

ESG IN LATIN AMERICA: HIGHLIGHTS AND THE COMPASS APPROACH

May 2021

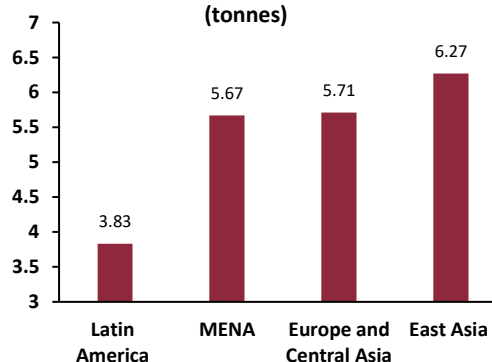


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In the following piece, we discuss the current landscape for environmental, social and governance (ESG) practices within Latin America and how the region fares against other parts of the world. In the case of environmental factors, we examine green energy and climate change on a macro level and highlight the positive attributes throughout Latin America. Regarding social factors, we identify companies that we have invested in and consider to be leading actors in terms of implementing corporate responsibility policies. Finally, for governance factors, we explore the corporate governance environment in Latin America and discuss what Compass is doing to measure and approach it from a holistic ESG perspective.

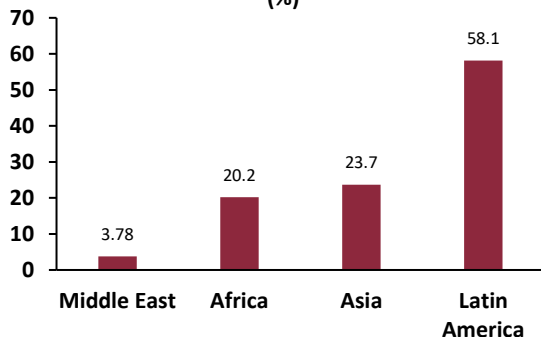
In general, Latin America has shown positive results on **environmental** factors such as emissions, clean energy, and total forest area. In 2018 the region recorded under four tones of CO₂ emissions on a per capita basis, a stark contrast from its emerging markets (EM) peers. Despite the ongoing criticism and bad publicity for mismanagement of the Amazon, Brazil has stood out on clean energy production, ranking higher even among other LatAm countries. While deforestation and wildfires remain serious issues that must be handled as a top priority by the government, Brazil has not been a major contributor to world pollution and global warming. To this end, 59.6% of Brazil is covered by forests, a much higher percent than any other developed country and only falling short of Japan.

2018 CO₂ Emissions per Capita (tonnes)



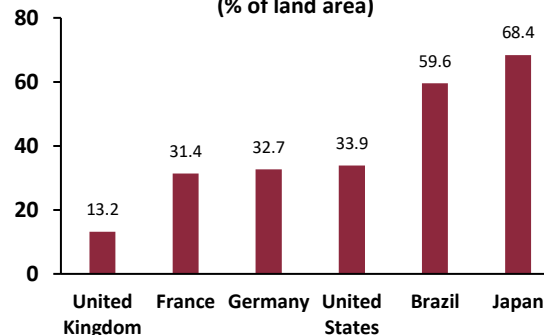
Source: Climatewatch.

2019 Share of electricity from renewables (%)



Source: Climatewatch.

Forest Area (% of land area)



Source: Our World in Data.

A combination of geography and green policies places the region in a privileged position regarding its energy matrix. In 2019, Latin America's share of electricity production from renewables greatly exceeded that of other parts of the developing world. Specifically, in Colombia, the latest five-year stimulus plan aims to create over 100,000 green jobs, while President Duque recently announced the country's pledge to reduce greenhouse gas emissions by 51% by 2030. In Chile, the government has made plans to allocate at least \$1.3 billion towards environmentally friendly measures as part of its target of achieving carbon

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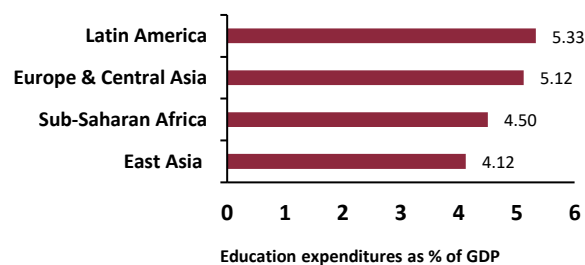
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neutrality by 2050. Subsidiaries of AES, Engie, Enel, EDP and Iberdrola are currently developing 57 GW in renewable sources in Brazil, Mexico, Chile, Colombia, Peru, and Central America.

