17.01.2023

Jupiter Value Equities Team: 2022 Stewardship Report - UK Value

The Value Equities team provide an insight into the companies they have engaged with in 2022 as part of their annual stewardship report.

Ben Whitmore
Investment Manager, Value Equities

Brian McCormick
Investment Manager, Value Equities

Claudia Ripley
Investment Director

Dermot Murphy
Investment Manager, Value Equities

Ellen Mann
Investment Analyst, Value Equities

On the Jupiter Value Equities team, we are in the privileged position of being stewards of our client's assets and believe that direct active company engagement is crucial to be able to understand issues and help drive positive change. We think it's impossible to disaggregate Environmental, Social and Governance factors and financial analysis, which is why we conduct the ESG analysis ourselves as part of our integrated investment process. We are aided by our dedicated in-house stewardship team who run analysis in parallel to us, as an effective form of crosschecking.

Record of Engagement

	2021	2022
Shareholder Meetings	48	56
Voted Against/Abstained	9 meetings (19%)	21 meetings (38%)

In this, our third annual dedicated stewardship report, we review:

- The different outcomes between Take-Overs
- The importance of Health & Safety
- Defence: Not as black and white as initially appears
- The full picture: Third Party Ratings Agencies
- Carbon Emissions: the evolution of reporting and data

The different outcomes between “Take Overs”

Over the year, two of our holdings received take over approaches: Go-Ahead and Ted Baker. Take overs require very careful thought as they often result in shareholders selling the business forever. The correct price for any business is a difficult judgement to reach and fraught with biases. We voted in favour of both, but this hides a very different approach and outcome for each situation.

Go- Ahead: The company was approached with an initial offer at 1450p plus a 50p special dividend. (Prior to the approach the company had a share price of 1010p). We were a very significant shareholder (c. 10%) and had a detailed conversation with the board to understand why they were prepared to recommend the initial offer. We felt that the risks and rewards were explained and that enabled us to make a judgement. Our view was that the initial offer was too low and following our active engagement and debate with the board and further negotiations, an improved offer was made. We finally accepted a revised offer of 1450p and a 100p special dividend. We were cognisant that Go Ahead had recently had some serious issues in their South-eastern rail franchise, which drove the share price down. There is often a tendency to anchor off recent share prices which we were very aware of, but in the end we felt that the absolute value was acceptable.

Ted Baker: This process was very different. In early March 2022 Ted Baker received a non-binding possible cash offer of 137.5p, which they rejected. Prior to the offer, the company had a share price of 98p. On receipt of an improved proposal, they also received an unsolicited bid interest from an additional party. Following this the company put in place a formal sale process. However, during the process the preferred bidder pulled out and the company ended up recommending a 110p offer. Given that the recommended offer was only a small premium and someway below the initial offers we engaged with the company.

This was particularly disappointing as they said they were not allowed to reveal much information making it very hard for us to judge the merits of the offer. This offer valued the business at c.£200m which seemed to us very low in relation to a £30m free cash target and trailing brand sales of just under £1bn. Clearly the economic environment had worsened, but we were very disappointed about both the offer and the process. We would strongly question why rules are in place that don’t allow a company to discuss with its shareholders the reasons why they are prepared to recommend selling the business.

The importance of Health & Safety

Working in a desk-based job in London it is easy to take safety in the workplace for granted, but for many thousands of workers around the world a safe workplace is not guaranteed. For example, 35% of all companies in the FTSE 100 (excluding investment trusts) have reported at least one workplace related fatality in the past 6 years (according to Bloomberg data). The aggregate number of workplace deaths reported during this period for these companies has been 97.

The reason given is often that some industries are inherently dangerous. This argument has some merit, but it does not absolve a company's responsibility to their employees, and is also diluted by the significant improvements some companies have made to their safety track record. This is particularly noticeable in industries where a fatality free year was once seen as impossible. For example, in 2019 Rio Tinto, a global mining conglomerate with a workforce of more than 40k employees, reported their first fatality free year in 147 years. 2020 and 2021 were also fatality free and it is probably not a coincidence that Rio Tinto is one of the most profitable mining companies.
We strongly believe that each of the companies in our portfolio should target zero workplace related fatalities for two reasons. Firstly, we think the companies we invest in have an ethical duty to provide a safe working environment for their employees. Secondly, we believe that safety provides a broad indication of how well the company is being run. A poor safety track record is often symptomatic of poor working practices and lack of management control.

