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Annual Sustainability Summary - 2023

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Fundsmith Equity Fund SICAV Annual Sustainability Summary

The intention of this Sustainability Summary is to act as a supplement to our Responsible Investment Policy and annual Stewardship Report, providing a more detailed insight into the environmental, social, and governance-related performance of our companies over the past year and to compare this with the impact of the average company in MSCI World and S&P 500 indices.

The Fundsmith Equity Fund's portfolio is constituted of a small number of high-quality companies, each with an ideal holding period of forever. Given the long-term horizon we invest with, we expect the companies that form the Fund's portfolio to act similarly, prioritising their long-term sustainability and not inflating short-term profits at the expense of the environment or society.

The Fund performed strongly across each of the environmental, social and governance measures assessed in 2023:

- It had particularly strong environmental performance, with significantly lower levels of waste generation and water and energy use compared to S&P and MSCI World indices. Most notably, the Fund's carbon intensity (metric tonnes CO_2e/ £m of free cash flow) was around 90% and 85% lower than that of the S&P 500 and MSCI World respectively at the end of the year.
- 75% of the portfolio has now either committed to or has already set carbon reduction goals in line with keeping global warming below 1.5°C, up from 74% in 2022.
- Women continue to have higher representation at the board, executive and management levels as well as in the general workforces of the Fund's companies, versus the MSCI World.
- On average, over three quarters of board members at investee companies were independent in 2023, higher than the MSCI World's 69%.
- Our independent negative impact proxy, RepRisk's 'RepRisk Index', showed that on average the Fund's companies received less negative press compared to the MSCI World's average during 2023.

One important aspect of sustainability is the positive impact that research and development can have on the products and services provided by businesses. The final section of this Sustainability Summary discusses some of the innovations from the companies held in the portfolio during 2023. This covers the innovative use of fish skin in wound care, ice cream reformulation to reduce greenhouse gas emissions and the adaption of self-stabilising cutlery to help with the application of make-up.

Contents

Environmental	**4**
Climate change	5
Social/Society	**6**
Governance	**7**
Remuneration	8
RepRisk	**9**
Innovation	**10**

Environmental

The quality of environmental reporting has increased significantly in recent years. Companies have been under increasing pressure to quantify their environmental impact and, consequently, the infrastructure/systems to collect and report the data needed for this have improved rapidly. Despite this, not all companies report environmental data and fewer still report using the same collection, processing, and reporting methodologies. The lack of standardisation both within and between industries, as well as the lag in reporting (typically 2 years) often renders comparing companies' environmental performance both unreliable and inaccurate. Additionally, it means environmental data is retrospective and doesn't necessarily have any bearing on how the company will behave in the future.

We estimate the environmental impact for those companies that do not report data by taking the average of the relevant environmental metric per £m of assets for their relevant subsector and then scaling it to the assets of the company. We don't do this for hazardous waste as companies that don't report typically don't produce any.

To produce statistics that are meaningful to investors and that are relevant to all the companies we invest in, we have chosen to track five metrics that are most commonly reported and related to globally pertinent issues. The issues are climate change (greenhouse gas emissions and energy use), resource scarcity (water and energy use) and pollution (non-hazardous and hazardous waste).

As the table below shows, on average, our companies report 79% of these simple environmental numbers, with all companies now reporting their energy usage and GHG emissions. This compares favourably to the MSCI World or S&P 500, where on average 62% and 63% of companies report these metrics respectively.

As at 31/12/23	Weighted average absolute emissions					per £m of FCF				
	Total waste	Hazard waste	Water use	Energy use	GHG emiss	Total waste	Hazard waste	Water use	Energy use	GHG emiss
	k metric tonnes	k metric tonnes	m m^3	k of MWh	k metric tonnes	metric tonnes	metric tonnes	m^3	MWh	metric tonnes
FEF SICAV	215	4.4	24	5,375	870	11.7	0.2	1,322	291	47
S&P 500	2,682	43.8	462	17,072	6,930	165	2.7	28,422	1,051	427
MSCI World Index	8,392	269	470	19,501	6,026	468	15	26,257	1,089	336
FEF port % reported	74%	44%	78%	100%	100%	74%	44%	78%	100%	100%
S&P 500 % reported	51%	36%	59%	78%	91%	51%	36%	59%	78%	91%
MSCI World % reported	56%	35%	59%	73%	89%	56%	35%	59%	73%	89%

Table 1: Environmental look through table showing the weighted average emissions of the different FEF fund vehicles both on an absolute basis and by our measure of intensity (per £m of free cash flow) relative to both the MSCI World and S&P 500. Source – Latest company reported numbers with numbers for those not reporting estimated.

