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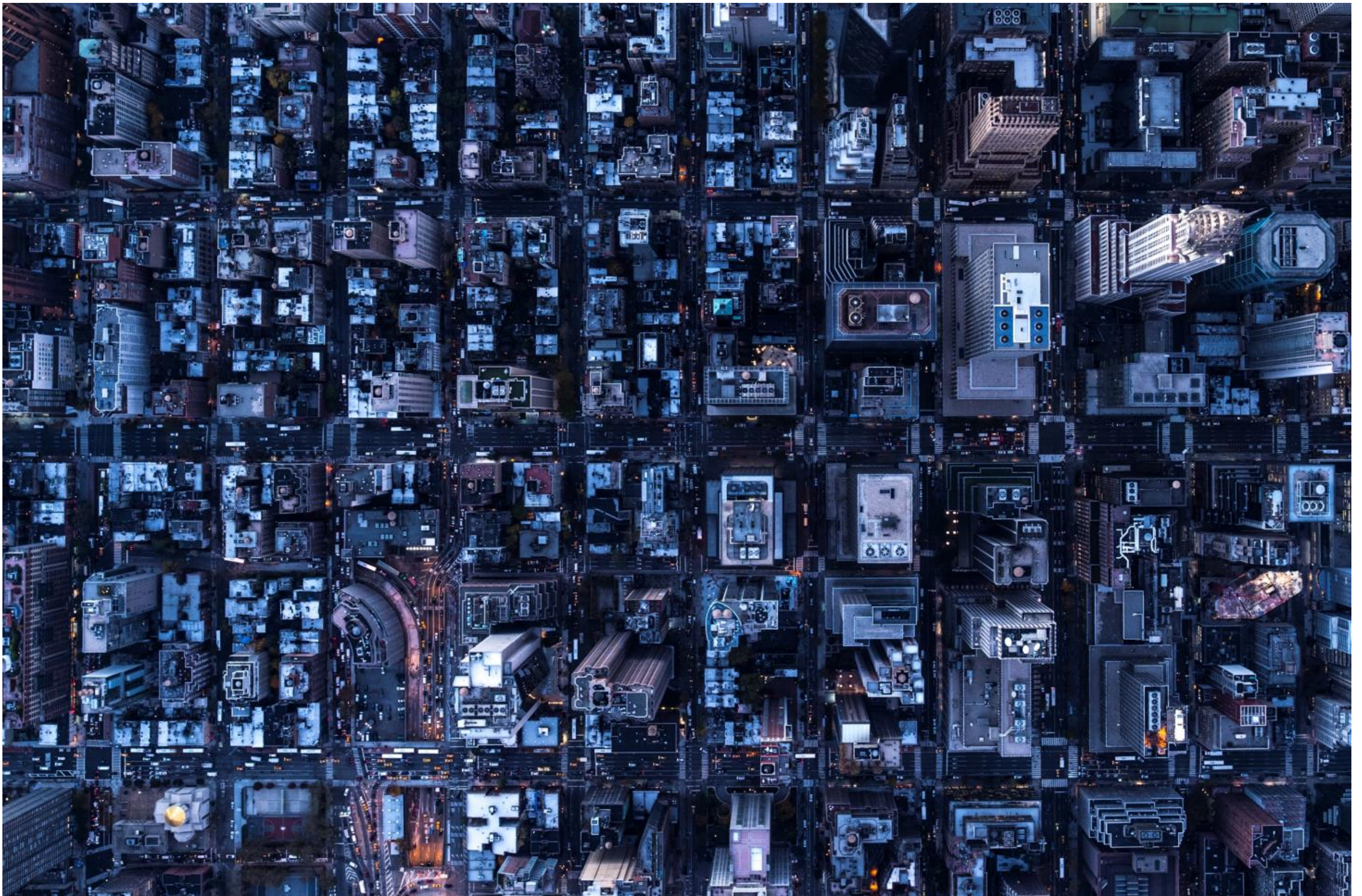
Generation Investment Management Global Equity Quarterly Investor Letter

October 2024



Dear fellow investors

In this quarterly letter we reflect on the current market environment and our outlook for AI.

The Federal Reserve's rate cut on 18 September marked the end of a nerve-racking chapter. Many economists were certain that interest rate hikes in 2022 and 2023 to fight inflation would tip the global economy into a deep downturn, with a big rise in unemployment. We have previously referred to 'the most anticipated recession in history.' But, thankfully, that recession did not come to pass.

While inflation caused great social harm, joblessness remained low and household incomes kept growing. The feared recession might of course still come, but with rates falling, we hope we can look forward to brighter days ahead.

