or practice of a company has attracted a lot of controversy / negative feedback, the research team engages with the company management to get their point of view, as well as seek additional disclosures. In case the company is already in the portfolio then the investment team may consider writing to the board of directors to highlight its observations and seek immediate action.

In evaluating controversies, we place primary emphasis on -

- Whether the company has upheld the laws of the land in which it conducts operations

- Has the controversy led to loss of trust in the company by its stakeholders?
- Will the controversy impact the long-term sustainability of the company?
- Has the management taken steps to address concerns and been transparent to communicate its view to its stakeholders?

### **3.5 Portfolio action**

We believe organizations that manage environmental, social and governance (ESG) factors effectively are more likely to endure and create sustainable value over the long term. The sustainability objectives of our ESG strategy are: (a) achieving positive and above-average ESG profile (b) mitigating ESG risks and harnessing ESG opportunities, and (c) influencing overall positive behaviour by investing in companies that promote sustainable products and services.

#### Top Down Approach

Generally, for a company in our investment universe to be included in QESG, the following conditions need to be met -

- **Liquidity criteria:** US\$ 1 mn average daily trading volume in the preceding 12 months
- **ESG compliant score:** Company's ESG score is positive and above the minimum threshold as decided by the portfolio team.
- **Financial Filters:** Compliance to minimum thresholds of return on invested capital and growth rates and maximum leverage limits as decided by the ESG team.

Effective October 01, 2022, for a new company (issuer) added to the portfolio (i.e., in case of first time buy in a client's portfolio across all clients under QIRR Strategy), the Firm shall only invest in securities of those companies which have made Business Responsibility and Sustainability Report ("BRSR") disclosures as prescribed by the Securities and Exchange Board of India ("SEBI") and/or other applicable laws. Existing portfolio companies which have no BRSR disclosures may be continued to be held in the portfolio at the Fund Manager's discretion.

An ESG portfolio would take exposure to those securities with a positive / relatively high sustainability score and would generally exclude companies with, for example, poor records on pollution, labor relations or management practices. As part of our fiduciary responsibility, value system and risk management strategy, it is our core belief that a business, run in best interests of all stakeholders seldom fails to create a lasting value for its investors. Higher scoring companies will have higher weights (subject to total sector guardrails). If a portfolio company's ESG score falls below the minimum threshold or it fails our financial filters, the position will be immediately liquidated.

#### **4. Exclusion List**

Our Exclusion Policy covers the following sectors

- **Hard liquor** (the term 'liquor' does not include wine and beer)
- **Tobacco**
- **Gambling**

#### **Investor reporting:**

On an annual basis, we will report the following:

- Our practice, approach and engagement with our portfolio companies
- Updates to the responsible investment policy
- Carbon intensity of the portfolio when such data is available
- Outline in a clear and transparent manner our proprietary ESG methodology – we aim to improve our methodology, data collection and verification mechanism over time.

#### **Long term Goals**

We are committed and improve the way we deploy capital to ensure it is contributing towards sustainability and privileging companies with positive ESG performance and adherence to high sustainability standards.

## Annexure I

### Quantum Advisors: ESG Process

At Quantum Advisors, Environmental, Social and Governance (ESG) considerations are being increasingly embedded in the investment process. We believe that companies that focus on ESG issues tend to have a lower risk profile and are better prepared to deal with possible negative externalities. Companies adopting a sustainable framework to their operations are perceived to have more credibility and the framework can be used as a source of competitive advantage. The above factors allow them to deliver superior returns over the long term.

### ESG Scoring methodology

Our scoring methodology has been internally developed. We evaluate the ESG performance of the company on two broad parameters.

**1) Disclosures (30% weight):** Companies are judged on their levels of disclosures based on inputs provided in their sustainability reports / business responsibility reports / annual reports. Companies with higher disclosures get higher scores. Our disclosure scores are based on a binary scoring system (+1 for disclosure, 0 for non-disclosure). The total disclosure score is then standardized and ranges from 0 (least score) to 100 (highest score).

**2) Qualitative checks (70% weight):** We check for any past violations / red flags of certain E&S metrics and corporate governance regulations. Depending on the severity of the violation, negative points are given ranging from **-10 (most severe violation) to 0 (no violation /no red flags)**. The total qualitative score ranges from 0 (highest score) to -100 (least score).

Within **disclosures** and **qualitative checks**, Governance is given a **50%** weight; **Environmental and Social** have a weight of **25%** each.

### Some of the key aspects that we evaluate are –

#### 1) Governance:

We believe companies that have effective boards and are resilient, agile and able to anticipate, manage and integrate into their strategy material environmental and social factors, are more likely to create and preserve value over the long term than those that do not. A company's governance and incentive structures, including its board make-up and remuneration practices, influences the ability of management to deliver long-term success.

