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Annual Sustainability Summary - 2022

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Don't overpay
Do nothing

Fundsmith Equity Fund Annual Sustainability Summary

The intention of this Sustainability Summary is to act as a supplement to our Responsible Investment Policy and annual Stewardship Report. The document aims to provide our investors with a detailed insight into the environmental and social 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 indexes.

We operate concentrated portfolios of “good companies”, with an ideal holding period of forever. Given the length of our investment horizon, we expect our companies to avoid inflating current profits at the expense of the environment or society as this can damage future returns.

We will continue to add data to this factsheet as the collection and reporting methods become more standardised and we feel it provides a more meaningful and insightful assessment of our portfolio companies’ impacts.

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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 numbers for those companies that do not report data by taking the average of the metric in question and balancing it per £m of assets for their respective subsector. We then scale this to the assets of the company we are trying to estimate.

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, just over 75% of our companies report these simple environmental numbers, significantly better than the MSCI World or S&P 500 where only around 50% of companies report metrics.

Fund (31/12/22)	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 m³	k of MWh	k metric tonnes	metric tonnes	metric tonnes	m³	MWh	metric tonnes
FEF SICAV	211	3.8	17	6,391	807	15.5	0.3	1,277	469	59
S&P 500	5,784	11.2	500	18,589	4,693	440	0.9	38,004	1,413	357
MSCI World Index	9,749	220	401	16,400	4,506	770	17	31,649	5,462	356
FEF port % reported	78%	48%	81%	93%	100%	78%	48%	81%	93%	100%
S&P 500 % reported	50%	35%	58%	77%	88%	50%	35%	58%	77%	88%
MSCI World % reported	56%	34%	58%	75%	87%	56%	34%	58%	75%	87%

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	78%	91%
Paris Agreement Aligned (max 2°C)	74%	44%
Business Ambition for 1.5°C	74%	44%
Net Zero Commitment	83%	91%

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

For comparison, 19% of listed companies in the G7 indices have climate targets aligned with the Paris Agreement[1]. 33% of listed companies are aligned with the Paris Agreement, while only 16% of listed companies align with a 1.5°C temperature rise[2].

[1] https://sciencebasedtargets.org/news/g7-stock-indexes-science-based-targets.
[2] MSCI October 2022 Net Zero Tracker.

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.

To demonstrate the paucity of social and governance data, Bloomberg, who collect data from a variety of third parties such as CDP, Sustainalytics, and MSCI, as well as any data companies report themselves, show that the average environmental stat is reported by 20% of our investable universe, compared to just 8% for social metrics. What's more troubling is that for all the businesses in our investable universe, which as our previous environmental stats show are better than most at reporting, the most widely reported social metric is only reported by 28% of companies.

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	45%	38%
% of management who are women	31%	29%
% of executives who are women	24%	17%
% of the board who are women	37%	28%

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 is 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	99%	95%
% of board independent	75%	71%
% of executives holding shares in the company	59%	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 2022, across both FEF[3] and FSEF[4], of the 29 companies whose shares we owned at their AGM and were given the opportunity to vote on their executive compensation plan, we voted against 27 as we failed to see how it aligned executive incentives with those of long term shareholders.

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

Table 5: Source – Fundsmith.

[3] Fundsmith Equity Fund.
[4] 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 their 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. We discuss the contributors to the changes in RRI over the year in more detail in the FSEF annual letter.

	FEF SICAV	MSCI World
Environmental	3.6	5.5
Social	11.1	12.0
Governance	13.1	10.4
TOTAL	**27.7**	**27.9**
Change YoY	-4.7	-1.3
Peak RRI	40	39

Table 6: Total RepRisk Indicator (RRI) for different fund vehicles 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 (62)
2.	Microsoft (61)
3.	Apple (58)
4.	Meta Platforms (58)
Lowest ranked portfolio firms	
1.	Brown-Forman (0)
2.	Waters (0)
3.	ADP (0)
4.	Amadeus (8)

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.

Novo Nordisk

In last year's annual sustainability summary, we discussed Novo Nordisk's semaglutide. The drug mimics a hormone called glucagon-like peptide-1 (GLP-1) and has been found to be highly effective in treating diabetes and obesity by stimulating insulin secretion. The drug was first approved by the US Food and Drug Administration (FDA) in 2017 as a treatment for diabetes, as both an injection (Ozempic) and as a pill (Rybelsus). In 2021 the FDA approved the use of semaglutide for chronic weight management in adults, under the brand name Wegovy.

Ozempic has, up until 2022, only been available in 0.25mg, 0.5mg and 1.0mg doses taken once a week via injection to help type 2 diabetics lower their blood sugar and A1C levels.

Following the results of Novo Nordisk's SUSTAIN FORTE trail in 2021, the FDA approved a 2.0mg dose of Ozempic for adults with type 2 diabetes last year[5]. The trial showed that the 2.0mg dose of semaglutide achieved a significant and superior reduction in the haemoglobin associated with sugar retention in the blood stream compared to lower doses. The availability of additional strength Ozempic will allow healthcare providers and people with diabetes more flexibility in their treatment options, based on their health goals.

Ozempic may also reduce the risk of major cardiovascular events, for example heart attacks and strokes, in adults with type 2 diabetes and a known heart disease. And, as mentioned last year, it is also thought that semaglutide could be used as a treatment for fatty liver disease (NASH) and Alzheimer's. Research into these areas is ongoing.