Climate change

Climate change has the potential to be one of the most significant risks our portfolio companies face given the consequences of failing to mitigate the drivers behind it and/or adapt to the consequences of it. An essential part of managing this risk is reducing global greenhouse gas emissions. The 2015 Paris Agreement set a target of keeping warming below 2°C and, if possible, below 1.5°C by the year 2100 to avoid the worst predicted impacts of climate change.

The Science Based Targets initiative (SBTi) was established to provide corporations with a platform to develop and assure emission reduction pathways in support of meeting this 2°C target, as well as the more ambitious 'Business Ambition for 1.5°C' framework. The table below shows the percentage of the portfolio and the percentage of the portfolio's greenhouse gas emissions committed to developing reduction pathways with the SBTi, as well as those that have already aligned to either a 2°C or 1.5°C reduction target. Also included are net zero emissions commitments made by the companies held in the portfolio. These commitments are collected from company publications and are independent to the SBTi commitment.

	FEF SICAV	
	% of Portfolio	% of Emissions
SBTi Commitment	82%	91%
Paris Agreement Aligned (max 2°C)	75%	80%
Business Ambition for 1.5°C	75%	80%
Net Zero Commitment	86%	92%

Table 2: Percentage of portfolio with different emissions reduction commitments and the percentage of the portfolio's emissions those commitments cover.

For comparison, 55% of listed companies have set climate targets aligned with the Paris Agreement and 22% have targets aligned with a 1.5°C pathway. 34% of listed companies have set a target to reach net zero emissions[1] .

[1] https://www.msci.com/documents/1296102/41874802/NetZero-Tracker-NOV-cbr-en_11_30.pdf

Social/Society

Social data is far more challenging to collect and report compared to environmental data. This is largely due to environmental data being significantly easier to quantify (e.g. CO_2 emissions) and, if the methods used are the same, compare between companies. The impacts a company has on society are more nuanced and, as such, difficult to compare with other businesses. For example, how can one accurately measure the positive social impact of diabetes medication? How would one then net that with the negative impacts that inevitably come with the supply chain that creates them? To accurately reflect the positive and negative impacts a company has, one needs to look beyond the numbers they report and make an objective assessment of what the company does and the resultant effects on society.

The difficultly in quantifying an impact that fundamentally cannot be quantified results in most investors and companies reporting diversity statistics when looking at the 'S' in ESG. At Fundsmith, we think this data is important as, for a business to adapt and successfully sell their products their employees should be representative of their customer base. Further, it is important to create an inclusive and supportive working environment as, not only is it the right thing to do, it typically results in lower employee turnover and helps a company attract the best talent to support its long term success.

However, while we think it is important to report what we can, we don't think that these limited numbers reflect the social impact our companies actually have. These impacts can't be quantified, making contrasting the various positive and negative impacts a company may have to reach an overall conclusion very difficult. For example, all companies will know the percentage of their board or upper management who are women and will be quick to report it. Nevertheless, obtaining a number that accurately reflects how happy employees are working for the company is far more challenging.

The table below is what we can report for our portfolio and comparable indices. We will continue to add to the statistics below when we have enough companies reporting informative metrics in a comparable way.

Social	FEF SICAV	MSCI World
% of employees who are women	44%	38%
% of management who are women	31%	27%
% of executives who are women	24%	15%
% of the board who are women	30%	25%

Table 3: Averages with no estimates. Source - company reports

Governance

Governance refers to the processes and systems a company has in place to protect the interests of minority shareholders, such as ourselves. This can be in the form of independent checks and balances on management's actions by the board of directors, but also anything that influences the decision-making and incentive structure within an organisation. This can be a company's policy toward forced labour, which is somewhat easy to measure, or a company's culture and whether that incentivises employees to do the right thing, which is much harder to assess.