In 2015 we bought shares in Anglo American and in 2016 there was a worrying climb in the number of employees who lost their lives while working for the company. It became clear that the link between executive remuneration and employee safety wasn't as strong as it should have been. We engaged with the company, changes were made to the structure of executive remuneration, and the company has reported a fall in the number of employee deaths every year since. This drastic improvement in safety has coincided with a material improvement in margins relative to peers. The shares have significantly outperformed the index since then but have also outperformed all other major mining companies listed in the UK. In 2021 the company reported 1 fatality which was a 93% reduction relative to 2013.

In last year's stewardship report we highlighted our holding in Royal Mail which has since been renamed 'International Distributions services' (IDS). In 2020-2021 the company reported 31 workplace related fatalities (7 in Royal Mail UK and 24 in their international subsidiary GLS), which, in our view was unacceptably high. Since our first engagement in November 2021 there has been a modest improvement but the numbers are still far too high: there were 3 deaths reported in Royal Mail UK in 2021-2022 and 19 deaths in GLS. We believe these numbers highlight poor governance but hope that things are improving following our engagement. Improvements in workplace safety take time and tend to be incremental but unless we continue to see a sustained improvement we will have no option but to escalate our engagement further and consider voting against management at the next AGM (July 2023).

Nokia is another holding where we have recently been engaging on safety. They reported one employee fatality over the past 8 years, but when you increase the scope of reported fatalities to

include contractors and subcontractors the number grows to 41. We were shocked by the quantum of workplace related deaths and decided to engage with the company to see what was going on.

NOKIA

Fatalities	2014	2015	2016	2017	2018	2019	2020	2021	Total
Fatalities involving employees	0	0	0	0	0	1	0	0	1
Fatalities involving contractors / subcontractors	8	6	7	5	1	6	3	4	40
	8	6	7	5	1	7	3	4	41

Source: Bloomberg

Nokia's answer is that these fatalities are primarily contractors falling from height while installing and maintaining Nokia equipment in Emerging Markets. They agree with us that the level of fatalities is unacceptably high. Nokia's management introduced a set of non-negotiable rules called the 'Nokia Life Saving Rules' in 2015 but these don't seem to be having the desired effect because many contractors are not adhering to the rules properly. Our view is that more needs to be done. Improving compliance may not be easy but as has been seen in the mining industry positive change is possible. This is another company where unless we see a sustained improvement we will have to consider voting against management at the next AGM.

We have also been engaging on safety with the management of South32. Relative to the other two companies mentioned (IDS and Nokia) South32 doesn't immediately stand out as having a poor safety track record. In 2021-2022 they had one workplace related fatality. However, unlike many other mining companies they are not reporting any meaningful improvement in their safety performance: They have had one fatality in 5 of the previous 6 years. Anglo American also had one fatality last year but Anglo American has over 60,000 employees relative to only 9,000 at South32. As previously mentioned, Rio Tinto has managed 3 consecutive fatality free years with a workforce of more than 40,000. We feel that South32 should improve further and we have started to engage with the company to outline our views.

We think safety is extremely important and spend a lot of time engaging with the companies in our portfolio on this topic. Our hope is that over time the companies will improve and this process will be positive for both employees and shareholders alike.

Defence: Not as black and white as initially appears

The war in Ukraine has prompted a discussion around how defence stocks are viewed from a broader responsible investing standpoint. For many European governments there has been a distinct change in approach. The German Chancellor, Olaf Scholz, delivered a speech dubbed the "Zeitenwende" or watershed. This change in approach to defence, supported by the German people and crucially the Green Party, has injected significant funds into military spending and support to Ukraine. For some investors defence companies can never be responsible investments, but the aggressive military actions of Russia have caused some to reconsider their views.