Today, the global economy is not the only thing that is hard to predict. In geopolitics, events are happening at such a pace that it is difficult to keep track of them. And, of course, we have no idea who between Kamala Harris and Donald Trump is going to win the US election in November.

In this confusing environment, what can you do? We continue to follow the moral of Voltaire's novel Candide: "We must cultivate our garden." Rather than getting lost in abstract debates or grand speculations, we focus on what we can control. For us, that means finding great companies, at the right price, in which to deploy capital.

We believe the portfolio is comprised of high-quality companies with strong balance sheets and excellent management teams. Our proprietary measure of Business Quality is near an all-time high. Even at a time of economic uncertainty, the portfolio has estimated annual earnings growth in the mid-teens over the coming years. In our view the companies have another crucial advantage: they are pushing the world towards a sustainable future. They are implementing policies on climate, nature and equality – not to please politicians or regulators but because it is the smart thing to do.

OUTLOOK

We are seeing good opportunities in the market. This chimes with a recent paper written by investor Clifford Asness, which we thought was worth sharing with you.[1] Asness argues that social media has made today's markets even less predictable than before. Companies and their share prices can 'go viral,' meaning that shares are more likely to disconnect from their fair value. The onslaught of information can cause investor confidence to rise, even if the quality of that information is low. To use Ben Graham's parlance, Mr Market now has bigger mood swings than he used to.[2] But this has an upside for investors like us. We believe there are more inefficiencies than before. Capital allocators willing to take the other side of these inefficiencies can potentially be rewarded with higher returns.

We believe that our portfolio is well-positioned for future growth. The magic of compounding, coupled with relentless discipline about the prices that we are willing to pay, make us optimistic about the future.

[1] Asness, Clifford S. "The Less-Efficient Market Hypothesis." Forthcoming in the 50th Anniversary Issue of The Journal of Portfolio Management, 2024.
[2] Graham, Ben. "The Intelligent Investor," 1949.

COST OF ARTIFICIAL INTELLIGENCE

We are looking to invest in the current artificial intelligence trend for the long term. This technology has the power to change not only the economy, but also how we do things as investors. The past quarter has brought some more issues to light.

The share price of Nvidia, the archetypal 'AI stock,' has stopped marching upwards. This may in part reflect the dynamics of a hot investment. Sometimes the stock zooms up, and sometimes it zooms down, without rhyme nor reason. It also reflects, however, some anxiety among investors. AI, for all its technical brilliance, is struggling to find a 'killer app' in the real world. So far, we have no AI use-case as earth-shattering as the personal computer, the smartphone or Google search. We believe that AI agents – autonomous systems completing specific tasks without human involvement – could very well be that killer app. But it is still too early to say.

We have also improved our thinking on the economics of AI adoption. The era of 'zero marginal cost,' that characterised the wave of technological innovation in the 2000s and 2010s may now be over. Before, and exaggerating only a bit, companies could sell one unit of software for the same cost to them as selling a million units. The marginal cost was essentially zero. As a result, the prices facing consumers were also often very low.

With AI, this is no longer true. AI requires enormous investment to provide the brainpower for the models. The big cloud companies are spending a trillion dollars or more to build AI, as well as on the energy systems to power it. They will need to charge their customers appropriately to make a return on this unprecedented level of investment. Put it this way: Google search has always been free, but the best AI chatbots are not. For this reason, it is best not to view the 2000s and 2010s as a blueprint for AI. Different dynamics could be at play. Adoption could be slower. We note that, at present, AI is a key production input for only a minority of companies in the real economy – 5% or so in America.[3]

Indeed, the future benefits of AI will not accrue to all companies equally. If AI continues to improve, this may enable companies with lots of white-collar employees to do things more efficiently. These companies, including non-tech companies from healthcare to consultancy, could expand their margins significantly. This could create enormous value. And yet we see little evidence in the market right now that share prices reflect this potential.

This is not the only underappreciated trend, we believe. In recent months we have been impressed with the strong momentum in electrification. We are also truly excited by continued progress in healthcare. Biologics – therapeutic products derived from living organisms or their cells – hold significant potential for treating complex diseases and improving patient outcomes. And, whatever happens with the US election in November, it is important to remember the following maxim: these trends are more powerful than politics. The world is moving inexorably to a sustainable future.

As we enter Generation's third decade, we remain true to our guiding principles. Over the next ten years a different set of major economic and political shocks is sure to emerge. But, as before, we will neither try to predict these nor to profit from them. Instead, we focus on what we can control. If we can identify sustainable businesses similar to those we have purchased in the past, we believe an uncertain world will have little effect on our long-term returns.