Knowing whether a company has a policy toward something is all well and good, but it doesn't tell us much about how the company actually behaves in the real world nor how it responds when it becomes aware of negative impacts it may be having. Policies provide an expectation of how a company would like to behave but are not necessarily a reflection of its actual actions. Further, while one can measure the percentage of independent directors on a board, which is reported by most companies, it is much harder to know whether they are truly independent. There is also a question over whether someone who is paid more than £100k a year for four meetings can ever really be independent.

Much like the challenges with social data, meaningful data on governance can also be hard to find; what comparable metric is going to reflect a company's culture? Even when one can find it, the numbers can still be manipulated by a company to be misleading should they wish.

That being said, there are some limited numbers we can report but we don't find these to be an effective proxy for the quality of governance in our portfolio. As mentioned above, just because a company has more independent non-executive directors on its board or on various committees, this doesn't say a huge amount about the quality of its corporate governance. It also says nothing about how the company's incentive structure is designed to promote sustainable growth, nor whether the company's culture attracts employees who want to promote the company's purpose.

Like social impacts, a lot of the quality of a company's corporate governance can only be measured qualitatively, making it impossible to aggregate across a portfolio. We would like to report more data but not enough companies produce meaningful and comparable statistics on anything other than the make-up of their boards.

Governance	FEF SICAV	MSCI World
% non-executive directors on board	87%	80%
% non-executive directors on nomination committee	100%	95%
% of board independent	76%	69%
% of executives holding shares in the company	56%	48%

Table 4: Averages with no estimates. Source - company reports

Until the companies we invest in produce better data on their impacts on society and the quality of their governance structure, we will continue to use data from RepRisk as proxy. The reasoning for this is explained in the RepRisk section of this document.

Remuneration

One of the areas of governance that we have a particularly strong view on is the remuneration of our companies' executive management teams. We don't care how much a management team is paid, but we do care how it is calculated.

Usually, executive management have three components to their compensation: 1) a fixed base salary, 2) a short-term bonus (STI), and 3) a pay out from a long-term incentive plan (LTIP). The LTIP is typically paid out in shares or options with the amount that is paid based on the company achieving a set of targets based on a selection of performance-related metrics.

We have come across many different types of metrics in company's LTIPs, with the worse versions including metrics that management have no control over (e.g. total shareholder return) or those that they have too much control over (e.g. adjusted EPS growth).

We will typically vote against remuneration policies without measures of both growth and returns as we believe these are the most effective way of incentivising profitable growth. It is not very difficult to grow revenues if one is willing to make a loss. We also frequently engage with management teams and remuneration committees, putting forward our arguments to better align management's incentives with those of long term shareholders, where necessary.

In 2023, across both FEF[2] and FSEF[3], of the 27 companies whose shares we owned at their AGM and were given the opportunity to vote on their executive compensation plan, we voted against 25 as we failed to see how it aligned executive incentives with those of long term shareholders. The two companies whose remuneration polices we voted in favour of were the same as in 2022.

Year	No. of compensation votes	Voted against
2019	26	16
2020	26	16
2021	30	19
2022	29	27
2023	27	25

Table 5: Source – Fundsmith.

[2] Fundsmith Equity Fund.
[3] Fundsmith Sustainable Equity Fund.

RepRisk

Due to the challenges in reporting effective and meaningful social and governance data, we use a proxy derived from data provided by RepRisk alongside our own qualitative research on the company. RepRisk provides their 'RepRisk Index' (RRI), which is a measure of the reputational risk resulting from a company's environmental, social, and governance performance. It measures this by scanning over 100,000 news sources in 23 languages on a daily basis. They then use a combination of machine automation and human analysis to assess the scale of the negative impact, the reliability of the source, and whether it is a repeated story to create the RRI; a higher score indicates greater reputational risk. Whilst we are concerned about the reputational risks our businesses face, we mainly use the indicator as we think it acts as a strong proxy for the underlying impact companies have.

The RepRisk Indicator gives us an independent assessment which, when combined with what we know about the companies and the other information they give us, means we have what we think is an objective framework to assess our companies' impact on the world.

It is by no means a perfect proxy as it only looks at negative impacts. The majority of companies we invest in are consumer facing and these businesses typically have higher scores due to the public nature of their operations. However, it remains the best proxy we have found for these hard-to-measure impacts and risks.

