LINDSELL TRAIN

Company Engagement Examples

2020

Q1 2020

It would be remiss to produce an ESG report that did not address the COVID-19 pandemic. That said, our client reports have reported on the implications for our individual holdings and so this report does not seek to amalgamate or replicate that work, but rather consider our role and responsibility as an Investment Manager.

The PRI (Principles for Responsible Investment) – to which we became a signatory in November 2019 – have called for investors to ensure that their response to the crisis "be predicated on the basis of systemic integrity and long-term universal returns being more important than relative company performance." As a company that invests for the very long term, which for us means several market cycles, we continue to do what we say on the tin. We have no notion of how malign the coronavirus effect will be, but we do know it will last only a relatively short time in the context of our investment time horizon. As Equity investors, we are also reminded that the warranted value of a company depends very little on this year's profits, or the year after that. Indeed, with global bond yields falling to record lows, it means that today's value of the far distant earnings for our companies has risen materially, helping to offset any short-term hit from the virus effect. As such, Lindsell Train portfolios remain fully invested and we seek to support our concentrated portfolio of companies by adding to our existing positions when flows permit.

The PRI has also called on signatory investors to engage companies with regards to their crisis management and encourage responsible financial management. Here at LT, engagement forms an integral part of our investment process and as such we have conducted a number of calls with company management this quarter (some examples below), covering a range of topics. These conversations have reassured us that management are taking the necessary steps to ensure that there is no untoward change in strategic direction, whilst navigating these challenging times. Where management have come under financial pressure, we have supported and will continue to support responsible and prudent capital allocation, for example the suspension of buybacks – so far two of our companies, Pearson and Sage, have suspended buybacks - and the reduction or cutting of dividends.

Kao Corporation – February 2020

Lindsell Train are long-term holders of Japanese cosmetics company Kao Corporation, having initiated a position in the company in 2004. In February, the investment team participated on a regular update call with company management.

Whilst this call was not specifically focussed on matters related to ESG, we were pleased to hear that management are becoming increasingly cognizant of the need to source their products sustainably and demonstrate a higher degree of sensitivity to environmental considerations. Management have realised the branding power of appealing to a younger, more environmentally sensitive, generation. Through recycling and sustainable packaging they are reaching a group of consumers in a way that wasn't previously possible.

To add further detail, management explained that they are bolstering their line-up of environmentally friendly containers, which contain 74% less plastic. They are also promoting their more ethical brands, including hygiene related products and launching a new ESG strategy that will operate across multiple business units. Whilst this won't deliver significant sales initially, they expect it to grow substantially over the longer term. We fully support their efforts and welcome the opportunity to discuss with management all matters relating to environmental risks and opportunities.

LSE and Diageo

Our longstanding clients will know that we pay careful consideration to the compensation policies of the companies in which we invest and, as such, engage regularly with management regarding matters relating to remuneration. During the first quarter of 2020 our investment team spoke with the management of both LSE and Diageo.

LSE

The investment team reminded LSE management of our preference for cash compensation linked to measurable performance goals. Management agreed in practice and pointed to the minimum shareholding requirements for executives, their bonus deferral changes (deferrals moving from 2 to 3 years) as well as changes to their clawback policy, as measures that could hopefully alleviate some of our specific concerns surrounding their use of options. They also mentioned their intention to introduce a system whereby independent directors have to buy shares in cash, in the same way that we do as shareholders. We are fully supportive of this proposal as this aligns with our principles. Finally management wanted to seek our opinion on potential increases to the CEO and CFO salaries. We judged the figures proposed to be prudent and fair.

Diageo

Susan Kilsby, Compensation Chair of Diageo sought the investment team's views on the proposed changes to their remuneration policy. One of these changes was implementing a mandatory bonus deferral plan. Diageo is one of the few FTSE 100 companies that doesn't have this in place so this brings them into line with peers. It also further aligns executive directors with shareholders. They are also looking into enhancing their clawback and malus policies. We stated that we have no issues with any of their proposed changes.