**a. Board independence:** We prefer boards that are independent in substance and have the ability to engage in constructive debate, ask hard questions and challenge management's assumptions / proposals when necessary. We typically check the compliance to listing regulations and Companies Act,



whether there is separation of role of Chairman and CEO, disclosures on process and criteria for appointing independent directors, director expertise and qualifications, participation in meetings and the overall performance evaluation process of independent directors.

**b. Executive compensation:** We prefer companies where executive compensation is linked to long-term performance and aligned with the long term shareholder interests. We check for disclosures on variable and fixed pay, policy on issuance and structuring of stock options and comparison of managerial pay with respect to peers as well as average employee remuneration in the company.

**c. Treatment of minority shareholders:** We avoid companies where related party transactions and other transactions such as mergers and acquisitions are clearly detrimental to minority shareholders. We also check for opaque and complex ownership structure which may have the potential to violate minority shareholder rights.

**d. Functioning of audit, remuneration and nomination committees:** We prefer committees with an independent chairman and consider it a good practice if executive directors are not members of the remuneration / audit committee.

**e. Reputation / regulatory compliance:** We avoid companies that have been subjected to a pattern of fines / penalties / settlements in relation to significantly negative or protracted ethical controversies / corruption issues / regulatory violations.

## 2) **Environmental:**

Environmental issues, and most notably risks and opportunities related to climate change, can impact a company's financial performance and longer-term outlook, and therefore the value of our investments.

**a. Climate change and environmental pollution:** We are conscious of the fact that companies belonging in certain industries will have a high degree of exposure to environmental risks. We evaluate whether such companies have an active plan in place to reduce / mitigate their environmental footprint. We evaluate company disclosures on its climate change strategy, performance on emissions, efforts to increase the share of cleaner fuels, waste management practices, compliance to local and central pollution control board regulations.

**b. Natural resource use:** Resource extractive industries (power, cement, oil and gas, steel, chemicals, etc.) are facing increasing regulation to improve the efficiency of their operations and minimize their environmental impact. We analyse how companies are faring on these parameters by benchmarking them against their peers as well as global best practices. In addition to



pollution mitigation measures mentioned above, we also consider the initiatives undertaken by companies to improve the resource efficiency (materials, energy, water, land) of their operations and their efforts to promote sustainability initiatives throughout the supply chain.

**3) Social:**

A company's approach to human capital is reflected in the resilience of its work force and its supply chain.

**a) Human capital development / employee relations:** We evaluate whether companies have cordial relations with employees or whether there is a history of work stoppages or strikes. We consider training and development initiatives for permanent as well as contractual employees.

**b) Health and safety:** Frequent accidents and injuries at the workplace would be a cause of concern for us. We evaluate company disclosures on health and safety policies, injury frequency rate and fatalities data as well as efforts by the company to impart health and safety training. In addition, we also track incidences of sexual harassment cases which are reported by the company.

**c) Equal opportunity and workforce diversity:** We evaluate whether the company follows the principle of equal opportunity in regards to its hiring and promotion procedures. We also consider the representation of women at different levels of hierarchy.

**d) Corporate social responsibility:** According to regulations 2% of average profits of last three years have to be spent on CSR initiatives. We judge the quantum and quality of spending on CSR activities to evaluate whether the truly marginalized and vulnerable sections of society are the ultimate beneficiaries.

**e) Human rights / child labour:** We avoid investing in companies that employ child labour or have been convicted of human rights violations. We also evaluate whether the child labour / human rights policies are enforced throughout a company's supply chain

**f) Responsible sourcing:** Since consumers are increasingly seeking to purchase goods that have been produced in socially and environmentally responsible ways, it is necessary to evaluate responsible sourcing practices of companies and their efforts to increase supply chain traceability and counterfeit management systems.

In addition to the above there are other aspects that we evaluate such as customer satisfaction and grievance handling mechanism, data privacy and protection measures, product recalls, product safety and service labeling.

## Annexure II

*Investors get exposure to broad basket of ESG compliant companies which in the long run is expected to outperform conventional market indices*



**PORTFOLIO**

40-60 stocks

Companies > ESG score of 0 qualify for inclusion in the portfolio.  
Allocation is based on the ESG score of the company, with guardrails around Index sector ranges



**ESG COMPLIANCE CHECK**

> 150 stocks

Based on Quantum's proprietary research methodology, companies within the coverage universe are ranked on their ESG performance. The evaluation process consists of a blend of quantitative and qualitative factors. *Assign scores -70 to +30*



**INITIAL SCREEN + INTEGRITY**

350 stocks

Addressable universe with avg daily traded value of > \$1 mn

+650 stocks

Quantum Advisors follows a bottom-up stock selection process. Our initial stock universe includes all the companies which meet a minimum requirement of average daily traded value of >\$1 million in last 1 year. Within our investment universe, we run an initial integrity screen and filter out companies which do not pass our integrity screen. We then assign scores to the companies in our coverage which has a scoring range of -70 to +30. All the companies which have a positive score then has to go through financial check for leverage, ROIC and growth and only if they meet the criteria; it will be added to the portfolio.