As active investors in the region, we consider it crucial to address the systemic **social** issues that have long plagued Latin America, including human rights, access to healthcare, education, and inequality. While improvements in some areas have been made, the region continues to face an uphill battle and a great deal of progress needs to take place in order to raise the overall standard of living. However, it's important to highlight areas where progress has been made and examine how the trajectory of certain trends compares to other regions.

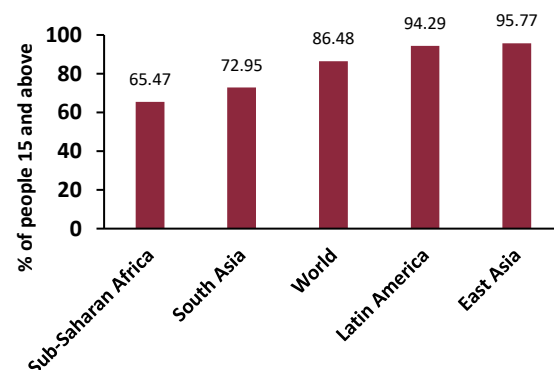
On education, Latin America has performed better than numerous peers when it comes to financing and allocating a greater portion of public spending towards all levels of education. Additionally, Latin America's literacy rate (i.e. the ability to read and write at a basic level) has steadily risen to nearly 95% placing it above both the global rate and other low-income regions.

**Total Government Expenditure on Education
(2014)**



Source: Our World in Data.

**Adult Literacy Rate
(2019)**



Source: Macrotrends, World Bank.

On healthcare matters, progress towards increasing access to medical care has been hindered by slow growth, as countries with higher GDP per capita exhibit higher expenditure on healthcare as a share of their income. While some LatAm countries have made strides on this front, state institutions across the region have generally been weak addressing the issue. When it comes to healthcare expenditure, Latin America has remained in line with its peers, averaging just over 7% of GDP being spent on health. On a per capita basis, expenditures on health are well above South Asia and Sub-Saharan Africa, but significantly lower than the world average. In the following section we will share a few case studies of companies that have been leaders in advancing environmental and social programs in the region.



The region has many important companies that have incorporated ESG values to their culture. Below we highlight three examples in different sectors that we consider to be world leaders in sustainable business and development. Each company for their respective sectors has developed specific projects that contribute to the improvement of their surroundings while increasing investor's value.



An interesting example is Natura, Brazilian cosmetics company founded in 1969 and committed to developing products that express values and sustainable practices. In 2004, Natura went public and continued its efforts on sustainability, receiving its first carbon neutral certification in 2007 and becoming the first Brazilian company to join climate advocates. Natura has developed key partnerships with local communities that have allowed it to combat climate change while supporting farming populations. Through these relationships, Natura has steadily improved the income of thousands of families and has conserved of over two million hectares of forest.



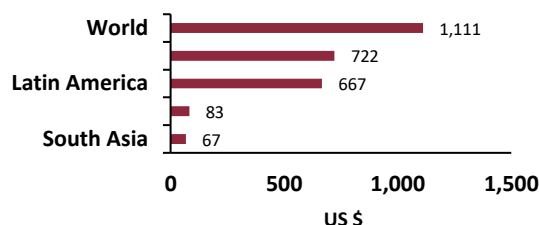
Omega Geração is a Brazil-based company founded in 2008. It is involved in the operation of renewable energy projects in hydro and wind production. Omega focuses on power generation that is 100% clean, renewable, and cost-competitive energy, while contributing to Brazil's socio-economic development in a sustainable way. Through its clean matrix, Omega was able to avoid the emission of 289 thousand tons of CO₂ in 2019.

Within a short timeframe, Omega has fulfilled 14 of the 17 global goals established by the UN General Assembly that fall under the firm's social and environmental commitments.¹ Omega has strongly prioritized their social commitments and obligations towards the regions in which they operate. The firm's social investment pillars are education and income generation, such as the Janela Para o Mundo projects.²

¹ <https://sdgs.un.org/goals>.

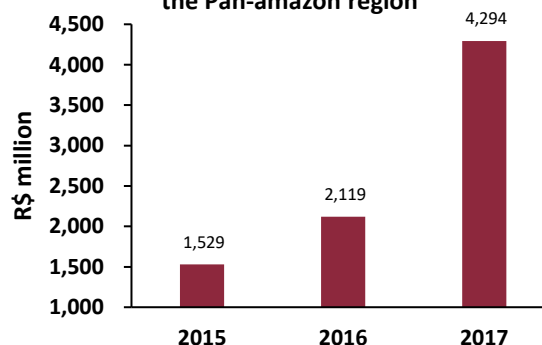
² The Janela para o Mundo initiative is an educational program that offers free courses to over 600 students.