[5] https://www.novonordisk.com/content/nncorp/global/en/news-and-media/news-and-ir-materials/news-details.html?id=108096.

Diageo

Figure 1: Diageo Black and White Whisky bottles.

As part of Diageo's 'Spirit of Progress' sustainability plan, the company has committed to reducing their supply chain (scope 3) emissions by 50% by 2030. Supply chain emissions currently constitute 90% of the company's total emissions and within this, packing accounts for 34%[6], largely from the production of glass bottles. Diageo has identified this as a key area to tackle if they are to achieve their carbon reduction goals.

In 2021, the company trialled a technology using waste-based biofuel-powered furnaces as well as 100% recycled glass to produce their Black & White whisky bottles. The result was a bottle made with a carbon footprint 90% lower than an equivalent made using traditional methods[7].

In 2022, the company continued to innovate. Partnering with Encirc, Diageo announced plans to create a brand-new furnace which will allow the company to produce glass bottles with net zero greenhouse gas emissions at scale, a world first. The new furnace will reduce the carbon emissions of bottle production by around 90% through using an energy mix of green electricity and low carbon hydrogen. The green electricity and hydrogen will be sourced locally from a plant near the production site in Cheshire. The plant will be fully operational by 2027 and will produce up to 200 million bottles for Diageo's Smirnoff, Captain Morgan, Gordon's and Tanqueray brands annually.

Adobe

Figure 2: Leica cameras displaying image content credentials.

Three years ago, Adobe announced the launch of the Content Authenticity Initiative (CAI) in partnership with the New York Times and Twitter. The Initiative's goal is to increase trust and transparency and combat misinformation and disinformation in online content, particularly focusing on the increasing prevalence of deepfakes and other deceptively manipulated content.

The CAI's goal is to create an industry-wide attribution framework, using provenance technology to provide transparency regarding the origins of digital content. In 2020, Adobe launched their first tool to contribute towards this goal, announcing a new integrated attribution tool in Adobe Creative Cloud. The tool is designed to install a tamper-evident layer of attribution data to photos, including the name of the author, the location and a history of edits made to the image[8].

Working alongside camera manufacturers Leica and Nikon, Adobe announced in 2022 the development of technology that implements provenance and authenticity to images at the point of capture.[9] This technology attaches information regarding authorship of the image, as well as when, where and how it was captured to a digital image. This help create traceable authenticity from the capture of the image to its publication. Both companies are aiming to install the technology on production cameras, with Leica planning to sell models with it installed later this year.

[6] https://media.diageo.com/diageo-corporate-media/media/eb2cxzsp/accelerate-to-a-low-carbon-world-our-net-zero-carbon-strategy-october-2022-pdf-290mb.pdf.

[7] https://www.diageo.com/en/news-and-media/stories/2021/diageo-collaborates-on-innovation-trial-to-make-most-sustainable-glass-scotch-whisky-bottles-ever.

[8] https://blog.adobe.com/en/publish/2020/10/20/content-authenticity-initiative-unveils-content-attribution-tool-within-photoshop-behance.

[9] https://blog.adobe.com/en/publish/2022/10/18/major-steps-forward-cai-partnerships-leica-nikon-new-content-credentials-features-photoshop-beyond-max-2022?clickref=1011lwv4p9ZC&mv=affiliate&mv2=pz&as_camptype=&as_channel=affiliate&as_source=partnerize&as_campaign=pzphorum.

Unilever

Figure 3: Unilever brand Cif spray bottle with a recyclable trigger.

Unilever's push to be a global sustainability leader continued in 2022. Last year we focused on their goal to reduce their consumption of virgin plastic by 50% by 2025[10], and their role in the Pulpex consortium to help achieve this. Unilever has also committed to ensuring that 100% of their plastic packaging is designed to be fully reusable, recyclable or compostable by 2025. Unilever made step towards this goal in 2022 by creating the first fully recyclable bottle trigger with dispensing specialist Silgan Dispensing[11].

The triggers used by spray bottles are complex pieces of machinery, using several precision-engineered, moving components, Silgan says even their most basic triggers use at least 11 different pieces, including springs, valves and nozzles. While these are a feat of modern engineering, the high number of components makes these triggers non-recyclable. The triggers are made from a range of different plastic polymers, each using their different properties as part of their role within the trigger mechanism. However, not all of the plastic polymers are the same, and therefore cannot be recycled in the same plastics stream. Therefore, without breaking the triggers down into their individual components they cannot be recycled.

However, Silgan and Unilever were able to use polypropylene (PP) and polyethylene (PE) polymers, both from the polyolefin polymer group, to create all of the components in their newly designed triggers. Achieving this required a total redesign of the spring component used in the trigger. As both polymers are from the same polymer group the triggers are now fully recyclable. Unilever have already rolled out the triggers in Europe, and estimate that 160 million units will use the new triggers every year.

[10] https://www.unilever.com/planet-and-society/waste-free-world/rethinking-plastic-packaging/#:~:text=Our%20plastic%20goals&text=Ensure%20that%20100%25%20of%20our,recycled%20plastic%20in%20our%20packaging.

[11] https://silgandispensing.com/news/unilever-works-with-silgan-on-a-new-trigger-fabricated-from-either-pp-or-pe-polymers-making-it-fully-recyclable-alongside-the-bottle-new-trigger-is-being-used-across-europe-for-unilevers-ci/.

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