We place great consideration on the role defence companies play in national security. It is of course most Presidents and Prime Minister's primary responsibility to safeguard the security of their people. The reason we choose to invest in certain defence stocks is due to this essential defence of national freedom and democracies. Defence, unlike some other undesirable products, is critical for functioning societies. Whereas other industries that are also deemed "non sustainable" such as alcohol, gambling, thermal coal and tobacco, are not needed, defence will always be critical to safeguarding societies. Notwithstanding this view can defence companies ever be regarded as sustainable investments? There are several areas that are raised as concerns. Who do companies sell their weapons to and what weapons do they make?

Exports
The UK defence companies are very tightly regulated. The Export Control Joint Unit scrutinizes every application for a licence to export weapons. Their decisions are legally binding and subject to judicial review. They also operate under many multi lateral agreements (The Australia Group, The Missile Technology Control Regime, The Wassenaar Agreement) which are all legally binding.

Number of licence refusals by country in 2021:

China	**113**
Russia	54
Pakistan	12
UAE	7
Hong Kong SAR	6

*Source: Export Control Joint Unit, strategic export controls commentary, 2021

The most common reasons for refusal are the risk of weapons being diverted to other regimes, international treaty obligations and national security.

Controversial weapons
A common reason for avoiding investing in defence companies is to do with controversial weapons, which are defined as cluster munitions, anti -personnel mines, chemical & biological weapons, depleted uranium, white phosphorus and nuclear capabilities. Many of these products are covered by international treaties (Oslo convention on cluster munitions) and for the UK listed companies their only involvement in controversial weapons is in the manufacture and maintenance of submarines that carry the UK's nuclear deterrent.

The defence sector is required to enable the free functioning of society. There is no alternative unlike other sectors such as alcohol, tobacco, gambling and thermal coal production. The UK industry is very highly regulated and operates under a very strict set of international treaties and judicial oversight. We think this combination means that there is a place for defence companies in portfolios. We understand that there will always be some disagreement with this view, but fundamentally a highly regulated defence industry plays a vital role in free societies.

The full picture: Third Party Ratings Agencies

Over the last several years, the importance of ESG within the industry has grown significantly, and the use of third party providers has become more important to help aid fund managers in ESG specific decision making. Whilst we have never outsourced our analysis, we understand the need for an industry standard and to use this as an initial point of reference, however, over the past few years we have found some issues with the ratings which are that ratings are both backward looking and subjective:

As fund managers, we believe we have a good direct line to our investee companies and engage with them more frequently than ratings agencies. Our information tends to be more current, enabling us to make decision that incorporate the most recent analysis. For example, over the year we have held a position in defence company BAE. At BAE's 2021 ESG day, they explicitly state they are not involved, at all, in cluster munitions, anti-personnel mines (banned under Oslo Convention and Ottawa Treaty respectively) and depleted uranium. However, ISS say they are involved in all three. As some investors rely on these ratings for exclusion purposes and ESG credentials, having contradictory results creates an issue.

Whilst the topic of defence companies has been controversial this year, data vendor ISS has also verified BAE as having involvement in facilitating the production of weaponised white phosphorus. According to BAE, this is also not the case. Due to situations like this, we want to ensure we are engaging with the companies directly to ensure we have the most up to date and accurate information.

Carbon Emissions: the evolution of reporting and data

Decarbonisation has become an ever-increasing area of focus, both for the overall portfolio and the companies we invest in. In last years report we wrote about the difficulties in determining a fair way to assess and present the emissions data and improvement trajectory of our portfolios. The nature of value investing means when the companies we invest in improve, we will look to recycle the capital into companies who are not as advanced. Therefore, whilst we will be able to speak to individual improvers, the overall portfolio may not "improve", but be in a constant state of improving.

Jupiter was named among the first tranche of asset managers to disclose a group level 2030 decarbonisation target, and our in-house stewardship team produced methodology to assess the alignment of our holdings to net zero. By 2030, our UK value equities strategy aims to be entirely either aligned or aligning with the group level decarbonisation target.