Below is a table showing the weighted average RRI for the portfolio broken down by environmental, social and governance risk components. It also shows how the RRI has changed over the past year, and what the weighted average of the peak RRI for each of our companies is. We also give tables showing the highest and lowest RRI companies in the portfolio, which we think is a relatively good proxy for the ranking of negative impacts.

	FEF SICAV	MSCI World
Environmental	3.8	5.2
Social	13.0	13.3
Governance	11.5	11.3
TOTAL	**28.4**	**29.9**
Change YoY	1.6	2.0
Peak RRI	42	41

Table 6: Total RepRisk Indicator (RRI) for the fund split by proportion of score from Environmental, Social and Governance factors. Peak RRI is highest RRI in the last 2 years. Source – RepRisk/Fundsmith.

As at the end of last year the companies with highest/lowest RRI in the portfolio:

	Highest ranked portfolio firms
1.	Alphabet (65)
2.	Apple (57)
3.	Meta Platforms (54)
4.	Unilever (52)
	Lowest ranked portfolio firms
1.	Waters (0)
2.	ADP (0)
3.	Fortinet (0)
4.	Mettler-Toledo (0)

Table 7: Source RepRisk.

Innovation

As well as assessing a company's negative impacts on the environment and/or society, we also look at the positive impacts they have through innovation. Improving existing products and innovating to create alternatives is an important aspect of many of our companies' business models. Innovation allows businesses to maintain or gain an advantage over the competition and to meet unexplored or emerging areas of demand, generating growth.

Product innovation is also the area where the most tangible examples of a company's adaptation to minimise their impacts are present. For many of our companies, reducing the impact of their products' lifecycles is not just beneficial to sales, but also their sustainability targets. Reducing the energy and raw materials required to make a product, using sustainable alternatives, and increasing the efficiency of the production chain can all result in significant reductions to the business's environmental and social impact. As well as minimising impact, innovation also allows our companies to create a positive impact, for example through creating new products that are beneficial to the environment and/or society by giving a solution to some unsolved problem, or by simply giving consumers a wider range of choice.

Accounting for the advances made through innovation is vital, as increasing sustainability and generating positive impacts directly influences the long-term sustainable outperformance of a company. Moreover, identifying companies failing to reduce negative impacts is an important aspect of our risk analysis. This final section gives some brief examples of some of our companies' innovations over the past 12 months to give you an idea of what the companies in the portfolio have been working on.

Coloplast

In 2023, Coloplast announced the acquisition of Iceland-based company Kerecis. Kerecis is a medical technology company specialising in innovative wound care products made from fish skin.

Most skin substitutes currently used in wound care are based on tissues from humans and pigs. These mammalian tissues carry the risk of disease transmission when they are used and require processing before use. This heavy processing removes most of the material's natural components, making it less similar to human skin and potentially less effective. For example, tissues from farm animals, such as pigs, must be treated to inactivate any viruses. This involves using detergents that remove lipids and denature the skin tissue's native structure, leaving only the most insoluble collagens in the product. There are also religious reasons that, for many people, using skin from pigs is not possible. Skin tissue from humans requires antibiotics to reduce the bioburden and risk of infection before use. It is also subject to a lot of regulation, which makes international trade practically impossible.

In contrast, Kerecis's patented fish skin products require minimal processing as there are no known viral transfer risks between the North Atlantic Cod Kerecis use and humans. The company's proprietary processing method avoids harsh chemicals, leaving a more naturally intact product as the tissue structure and lipid composition are preserved. Fish skin is more similar in structure to human skin than other skin substitutes, and this minimal processing means that this benefit is maintained. In the company's clinical trials, Kerecis's intact fish skin products perform better than mammalian skin substitutes.

The company's products are used to treat chronic wounds such as diabetic wounds and pressure ulcers, trauma wounds, and surgical wounds. The US FDA and European regulatory authorities have approved Kerecis's products. Its core technologies are also covered by patents registered in the US and other countries.

Image courtesy of Coloplast ©2024

Unilever

In 2022, Unilever announced its ambition to reduce the energy consumed and resultant greenhouse gas emissions generated by its ice cream freezer network. The company owns and maintains around three million of these freezers worldwide, and emissions from these cabinets account for about 10% of Unilever's value chain (scope 3) emissions.