The total assets under management for the Global Equity strategy as at 30 September 2024 are USD 28.1 billion.

[3] Bonney, Kathryn, Cory Breaux, Cathy Buffington, Emin Dinlersoz, Lucia S. Foster, Nathan Goldschlag, John C. Haltiwanger, Zachary Kroff, and Keith Savage. "Tracking firm use of AI in real time: A snapshot from the Business," Trends and Outlook Survey. No. w32319. National Bureau of Economic Research, 2024.

In each quarterly letter we share examples from the portfolio that bring our investment process to life. This quarter we focus on CBRE and JLL, commercial real-estate services companies.

Company example

CBRE

JLL

We last wrote about CBRE and JLL three years ago. Decarbonising the built environment is a key challenge in solving the climate crisis. These two firms are a critical part of the solution and together account for 6% of the portfolio.

Buildings are responsible for greenhouse-gas emissions in two ways. Emissions associated with the construction and de-construction processes are known as 'embodied carbon.' These include the emissions from the manufacture of carbon-intensive materials like steel and cement. In their use-phase, buildings are responsible for emissions from the consumption of fossil fuels on premises – for heating as an example – and from electricity consumption. It is hard to put a definitive number on the share of global emissions for which buildings are responsible, but it is typically cited as close to 40%.[4] As we note in this year's Sustainability Trends Report, the building sector is not currently on track to help meet the world's climate goals.

Many of the companies in the portfolio are providing solutions to this challenge and contributing to the reduction of emissions from the built environment. Sika's products lower the carbon footprint of construction materials like cement. Trane Technologies' heat pumps provide electrified, highly efficient heating and cooling. Schneider Electric's connected products and energy management software reduce power consumption. In total, around 15% of Global Equity Focus List companies have a significant focus on goods and services enhancing built environment sustainability.[5]

OUR INVESTMENT THESIS

CBRE and JLL, the two largest commercial real-estate (CRE) services companies in the world by market share, are at the forefront of this. Both provide a wide range of services including leasing, capital markets, loan servicing, asset management, project management, facilities management and strategic outsourcing. CBRE is also one of the largest CRE developers in the United States. Together, they operate in over 100 countries, are major players in most types of CRE from offices to data centres, and work with clients across every major industry.

We have been covering JLL for more than a decade. Our diligence highlighted several sustainable long-term industry tailwinds. These included increasing institutional ownership driving industry professionalisation and transaction velocity, growing occupier demand for outsourcing and more sophisticated services that only the largest players could provide, and finally, globalisation and industry consolidation. Uniquely, JLL had also shown early leadership in sustainability.

When we last wrote about these companies, we described the journey JLL was on from a siloed organisation built through a series of acquisitions into a unified global firm with centralised systems, functions and controls. We described our engagement efforts to move the company from a singular focus on revenue growth to cash flow per share with a more robust capital allocation framework, supported by appropriate alignment and incentives. We are pleased that the company has made tremendous strides, but there is still room for improvement and the difficulty of managing talented brokers in their high margin transactional brokerage businesses remains an ongoing challenge.

Thanks to our increasing conviction on the industry tailwinds and sustainability case, in 2019 we doubled down on the sector by adding CBRE to our Focus List. In the intervening period, CBRE has closed the gap on sustainability with JLL. For example, CBRE has forged an important partnership with Altus Power, the largest owner of commercial-scale solar in the United States, and has also diversified into green infrastructure. Arguably, CBRE has even more ability to influence key decisions on building efficiency than JLL due

[4] "Building Materials and the Climate: Constructing a New Future," UN. See report here.

[5] As of Q3 2024. This information may no longer be current. There is no warranty that any of the companies referenced in this letter remain or will remain in the portfolio.

to its larger size, particularly its much larger outsourcing business and development business.

CBRE had also learned from past mistakes and put in place a robust capital allocation framework. This has allowed it to use industry cycles to its advantage. The company entered the recent industry downturn with no leverage, enabling it to deploy USD 8 billion at highly advantageous terms into acquisitions, buybacks and development business co-investments over the past three years.

SUSTAINABILITY

We have excellent dialogue with both CBRE and JLL on sustainability. Both companies have set a target of reaching net-zero emissions across Scopes 1, 2 and 3 by 2040, in line with our net-zero goal for the portfolio. Both have near-term science-based emissions reduction targets validated by the Science Based Targets initiative (SBTi). JLL also has a net-zero target validated by SBTi, and CBRE has committed to set a net-zero target with SBTi.