Expenditures on Health Per Capita (2018)



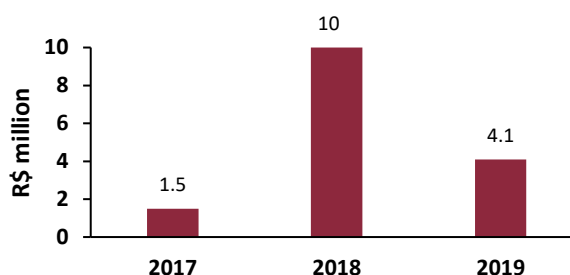
Source: Macrotrends, World Bank.

Communities and Families benefiting in the Pan-amazon region



Source: Natura 2017 annual report.

Historical Evolution of Private Social Investment



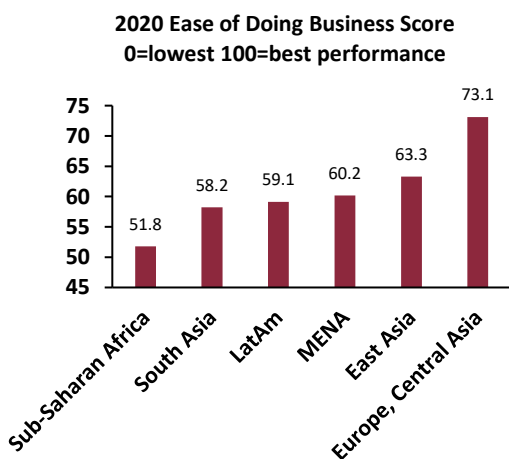
Source: Omega Geração sustainability report.



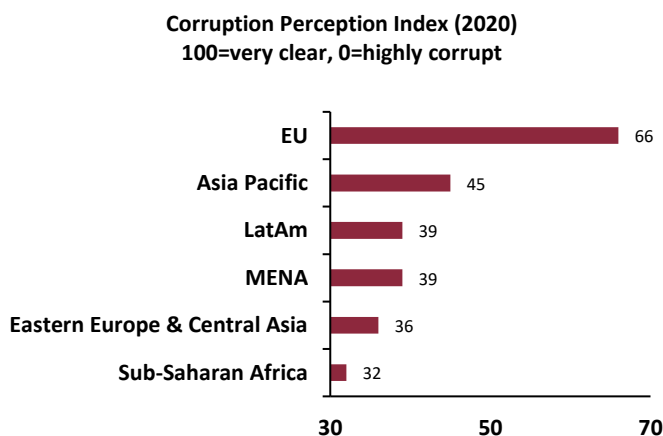
Globant

Globant is an IT and software development company founded in 2003 in Buenos Aires, Argentina. The firm strongly emphasizes its commitment to community development, with a particular focus on female empowerment. One of their action vehicles is the expansion of female participation rates in the IT industry. As such, Globant designed a program that supports women throughout their career journey through a five-stage approach (inspire, educate, hire, accompany and lead) with their objective of educating and introducing them to the labor force. For example, the initial “inspire” stage aims to encourage women to become interested in science, technology, and mathematics. As part of these programs, the “Girls Programming Club”, in which 1,500 girls have already participated, is educating and providing technical tools for girls. Globant has managed to combine through its social programs a business-oriented strategy that is creating value for their investors while helping its community. All of this while using 100% of its energy from renewable sources and looking to reach a neutral carbon footprint by the end of 2021.

At the macro level, Latin America continues to face **governance** issues that have been deeply rooted into its institutions at all levels of society. Corruption has played a major role in perpetuating the issues that have long plagued the region, including inequality, political instability, and lack of economic growth. Despite the reforms that have taken place over the last few decades, Latin America continues to be a difficult place to do business. Poor transparency and weak policy making has stunted foreign investment and limited the region’s potential. These issues are widely prevalent at the corporate level as well. In recent years, Latin American companies have come under the spotlight for their involvement in corruption scandals, including major oil firms like Petrobras and Pemex³. These cases are examples of quasi-sovereigns where government and corporate corruption is intertwined.



Source: World Bank.



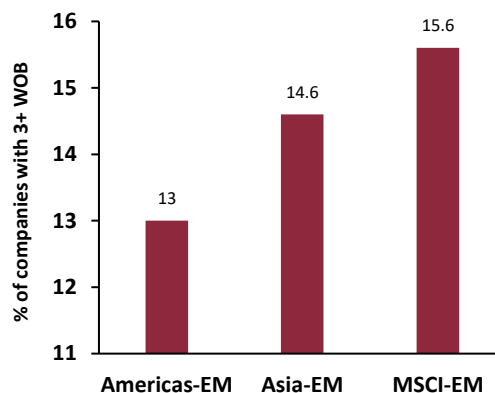
Source: Transparency International.