Image courtesy of Unilever ©2022

Retail ice cream freezers usually operate at an industry standard of -18°C, critical to preserving the ice cream's quality and consumer experience. Unilever's Global Ice Cream Research and Development Centre announced that it has developed and patented a series of new formulas for ice cream. The reformulation means ice cream products can be stored at the warmer temperature of -12°C without compromising the quality of the product. The 6°C increase in storage temperature can reduce the energy consumed by freezers by 20-30% and significantly reduce their emissions.

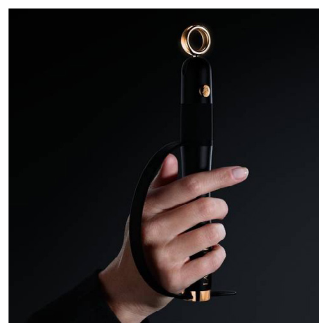
Further to this innovation, Unilever granted free, non-exclusive licenses to the 12 reformulation patents, allowing industry peers to reformulate their ice cream products. The company believes that sharing the patents with industry peers will have a significantly positive impact on the cold chain's environmental impact, as well as make freezers more cost-effective to operate.

L'Oréal

L'Oréal has developed a series of innovative technologies over recent years to provide consumers with more effective and sustainable products. Part of this innovation has focused on making beauty products more accessible to those with disabilities. Research suggests that while 15% of the world's population lives with some form of disability, only 4% of beauty brands create products that cater for physical disabilities. At CES 2023, L'Oréal unveiled a brand-new device called HAPTA. The device is designed to help those with limited hand and arm mobility apply lipstick and mascara. Approximately 50 million people globally live with limited fine motor skills, making everyday activities such as applying lipstick challenging.

HAPTA was developed in collaboration with Verily, developers of Liftwear. Verily's technology uses a series of sensors alongside machine learning to constantly stabilise and level the handle of a fork or spoon, allowing users to control their cutlery despite involuntary hand movements and, therefore, eat more easily. L'Oréal saw the potential of the technology and worked with Verily to optimise it for make-up products. The result is the first handheld, ultra-precise computerised make-up applicator in production. HAPTA uses Verily's steadying technology to help users with limited hand or arm mobility to precisely apply lipstick and mascara independently. The device can distinguish between hand tremors and intentional movements during use, bringing back independence and confidence to millions who struggle to apply daily make-up.

HAPTA, which means the science of touch, is being launched under L'Oréal's LANCÔME brand and will be available in Europe and the US in 2024.



Images courtesy of L'Oréal ©2024

P&G

Procter & Gamble ("P&G") has set the goals of making 100% of their consumer packaging either recyclable or reusable and reducing their use of virgin petroleum-based plastics in consumer packaging by 50% by 2030.

P&G launched their ECOCLIC cardboard packaging in 2022, which won the Diamond Award at Dow's 2022 Packaging Innovation Awards, demonstrating excellence across all areas assessed. The company continued their packaging innovation in 2023, creating new sustainable packaging solutions for its Lenor brand. Lenor's in-Wash Scent Booster cardboard pack has been simplified, resulting in a weight reduction of 20%. P&G achieved this by redesigning the packaging, using FSC-certified virgin board and 40% recycled fibres. The reduced weight of the pack has decreased transporting requirements by 50%, reducing carbon emissions and costs.

Lenor Liquid Fabric Softener and Beads transparent bottles were also changed and are now created using resin sourced from 100% post-consumer recycled plastics from both consumer and business waste. These designs were awarded "Best in Class" for the Sustainable Design Category at the 2023 PAC Global Awards.

P&G was also awarded "Best in Class" at the PAC Awards for their Air Capsule eCommerce package for eCommerce packaging innovation. The Air Capsule is entirely made from a single, newly developed material, making it fully recyclable. It also uses >40% less material versus the typical corrugated packaging. Using the Air Capsule in eCommerce requires 25% of the trucking needed to ship the same number of products in corrugated boxes. Also, it takes up 75% less warehousing space, giving operational savings and further reducing carbon emissions.

Images courtesy of Proctor & Gamble ©2024

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