After commitment, of course, comes the much trickier implementation phase. Both companies are deep in the process of developing their strategies for transition, which principally means attacking the indirect Scope 3 emissions associated with the buildings they develop and manage for clients. From our dialogue with the companies, we know that they are working hard to understand, in detail, where they can have the greatest influence with their clients on emissions reductions.

This is not easy work and there are many obstacles. Sometimes national real-estate regulations are too weak on sustainability. Sometimes low-carbon solutions come with a price premium: green steel, for example. Sometimes clients do not join the dots between their organisational climate goals and their property procurement processes.

The decarbonisation of CRE, and overcoming these obstacles, will require new behaviours from CBRE and JLL and relentless innovation of how they deliver their services. We know both of the companies' Chief Sustainability Officers well, and we know that this is their and the firms' mission. The task facing CBRE and JLL is not merely to remain the two largest CRE services companies in the world. It is also to become the two largest service partners for global business in the decarbonisation of commercial real estate. This is a huge task. It is also a business and impact opportunity that we find hard to parallel.

Stewardship and engagement

The second half of the year always brings climate change into sharp focus, as the annual inter-governmental 'Conference of the Parties' (COP) comes into view.

For investors, Climate Week NYC at the end of September is increasingly becoming the moment of sharpest focus. It is an opportunity for businesses and financial institutions not only to signal their expectations to governments ahead of COP but also to take stock, reconnect and re-energise on what they can do to address the ever more pressing climate crisis.

EXPECTATIONS OF GOVERNMENTS

The 2024 Global Investor Statement to Governments on the Climate Crisis was released on 17 September in advance of Climate Week – the most comprehensive investor call for climate action ever made. It calls on governments to ensure that the national climate plans they are required to submit by early 2025 under the Paris Agreement are aligned with the goal of limiting the global average temperature rise to 1.5°C. It also urges governments to adopt a "whole-of-government approach" to tackling the climate crisis.

The statement has so far been signed by 534 institutional investors and their representatives, managing more than USD 29 trillion in assets. Generation is among the signatories. The statement will remain open for investor signature until 1 November, after which it will be presented to governments with the final list of signatures for the start of COP29 in Baku, Azerbaijan.

A CALL FOR FINANCIAL INSTITUTION ACTION ON NATURE

Investors, of course, cannot sit back and wait for governments to take action in the face of the immense economic risks posed by climate change. As the Generation Foundation-supported Legal Framework for Impact report made clear, seeking to address systemic sustainability risk is often a fiduciary duty. There are voluntary actions that investors can and must take through capital allocation, engagement and policy advocacy.

In recent months Generation has been closely engaged in helping to develop voluntary guidance for financial institutions on incorporating nature into net-zero transition plans. We have been co-leading a Glasgow Financial Alliance for Net Zero (GFANZ) workstream on this.

We were pleased to see the guidance previewed at an event at Climate Week by GFANZ Vice-Chair Mary Schapiro. It will formally launch, and go out for consultation, at the biodiversity COP at the end of October in Cali, Colombia. The overarching message for financial institutions is that there is no net zero without nature. The report sets out the actions that this implies across governance, metrics and targets, engagement strategy, and net-zero implementation strategy. Do look out for the report later this month.

CORPORATE ENGAGEMENT

With so many companies in town, Climate Week NYC offers great opportunities for corporate engagement.

For the second year running, Generation hosted a breakfast meeting for company Chief Sustainability Officers (CSOs) in our network. This is a firmwide collaboration, drawing in not only Global Equity and Asia Equity portfolio companies but also companies from the networks of our private markets and Just Climate colleagues.

Our goal is to create a space for CSOs to collaborate on overcoming the obstacles they are encountering in the net-zero transition, as well as to make the most of the business opportunities that the transition presents. This year we discussed everything from how to use executive compensation to drive accountability on climate targets to ways to support the creation of an effective Global Plastics Treaty. It's an example of our partnership approach to engagement with companies which are leading the charge on global decarbonisation.

We also participated in a meeting organised by Amazon for investors during Climate Week as we continue to pursue the engagement objectives that we set out in a prior investor letter. These objectives are credible, external target validation given Amazon's removal from SBTi and disclosure of the emissions associated with the goods that Amazon sells on its platform. Amazon currently excludes these emissions from its inventory.

It was clear from the engagement meeting that these ‘asks’ have been registered by Amazon and are being incorporated into the company’s programme of work on climate. While we are not yet able to share any developments, we will if and when Amazon makes disclosures.

The other main touchpoint with major businesses for us during Climate Week were The Climate Pledge events we attended. The Climate Pledge is a commitment to reach net-zero emissions by 2040. It was co-founded by Amazon and Global Optimism, a non-governmental organisation led by Christiana Figueres and Tom Rivett-Carnac, who together oversaw the delivery of the Paris Agreement in 2015 when they worked at the UN. Generation is a signatory.