³ <https://www.linkedin.com/pulse/week-6-esg-latin-america-sasja-beslik/>



Additionally, corporate structures in the region are often composed of single families that hold majority power. This type of ownership contributes to better results and corporate responsibility but can also affect transparency. In a 2016 report from Ernst & Young, Latin America made up 7.2% (36) of the world's 500 largest family businesses. In that year, these 36 companies generated US\$439.3bn in revenues (9.8% of LatAm's GDP) and employed over two million workers (0.7% of LatAm's workforce)⁴. Compared to emerging Asia, Latin America showed similar results on female board representation, and just under the overall MSCI EM percentage. While Latin America still has a great deal of progress to make on corporate diversity, there is a wide push being made to expand opportunities for all, as it has become increasingly clear how important a diverse workforce with different backgrounds and perspectives is towards a firm's success.

2020 MSCI Breakdown of Companies by Female Board Representation



Source: MSCI ESG Research.

In this section we will discuss Compass' approach towards measuring and managing ESG and specifically governance standards in Latin America.

At Compass Group, we are increasingly focused on the integration of ESG issues across our portfolios. As stewards of clients' financial capital, we have a stake in encouraging robust ESG practices within our portfolio companies and the general LatAm universe. Our approach to responsible investments is unique insofar as it relies almost exclusively on proprietary data and 25+ years of experience operating locally within Latin America. We believe that the credit- and stock-picking processes are key to alpha generation. Naturally, our foray into ESG integration began with corporate governance. Recognizing governance as a key driver or component of a company's investment case, we have developed an internal credit rating methodology that incorporates "Governance" as a component of "Character", one of the four C's of credit analysis.⁵

In 2016, we formalized the integration of sustainability and governance factors by way of a checklist questionnaire in-house produced. Since its inception, the use of the questionnaire has continued to rise and now covers nearly all the companies owned by the equity and credit strategies. In all risk committees we measure and discuss carbon footprint in portfolios, review ESG scores positioning, and review proxy voting.

Since 2018, we have been a signatory to the UN-supported Principles for Responsible Investment (PRI), which monitors compliance with ESG-related factors and requires reporting on implementation of such principles. In 2020, we scored the highest grade (A+) in the Strategy and Governance Module and launched the PRI Academy ESG regional training as an additional resource available to Compass' investment team.

⁴ [https://familybusiness.ey-vx.com/pdfs/latinamerica-facts\(1\).pdf](https://familybusiness.ey-vx.com/pdfs/latinamerica-facts(1).pdf)

⁵ The other three 'C's of credit analysis include capacity (ability to repay), collateral (something of value that can be forfeited), and capital (overall worth).

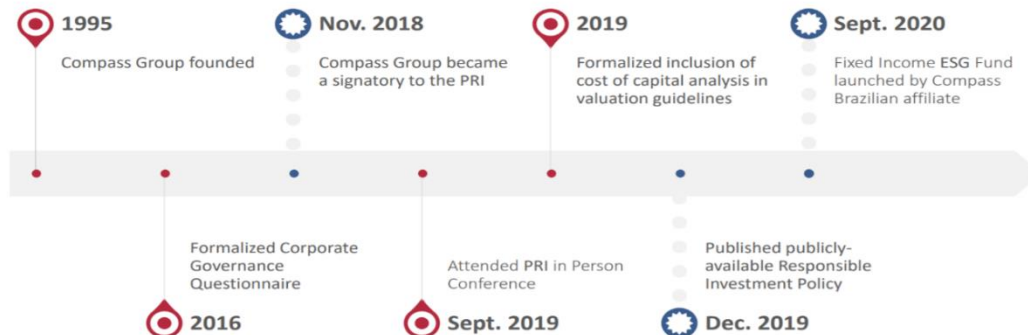


As of March 2021, multiple investment team members have completed the “Advanced RI Analysis” course which explores and examines the use of sustainability data in fundamental investment analysis and stock valuation. The PRI Academy has become an important resource to further expand workforce knowledge about ESG issues, and a major addition to our responsible investment policy and approach; we continue to evaluate additional ESG training for our investment professionals.

In 2019, we updated our valuation guidelines to incorporate research presenting the correlations between governance scores and cost of capital. We are now working on integrating environmental and social factors into the questionnaire with the addition of 17 questions. One of the ways in which we have managed to improve our governance practices has been through the prioritization of how we engage with companies. Engagement with teams at all levels provides us with greater insight into how each business operates.