We then discussed Lindsell Train's more general views surrounding compensation and stated our preference for rewards based on Returns on Capital (ROC), ideally over long periods of time. It was also noted that we are resistant to options or measures based around Total Shareholder Return (TSR). Kilsby explained that they review compensation policies of the companies they typically hire from, as in order to recruit and retain talent they need to mirror some of their practices. So while they have options as well as performance shares in their programmes, the options are limited to their top tier executives. They added that non execs have to buy shares in the same way that shareholders do and don't have access to options. They have also reviewed the use of ROC metrics versus their current metrics including relative TSR and explained the issues that make this move difficult. We are apparently not the only manager to have expressed a preference for some sort of ROC metric and we were assured that they would take our views into consideration for further evolutions of their remuneration policy.

Q2 2020

It should probably not come as a surprise that our investment team have had a particularly active first half of the year. According to our records, we have engaged with company management more over the last five months than any equivalent stretch in the history of Lindsell Train. In general we will speak to company management on average once a year, in the absence of any company specific concerns; however Covid-19 has, in many cases, resulted in us advancing these meetings for 2020, reflecting our desire to speak to company management during challenging times. As strategic, long-term owners it is imperative that we remind management of their responsibility to their shareholders (our clients), ensure that there is no untoward change in strategic direction, urge management to consider and protect their company reputation and encourage responsible financial management. Examples of such engagements have been provided below.

As Equity investors, the impact of Covid-19 has continued to remind us that the warranted value of a company depends very little on this year's profits, or the year after that. Indeed, our focus remains very much on the long term. As such, we have encouraged company management to take appropriate measures to ensure that they emerge from the crisis stronger than ever, and with enhanced future prospects. Most of our companies are conservative and cash generative and now is the time for them to capitalise on these characteristics. Where management have come under financial pressure, we have supported and will continue to support responsible and prudent capital allocation; for example the suspension of buybacks and the reduction or cutting of dividends. However, it is important that these actions are well thought out and explained to shareholders so as not to damage the company's reputation.

Finally, we are cognisant that in setting a high bar for the companies in which we invest, we too as a company need to set and adhere to high standards. One area that we believe is critical in this respect is providing value for money to our investors and you may recall that last July we reduced the management fee for all Lindsell Train pooled funds. This included the Lindsell Train Investment Trust, where we also recently took the decision to waive the performance fee of £381,256 due to us, following a meaningful fall in the Trust's share price resulting from a significant contraction in the premium to NAV in the year to March 2020. Although long-term investors of that fund could take comfort from the steady rise in the NAV, new shareholders were badly affected and we felt it was the right step to take in order to reinforce the alignment of interest with shareholders.

Prada

Our 2019 investment into Prada was preceded by a multi-year period of research into the company. This work included a look at Prada's handling of certain ESG themes and issues, both in isolation and in comparison to its peers. Such factors are increasingly relevant to the survival and success of a fashion company and are therefore a critical part of the initial and ongoing investment case.

During Q2 we engaged with Prada management to assess the measures they were taking to ensure that they emerge stronger from the Covid-19 crisis. In general, they are positive on the prospects for large players with heritage brands. However, notably, management also drew our attention to the acceleration in demand for 'green' products and the positive positioning of Prada's 'Re-Nylon' project, in which 30% of its iconic nylon handbag collection is now made from fully recycled plastic taken from the ocean.

Prada's future depends upon reaching a new generation of consumers, innovating to create trends that ensure they stay ahead of the curve, whilst always offering the highest quality products. Increased connectivity, via a more digitally engaged customer base, offers an opportunity for fashion houses to communicate with their customers, but it also brings with it transparency on a newfound scale. This leads to an increasingly informed shopper with a growing interest in environmental and social issues, including but not limited to: slave labour in supply chains, animal cruelty, water use, climate change and plastic pollution.

Recent headlines have very much underlined the need for fashion houses to take these trends seriously. It is therefore essential that Prada management respond with a well-informed strategy. During our initial assessment of the company we were pleased to find multiple examples of positive initiatives and behaviours within Prada: as stated above, the first and perhaps the most important is their 'Re-Nylon' project. Over time, Prada expects that its entire collection will be made from recycled nylon – there has already been a very positive consumer response to these products, with several models selling out. The company has responded to calls for increased attention to animal cruelty: in May 2019 Prada pledged that it will stop using fur in its designs or products from spring/summer 2020. We also paid attention to the fact that the company's supply chain is predominantly based in Italy with most relationships stretching back 30+ years. This supply chain is transparent and well established, allowing Prada not only to easily monitor product quality, but also to ensure that conditions are fair and equitable.