We were encouraged by plans that were revealed for The Climate Pledge. There are now more than 500 companies in The Climate Pledge, and the plan is to foster meaningful collaboration between members to advance the deployment of climate solutions in areas where signatories are struggling.

PROGRESS AND STRUGGLES

The fight to address the climate crisis has always been a story of progress and struggles, but this feeling was particularly acute for Generation this Climate Week. The net-zero transition is happening across our economy, and it is unstoppable. But the transition is also clearly not happening fast enough, and part of the reason is that voluntary market action is not of itself enough. There are too many obstacles embedded in our market systems. This especially includes incentives that do not support the transition or go flat against it.

The businesses and financial institutions gathered in New York for Climate Week were increasingly starting to acknowledge and articulate this – and to think about solutions. In different ways and to different degrees, our economic system is leaving us stuck, and we need to find ways to change it.

We are thinking hard about what this means and how progress might be made. Our view is that the answer is likely to lie in the systems thinking and system-positive behaviour that we have long called for from companies and our peers in the financial industry. But a deeper, more innovative version – one calling for even more co-operation across boundaries between companies, investors and governments who together have the means to deliver the sustainability impact we need – might be the way forward.

We plan to say more soon. In the meantime, we continue to work steadfastly, investing and engaging with companies which will, we expect, ultimately lead on corporate action around this important topic.

Portfolio metrics[6]

We provide select Environmental, Social and Governance (ESG) as well as Financial (F) metrics, which we believe best represent the data we use to inform our Business and Management Quality process, out of those currently available for the majority of the portfolio and benchmark. While they are best viewed as an output of our process rather than direct inputs, they also provide us with an additional lens through which to view the portfolio and stimulate internal discussion.

As well as measuring the portfolio against a benchmark, we now measure it against thresholds too. This is because the portfolio might beat its benchmark in one of the criteria below, but this still might not achieve what is needed for a truly sustainable society. For example: the portfolio has a lower gender pay gap score than the benchmark, but really we want the portfolio, and society more broadly, to move towards eliminating the gender pay gap completely. Therefore, in this situation, our threshold for success would be zero.

E

	Portfolio	Benchmark	Threshold
Carbon intensity, Scopes 1 & 2 (tCO_2e/$m)[7]	23	99	
Carbon intensity, Scopes 1–3 (tCO_2e/Eur m)[7]	448	785	
SBTi target validated (portfolio weight %)[8]	64%	44%	100%
SBTi committed but target not set (portfolio weight %)[8]	5%	8%	
Implied temperature rise (Scopes 1–3, degrees Celsius)[9]	1.7	2.4	1.5

S

	Portfolio	Benchmark	Threshold
Percentage of employees would recommend the company to friend[10]	74%	70%	
Effective tax rate[11]	20%	23%	
Commitment to a living wage[12]	43%		100%
Gender – female Board % (weighted average)[13]	34%	34%	40–60%
Gender – female executives % (weighted average)[14]	23%	25%	40–60%
Gender pay gap (simple average)[15]	14%	18%	0%
Advanced total race/ethnicity score (weighted average)[16]	55	51	
Pay linked to diversity targets (simple average)[17]	21%	11%	

[6] As at 13 September 2024. This information may no longer be current. To the extent not sourced from Generation, it is from sources believed reliable. However, Generation does not represent that it is accurate or complete and it should not be relied upon. It should not be deemed representative of future characteristics for the portfolio. For definitions of each metric, please refer to the appendix.
[7] Source: MSCI, weighted average calculation.
[8] Generation analysis based on data from the Science Based Targets initiative.
[9] Source: MSCI. The methodology has been updated since the Q4 2023 investor letter was published and therefore the new numbers are not directly comparable to those previously shown. We welcome the changes as reflecting the recommendations of the GFANZ report "Measuring Portfolio Alignment: Driving Enhancement, Convergence, and Adoption," published in November 2022.
[10] Source: Glassdoor.
[11] Source: CapIQ. This metric is not shown as above or below benchmark, as one cannot deduce from the number alone whether a company's effective tax rate is a positive or negative; company profits are taxed in a range of jurisdictions with a range of tax rates and permissible deductions. For comparison, the global average Effective Average Tax Rate (EATR) published by the OECD in November 2023 was 20.2%. This was calculated on the basis of data for 2022 from 77 jurisdictions.
[12] Source: Denominator. Coverage is poor for this metric and not adequately representative of the benchmark, therefore no comparison is made.
[13] Source: Denominator.
[14] Source: Denominator. This is a Denominator calculated data point because there is no universally agreed definition of an 'executive' and therefore without a standard method one company's disclosure might represent something significantly different to another.
[15] Source: Denominator. This metric is a simple average of gender pay gap data disclosed by companies. We would note that coverage is poor for this metric. Pay gaps are not measured in a consistent way. Some data points reflect all full-time employees at a company and others only reflect the workforce in jurisdictions where reporting on gender pay gaps is mandatory. Nonetheless, we think it is important to show the data available on this metric and we expect data quality to improve over time.
[16] Source: Denominator. This metric is a score out of 100 that measures the company's total performance on racial/ethnic diversity across the Board, executives and company as a whole. Comparison to background race/ethnicity is calibrated to the country of operations: a company with 100% Caucasian leadership in the US scores less than a company with same ratio in Denmark, due to the different race/ethnicity composition of the background population (higher % of Caucasian in Denmark).
[17] Source: MSCI.

