Veritas
— Asset
Management

Real Return
Investing

Veritas Asset Management LLP

Engagement Policy

Veritas Asset Management LLP ("Veritas") seeks to buy high quality businesses at the right price. Amongst the characteristics sought when assessing the quality of a business, we would include attractive returns on invested capital ("ROIC"), the generation of significant free cash flow, high barriers to entry to protect future cash generation and predictability in the deployment of the cash generated. In short, we seek to invest in businesses that are sustainable over the long-term at an attractive price.

Governance of a business is therefore central to the investment case. The management and board are accountable for the company's long-term strategy and should be cognisant of the risks and opportunities over a 10-year time horizon and deploy capital accordingly.

Strong management will incorporate sustainability and governance policies and be better placed to deal with emerging risks and opportunities; for example addressing the use of plastics, developing greater fuel efficiency/ electrification of air travel or positioning themselves for the transition of healthcare to a value-based system that focusses on reducing drug pricing. Weak management will find their businesses displaced or become uncompetitive.

Veritas runs a concentrated strategy of 25-40 stocks. The level of research is extensive, and a significant element of the research effort is centered on company management evaluating the following;

- Management's long-term objectives and how they intend to deploy cash. Have they a good understanding of target markets, competitive advantages, barriers to entry, any environmental/ social factors relevant to their business that may poor risk/reward.

- Whether management incentives are aligned with shareholders and Key Performance Indicators (KPIs) are reasonable and not too short term.

- The rating of management after a meeting. Each Veritas attendee will independently rate management before they are given an overall rating based on assessment of vision and capability. Rating drift results in a review and potential engagement.

- Where there is a question on sustainability/ predictability, we seek a higher margin of safety before we invest.

Materiality

We only seek to engage with management if we deem there to be financially material sustainability issues. Material issues differ from company to company and sector to sector. We only focus on material issues relevant to a particular company.

We will have an assessment from the original research as to what is material for a particular business. These are the issues that have the most potential to affect the company's ability to create value for shareholders. If the company engages in an activity that challenges the sustainability of its operation or demonstrates lack of vision to adapt, we will have cause to engage.

Two-Tiers

Coupled with Materiality, we believe VAM has a part to play in encouraging constructive behaviour. As such, we effectively have two tiers of engagement. Tier one is defined as significant engagement which as described above, is a specific attempt to influence governance/business practices that have a material impact on long-term sustainable value creation.

During 2019, for example, we engaged with Allergan on a tier one governance related item. Company management have not executed well on behalf of shareholders. There have been several issues that have brought into question the ability to steer the company under the joint Chairman/CEO Brent Saunders. Whilst not an exhaustive list, these have included the company's unorthodox bid to shield patents from a federal administrative court's review by transferring them to a Native American tribe and limited success in buying in later stage drugs to add to its existing franchises. We felt strongly that the role of Chairman and CEO should be split. As would be expected, we voted with the Appaloosa resolution to split the role of Chairman and CEO with immediate effect. Despite the logic of the split in this instance and the argument made by many third party ESG providers on why the roles in general should be split, the proxy houses ISS and Glass Lewis recommended shareholders vote with management and against the resolution. The majority duly obliged. The shares fell significantly in the period after the vote. We took the decision to sell at a reduced target price on the basis that given management was unlikely to now change, predictability of earnings/ cash flow was reduced.

Second tier engagement is classified as interactions with a company to promote good business practice. For example, Charter Communications scores poorly on the area of carbon/ climate due to a lack of disclosure. Whilst they produce a below average level of carbon, and data protection is a more significant issue, we believe disclosing carbon output is essential if any sense is to be made of carbon impact at the portfolio level. We have written to management to encourage it and have a policy to do so in all cases where management does not disclose carbon emissions.

Process of Engagement

1. We will usually start by writing to the company explaining the issue which we believe is both material and has a bearing on sustainability, we will include our suggestions on actions that should be taken.

2. If the issue is not addressed, we will seek to speak with senior management (CEO, CFO, COO etc.) to address the issue.

3. In cases where there is a regulatory or political angle, we may have already spoken to third party professionals via our networks.

4. Post meeting with management, where relevant we will follow up again in writing.

5. Should any activity be put to a vote, we may choose to vote against management and notify them of our intentions to do so.

6. If engagement and voting fail, we may choose to exit the position and the company will be removed from the Universe List. The activity will be recorded in the engagement log.

Constructive dialogue

We believe in treating management with respect and conduct our engagement activity away from press/media. On occasion we work with management to give them time to implement a strategy e.g. introducing more Non-Executive Directors ("NED's") to the board. Where one of the Red Lines within our Environmental, Social and Governance ("ESG") Voting policy is breached but we do not deem it to be material for full engagement, we may inform management that we will not vote against them but suggest they may wish to consider a cause of action. Whilst we tend not to invest in capital intensive businesses, we would expect companies to report their environmental impact, especially carbon emissions, in a verifiable and standardised manner.

Collaborative Engagement

Ideally, we would choose to engage with management on an individual basis to rectify an issue. In cases where management is unresponsive or we hold a small percentage of the float, we may choose to collaborate with other interested parties. Given our concentrated approach to investment, all holdings are important irrespective of the significance of our holding in terms of the issued share capital. Thus, if the issue is material and we need to collaborate to elicit a response, we will do so.

Reporting

We detail any engagement activity undertaken each quarter in our client quarterly reports within the section on ESG. This will include any outcome, both positive or negative from the engagement.

For further information please contact:

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