We view today's re-imagining of Prada's collections and products with an environmental and social focus as an expression of the company's sensitivity to consumer trends married with creativity, and a demonstration of the unquantifiable 'spark of innovation' that we believe makes a brand durable over time and very valuable indeed.

Shiseido

Lindsell Train are long term owners of the 148-year-old Japanese beauty giant, Shiseido, having initiated a position in 2012. Over the years we have engaged regularly with company management on various matters. We were pleased to have the opportunity to speak with company CEO Masahiko Uotani during the second quarter to discuss the impact of Covid-19, management changes, Uotani's proposed post-pandemic growth strategy and other ESG related initiatives.

Uotani and his staff have had a positive lockdown experience and the firm has functioned very successfully remotely. Technically 50% of the Shiseido workforce are now able to return to work, however management are ensuring that they maintain an 'easy balance'. Uotani is optimistic about how the future of work might now permanently change for the better. The flexi-working lifestyle has positively impacted the majority of

Shiseido's employees, and their female workforce in particular. By maintaining flexible work practices, Uotani hopes Shiseido will be able to further boost diversity across the company as a result.

As we would have hoped, Uotani is focused on ensuring that Shiseido has a positive crisis and is looking to China and e-commerce as post-pandemic drivers of growth. Online retail accounts for a fifth of total sales today, however this is expected to increase to 30% over the next 2-3 years. Shiseido is putting in place a number of strategic initiatives to drive this change, most of which have already been successfully implemented in China. Meanwhile, their domestic Japanese business is in much need of a 'shake up'. In an unusual management change, Uotani has identified himself as CEO of Shiseido's Japan business to demonstrate clear accountability.

Finally, Uotani talked of his long-term aim for Shiseido and its competitors to club together on certain aspects of the supply chain, i.e. use the same truck if they're all delivering products to the same shop. Japanese beer companies already do this and it makes good sense to reduce costs, especially since the Japanese market itself isn't predicted to grow, so they should look for wise savings. Of course, such a strategy would also positively impact the environment through a reduction in transportation pollution.

Burberry

We are long term owners of the global luxury fashion brand Burberry, having initiated a position in the company in 2008. Over the years we have engaged with management on various matters. Most recently, in March 2020, we engaged with management on capital allocation. The company had recently completed a share buyback of £150m and we wanted to ensure that their capital allocation framework and priorities remained unchanged. As per our opening comments above, we support responsible and prudent capital allocation, including the reduction or elimination of dividends where necessary and/or appropriate. Following this engagement, we spoke again with management during Q2 2020 regarding their capital allocation strategy and priorities and the implications for their corporate reputation.

Burberry has made use of government sponsored debt offered in the wake of Covid-19 and our investment team were eager to understand whether all commercial market options had been explored, as arguably there are plenty of other companies that need this debt facility more urgently. Burberry confirmed that they had considered commercial options, however the covenants and timeframes attached were less appealing. The government debt carries a low interest rate, is non-covenanted and speedily available. Burberry confirmed that they were using the debt as it was intended to be used, to support the business with 60% of the store network closed from March. The intention is to repay all of the debt at the earliest opportunity. Furthermore, Burberry confirmed that they did not access the government furlough scheme for their UK staff, which comprises a third of their workforce. Whilst this appeared a satisfactory response, we made it clear that we would prefer commercial companies not to risk their reputation by accessing taxpayer funded liquidity rather than commercial funding.

In terms of shoring up their balance sheet, Burberry have announced their intention not to pay their final dividend (£120m). We reiterated our support of such a decision and noted that the share price has gone up since the announcement, indicating that other shareholders are also accepting of it. However, all eyes are now on management and so it is imperative that they use the retained capital wisely and ensure that value creation is tangible. We also took this opportunity to remind Burberry of the fact that we value their financial conservatism and we believe that the decisions they have taken so far have been rational and prudent. We continue to monitor their capital allocation closely and would be disappointed if we saw any signs of intentional balance sheet deterioration or increase in financial leverage, given the degree of industry (fashion) risk associated with their business.