G

	Portfolio	Benchmark
Percentage of shares owned by executives (median)[18]	0.19%	0.09%
Independent Board (weighted average)[19]	78%	81%
Independent chair or lead non-executive director (simple average)[19]	93%	75%
Board not entrenched (simple average)[19]	78%	82%
All non-executive Board members on no more than four public company Boards (simple average)[19]	88%	94%
Equal shareholder voting rights (simple average)[19]	93%	89%
Independent compensation committee (simple average)[19]	80%	72%
Companies with regular 'say on pay' votes (simple average)[19]	98%	81%
Fewer than 10% votes against executive pay (simple average)[19]	63%	74%
Pay linked to sustainability targets (simple average)[19]	63%	31%

F

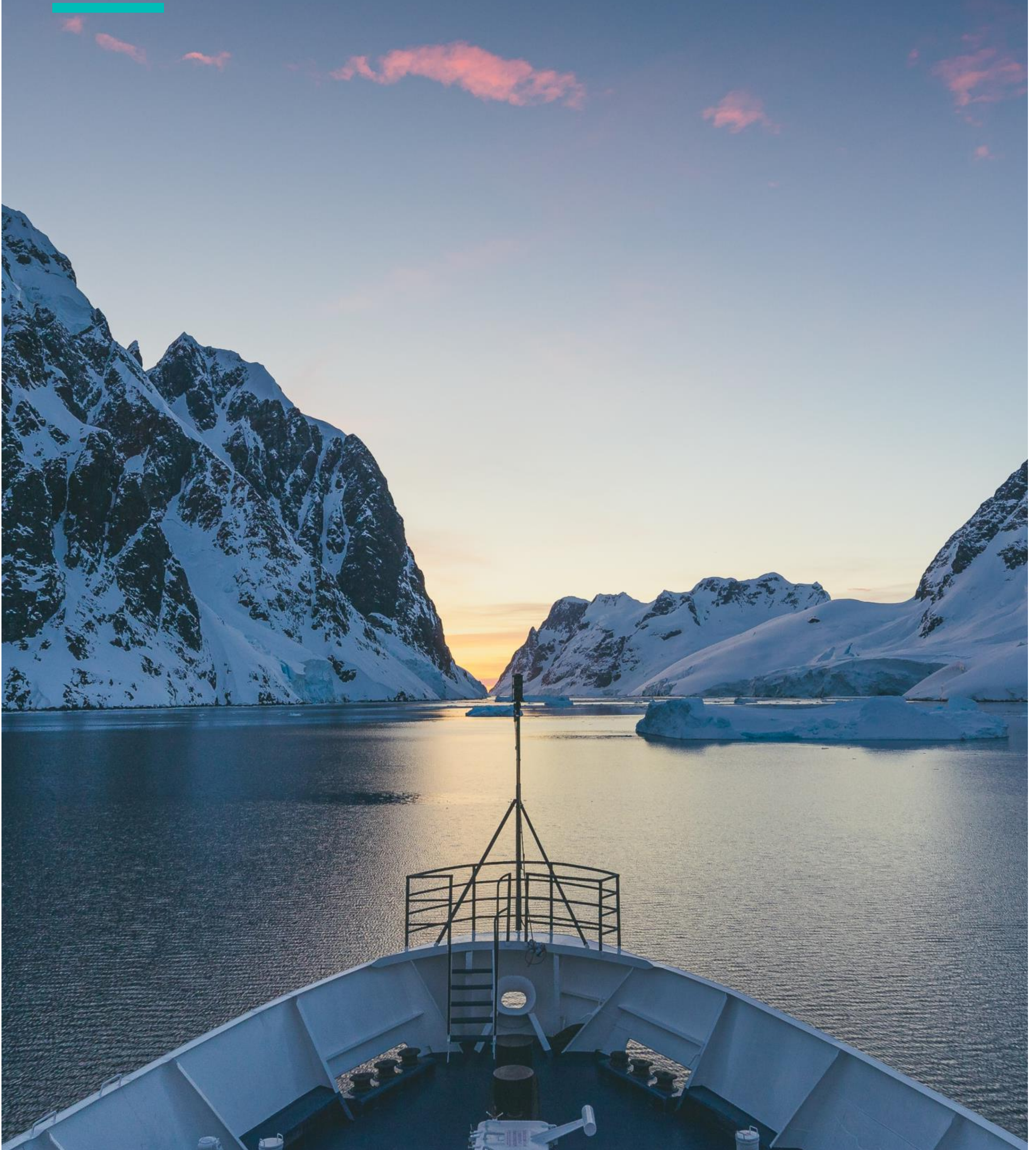
	Portfolio	Benchmark
Three-year revenue growth (weighted average)[18]	14%	15%
Gross margin (weighted average)[18]	55%	53%
Cash flow return on invested capital[20]	16%	9%