Availability of carbon emissions data among UK companies is good, however, monitoring the progress for the portfolio can be complicated. Restatements from the companies are common due to ongoing

The value of active minds: independent thinking

A key feature of Jupiter's investment approach is that we eschew the adoption of a house view, instead preferring to allow our specialist fund managers to formulate their own opinions on their asset class. As a result, it should be noted that any views expressed – including on matters relating to environmental, social and governance considerations – are those of the author(s), and may differ from views held by other Jupiter investment professionals.

Important information

This document is for informational purposes only and is not investment advice. The views expressed are those of the individuals mentioned at the time of writing, are not necessarily those of Jupiter as a whole, and may be subject to change. This is particularly true during periods of rapidly changing market circumstances. Every effort is made to ensure the accuracy of the information, but no assurance or warranties are given. Holding examples are for illustrative purposes only and are not a recommendation to buy or sell. Issued in the UK by Jupiter Asset Management Limited (JAM), registered address: The Zig Zag Building, 70 Victoria Street, London, SW1E 6SQ is authorised and regulated by the Financial Conduct Authority. Issued in the EU by Jupiter Asset Management International S.A. (JAMI), registered address: 5, Rue Heienhaff, Senningerberg L-1736, Luxembourg which is authorised and regulated by the Commission de Surveillance du Secteur Financier. No part of this document may be reproduced in any manner without the prior permission of JAM/JAMI.

*Although on average our companies reduced their emissions intensity by a striking 17% over 2019 to 2021, the total portfolio intensity increased by 3%. This was principally caused by South32, a mining company with revenues which are highly sensitive to commodity prices. While the company did reduce its total emissions from 2019-2021, due to lower global prices for alumina and metallurgical coal its revenue fell much more significantly. Its figures are also impacted by the company's June year-end; as at June 2021 many areas of the global economy had still not resumed normal operations. As a carbon intensive business, it is a large contributor to total portfolio intensity and therefore any increase materially impacts that for the portfolio. Excluding South32, the total portfolio intensity fell 10% between 2019 and 2021

The portfolio holdings in the above data set are as at December 2022. We have looked at how they performed over the preceding 3 years, though some holdings may not have been held in the portfolio for the whole period. This has been done to show the trajectory of the current portfolio. We have ensured the data is as up to date as possible and have adjusted the MSCI dataset to reflect the most recent company reports where appropriate and have then used the company restated numbers where applicable. Restating numbers is a manual task where we inevitably assume risk regarding the consistency of company methodologies and the potential for human error.

The overall emissions reduction achieved over 2019-2021 by our current holdings is surprisingly large and, in the short-term, we would expect to reverse by some degree. For example, Centrica was the holding with the largest reduction; but this was predominantly due to a temporary outage at a power station and the company expect a rebound in emissions in 2022. The second largest reduction was easyJet, which was heavily impacted by reduced flying activity caused by global travel restrictions, again, over the short term, we would expect this to increase. Across the portfolio, the pandemic substantially impacted absolute business activity.

Conclusion

On the Jupiter Value Equities team when we invest in a company something has typically gone wrong to make the valuation so low (and attractive to us as investors). It is not unusual for there to be serious issues regarding Environmental, Social and Governance (ESG) factors, however we believe that we can have a positive impact by actively engaging with company management and holding them to account. As value investors we believe that companies have the ability to change, therefore we don't tend to like exclusions or backward-looking ratings. Instead, for us, the direction of travel is crucial. Companies don't have to be the finished article for us to invest, but they do have to actively and openly engage with us and demonstrate progression.

We believe that we can have a more meaningful and direct impact on a company by being part of the conversation and being a shareholder gives us this ability. As a team, we often own a reasonable stake in a company and therefore can push for positive change, however, if after multiple engagements we feel there is no sign of improvement we will reassess and on occasion choose to walk away.

Stewardship is embedded into our process and something we take very seriously. This report is designed to highlight any areas of particular interest that we have engaged on over the year and that often means it may be slightly controversial as it focuses on where we are actively pursuing changes. With the regulatory landscape evolving and the implementation of the UK Sustainable Disclosure Requirements (SDR), further reporting on ESG will undoubtedly progress and change and we look forward to updating you in due course.

[1] Includes data scraped from MSCI and data verified directly with company accounts. Methodologies between companies may be inconsistent, most notably regarding location- and market-based Scope 2 measurement.