As part of this process, we have an internal Issuer Governance Review Committee that meets annually with the objective to use governance as leverage to maximize shareholder value and to defend the interests of the investors in the portfolios; the Committee will meet and discuss companies in which Compass may have a relevant stake (where the strategies own more than 5% of total share capital or 10% of free float, or if

RESPONSIBLE INVESTMENT MILESTONES



requested by a portfolio manager or analyst). This also allows us to monitor and assess our views about the companies, including views on their ESG management, performance, and disclosure issues. These meetings have been a major factor for idea generation as they provide our investment teams with additional perspectives that are crucial towards the analyses for each company.

Over the last few years, numerous companies within Compass’ portfolios have made positive changes relating to ESG that can be attributed to our active engagement with them. It was crucial for their success the fact that we have developed a regional *know how* that allow us to approach the companies understanding their culture and way of doing things while being able to explain them the benefits of our proposed changes. Below we provide two examples of companies in which we sought to improve each firm’s governance frameworks by asking for better disclosure within the companies.

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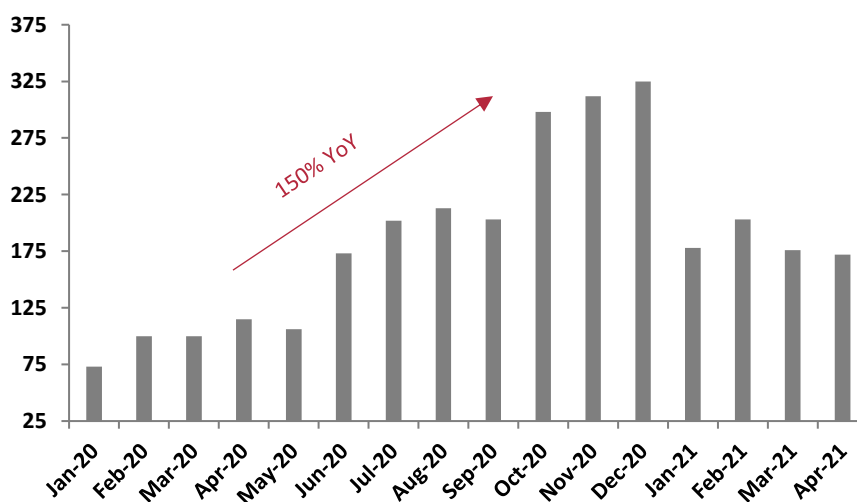
The first company originally founded Chile, produces and exports berries. We focused on “professionalizing” the company so that it was no longer managed primarily by family members. In addition, we asked for a detailed analysis of transactions between related parties and suggested that the firm’s auditor be replaced. Our objective was to create a more diverse management that would stimulate a broader discussion while retaining the business focus.

To accomplish these objectives, we held several meetings with the independent directors to understand changes or improvements relating to governance. Furthermore, we requested the company to provide clear disclosure of its transactions and we suggested the company to replace the auditor that had been employed since 2006. Ultimately, the board implemented several of the proposed changes and changed their auditor.

The second case is related to a company in the cement sector in Mexico. The issuer wanted to call for the annual shareholder meeting to vote on a new Chairman without disclosing who they were putting forward. We disputed the proposed action and requested full transparency for the new election and clarity on who was taking leadership before calling for a vote. By strongly voicing our opposition and outlining the steps required to meet transparent standards, the company ultimately published the new proposed board structure and it passed without issues.

Overall, the subject of ESG has become a frequent topic of discussion within our team. As we continue to explore different ways to systematically integrate ESG analysis into the investment process, the concept has gradually turned into a defining aspect of our culture. The growing relevance of ESG within our community can be observed largely in part by how often the term is mentioned in internal emails. Since 2019, the prevalence of ESG conversations has risen overall, showing that our team has become increasingly focused on improving procedures and preserving our status as an active investor.

ESG mentions in emails



Source: Compass Group.

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Through our commitments to a responsible investment policy and approach,⁶ we have continued to lead the charge for improved corporate governance in the region. For us to continue pioneering “G” throughout Latin America, it is crucial for the entire investment team to take responsibility for incorporating ESG factors into the investment process. Instead of forming a specialized ESG team, our unique approach requires that the group takes on the process together. Within our multifaceted approach to responsible investing, we have stressed the need to screen and evaluate, engage, integrate and customize. These principles are key to our overall framework and philosophy. Ultimately, we believe that our efforts to improve and enhance the approach towards ESG integration will allow us to remain leaders in the region and contribute to best practices within the global community.

⁶ <https://www.unpri.org/pri/a-blueprint-for-responsible-investment>

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