Data in green: relative performance above benchmark. Data in red: relative performance below benchmark.

[18] Source: CapIQ.
[19] Source: MSCI.
[20] Source: Credit Suisse Holt.

The firm

Generation has ambitious impact initiatives in addition to our core investment work. We know that to bring about the transformative change required over this decade, we must also motivate others.



SUSTAINABILITY TRENDS REPORT 2024

In September we published our eighth Sustainability Trends Report, which takes stock of the climate and environmental crises at a global scale. Last year's report was buoyed by the passage of the Inflation Reduction Act in the United States and by European success at countering the energy crisis manufactured by Vladimir Putin. This year, we felt compelled to write in detail about the difficulties still confronting the world as it tries to bring emissions down. We encourage you to read the report if you have not done so already, and a replay is available here of the launch webinar featuring our Chairman Al Gore and additional contributors to the report across Generation and Just Climate.

FIRM AND TEAM UPDATE

As at 30 September 2024, the Generation Investment Management team comprises 132 people and assets under management total approximately USD 35.6 billion with a further USD 11.4 billion of assets under supervision.[21,22] The Just Climate team comprises 43 people and the Generation Foundation is five.

Miguel Nogales,
co-Portfolio Manager

Nick Kukrika,
co-Portfolio Manager

[21] Includes subscriptions and redemptions received by the last business day of the quarter but applied the first business day after the quarter-end.

[22] Assets under management as at 30 September 2024 are USD 35.6 billion. Please note that this includes Growth Equity strategy assets under management, Just Climate assets under management and Private Equity strategy assets under management as at 30 June 2024. Assets under supervision (AUS) are USD 11.4 billion as at 30 June 2024. AUS form part of our Private Equity strategy and include assets where Generation sourced, structured and/or negotiated the investment and in relation to which it provides certain ongoing advisory services for a fee.

Appendix

Portfolio metrics: definitions

FACTOR	METRIC	SUMMARY DESCRIPTION
Carbon intensity, Scopes 1 & 2 (tCO_2e/$m)	Weighted average	Aggregate tonnes of GHG emissions (expressed as CO_2 equivalent) per USDm of company revenue.
Carbon intensity, Scopes 1–3 (tCO_2e/Eur m)	Weighted average	Aggregate tonnes of GHG emissions (expressed as CO_2 equivalent) relative to the company's most recent sales in million euro. Scope 3 emissions are estimated.
SBTi target validated (portfolio weight %)	Percentage	The percentage of companies in the portfolio with a validated science-based target.
SBTi committed but target not set (portfolio weight %)	Percentage	The percentage of companies in the portfolio that have committed to setting a science-based target with the Science Based Targets initiative but have not yet had their target validated.
Implied temperature rise (Scopes 1–3, degrees Celsius)	Degrees Celsius	A portfolio level number in degrees Celsius demonstrating how aligned the companies in the portfolio are to global temperature goals. This metric uses an aggregated budget approach: it compares the sum of 'owned' projected GHG emissions on a Scopes 1–3 basis against the sum of 'owned' carbon budgets for underlying holdings. Scope 3 emissions are estimated.
Percentage of employees would recommend company to friend	Average	Percentage of participating employees who would recommend the company to a friend. This metric may warrant caution where a small percentage of the workforce report.
Effective tax rate	Weighted average	The effective tax rate is calculated as the company income tax expense divided by earnings before interest and tax (EBIT) including unusual items. We show a three-year average for smoothing purposes and exclude significant outliers.
Commitment to a living wage	Percentage	The percentage of companies in the portfolio that have committed to a living wage. A living wage is defined by the Global Living Wage Coalition as the remuneration received for a standard workweek by a worker in a particular place sufficient to afford a decent standard of living for the worker and their family. Elements of a decent standard of living include food, water, housing, education, healthcare, transportation, clothing and other essential needs including provision for unexpected events.
Gender – female Board	Weighted average	A weighted average calculation of the percentage of female Board directors on each of the Boards in the portfolio.
Gender – female executives	Weighted average	A weighted average calculation of the percentage of female executives at each of the companies in the portfolio. There is no standard definition of an executive and companies can define the executive level in many different ways. Denominator, our data provider, works to calculate the data point based on standard definitions.
Gender pay gap	Average	The average salary gender pay gap across companies that disclose this metric within the portfolio. Calculation methods can vary between companies and jurisdictions. Some data points reflect all full-time employees at a company and others only reflect the workforce in jurisdictions where reporting on gender pay gaps is mandatory. Nonetheless, we think it is important to show the data available on this metric and we expect data quality to improve over time.
Advanced total race/ethnicity score	Weighted average	This metric is a score out of 100 calculated by our data provider that measures the company's total performance on racial/ethnic diversity across the Board, executive and company as a whole. Comparison to background race/ethnicity is calibrated to the country of operations: a company with 100% Caucasian leadership in the US scores less than a company with same ratio in Denmark, due to the different race/ethnicity composition of the background population (higher % of Caucasian in Denmark).
Pay linked to diversity targets	Percentage	The percentage of companies where there is evidence of a commitment to linking executive pay to diversity and inclusion targets. The metric is calculated as: number of companies where evidence exists divided by the total number of companies in the portfolio.
Percentage of shares owned by executive	Median	Executive share holdings as a percentage of shares outstanding. We show the median for portfolio and benchmark, as the average may be impacted by some companies (often founder-run) with large executive ownership stakes.

FACTOR	METRIC	SUMMARY DESCRIPTION
Independent Board	Weighted average	Board independence is inferred by MSCI. The following categories of director are not regarded as independent: current and prior employees, those employed by predecessor companies, founders, those with family ties or close relationships to an executive, employees of an entity owned by an executive and those who have provided services to a senior executive or the company within the last three years. The compensation of a non-executive chair must not be excessive in comparison to that of other non-executives and must be less than half that of the named executives. Where information is insufficient, the director is assumed to be non-independent. For the Board to be classified as independent, a majority of the Board members must be classified as independent.
Independent chairman or lead non-executive director	Percentage	Percentage of companies that have an independent chair or, where the chair is not independent, an independent lead director.
Board not entrenched	Percentage	Percentage of companies without an entrenched Board. Board entrenchment is inferred by MSCI using a range of criteria including: >35% Board tenure of >15 years, five or more directors with tenure of >15 years, five or more directors >70 years old.
All non-executive Board members on no more than four public company Boards	Percentage	Percentage of companies with no over-boarded non-executives. The threshold is where a Board member serves on five or more public company Boards.
Equal shareholder voting rights	Percentage	Percentage of companies that have equal voting rights.
Independent compensation committee	Percentage	Percentage of companies with independent compensation committee. Please see above for the independence criteria used.
Companies with a regular 'say on pay' vote	Percentage	The percentage of companies in the portfolio that have a policy in place to ensure that a firm's shareholders have the right to vote on the remuneration of executives on a regular basis.
Fewer than 10% shareholder votes against executive pay	Percentage	Percentage of companies that received less than 10% shareholder votes against executive pay at the most recently reported annual shareholder meeting. Only applies to companies that have a 'say on pay' vote.
Pay linked to sustainability targets	Percentage	The percentage of companies where executive remuneration is linked to sustainability targets. This metric is based on the company's own reporting. It considers whether one or more sustainability metrics are used to determine annual and/or long-term incentive pay and does not consider the effectiveness of those metrics.
Three-year revenue growth (annualised)	Weighted average	Aggregate (weighted) three-year revenue growth rate to the last reported fiscal year. Revenue growth is not adjusted for acquisitions and disposals.
Gross margin	Weighted average	Aggregate (weighted) gross margin for the last fiscal year. Gross margin is the difference between revenue and cost of goods sold divided by revenue.
Cash flow return on invested capital (CFROI)	Weighted average	CFROI (cash flow return on investment), a (trademarked) valuation metric.

Important information

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