Diageo

Our longstanding clients will know that we pay careful consideration to the compensation policies of the companies in which we invest and, as such, engage regularly with management regarding matters relating to remuneration. During the second quarter of 2020 our investment team spoke with the management of eBay and WWE, with regards to compensation and also continued their dialogue with the management of Diageo.

During Q1 the team spoke with Susan Kilsby, Compensation Chair of Diageo, regarding proposed changes to Diageo's remuneration policy. Whilst we took no issue with these proposed amendments, we seized the opportunity to discuss Lindsell Train's more general views surrounding compensation. Kilsby acknowledged our principles and assured us that she would take our views into consideration for further evolutions of their remuneration policy. As this was by no means a concrete confirmation of change, we were grateful for a second opportunity to recommend our views during Q2 2020.

One of our initial concerns had been with regards to Diageo's timeline for assessing compensation, which we deemed too short. Kilsby pointed to the fact that Covid 19 has made it harder than ever to elongate their assessment timeframe, however in general, management are willing to consider a longer-term approach and have demonstrated this by instigating a compulsory two year holding period following the three year vesting period after the award of equity. In the short term, as a result of the disruption and uncertainty caused by the pandemic, Diageo will have two six month periods (as opposed to an annual target) for their incentive programme for the next fiscal year. Management have also delayed the setting of LTIP targets, which will in effect mean that their three year target is shortened to two and a half years. We agreed that these changes were necessary and reasonable given the circumstances.

In terms of measuring success, management continue to investigate the application of a return on capital metric. We reiterated our view that EPS can be both opaque and malleable, whereas ROC is harder to manipulate and provides the best means for shareholders to align themselves with the key executives responsible for capital allocation as strategic long-term investors. Kilsby reminded us of the differing accounting treatment for buying a brand versus organically growing one and the fact that they want to avoid a structure that might bias executive behaviour. Kilsby also noted that it is management's intention to carve out the effect of share repurchases from the calculation of EPS, a proposal we strongly disagree with. We believe that buybacks are a critical component of capital allocation on which executives should be judged. Furthermore, any balance sheet manipulation utilised to hit EPS targets would be easily identified and thus our peers' concerns surrounding such behaviour are somewhat superfluous.

Finally, Kilsby brought to our attention the implementation of an ESG measure that will constitute 20% of the LTIP going forward. The ESG targets will be strategy linked, and will likely focus on water stress and carbon footprint. There will also be some aspect that addresses the negative connotations of drinking and also a metric that addresses diversity. The finer details are still a work in progress and we look forward to learning more in due course.

Unilever

Lindsell Train is a long-term holder of consumer goods company, Unilever, having initiated a position in the company in 2001. In 2018 we engaged extensively with management and other institutions regarding a proposed modification to Unilever's corporate structure. The proposed plans were abandoned at the time. During Q2 2020 Unilever announced an about-face on the 2018 plan to move its headquarters to Rotterdam, naming London as its proposed new home. We were pleased to once again engage with management on this matter and in this instance support its proposed plans.

Management has always alleged that a move to one legal entity would give Unilever greater corporate flexibility and also strengthen its corporate governance, through reducing the complexity of the business and increasing transparency. We have always been supportive of the simplification of what is a rather unwieldy structure, however in 2018 this came at the cost of Unilever losing its FTSE 100 status. This was of notable concern for some of our UK clients invested in our UK Equity strategy, who insist on strict adherence to benchmark holdings and might have become forced sellers at a time and price not of our choosing - a big holding in a UK company was about to become a big holding in a non-benchmark, non-UK company. As a result of positive shareholder engagement, Unilever management abandoned its controversial plans three weeks before the planned shareholder vote.

This was a blow to management, who upheld their view that overhauling the complicated dual-headed structure was in the firm's best interest. They continued to engage with investors to that effect and in Q2 2020 announced a new plan that potentially unifies the company's share structure, this time without disadvantaging existing investors, whether from UK, Holland or other international locations. We support the concept of a single parent company that makes share-based acquisitions and demergers easier to undertake and also allows greater flexibility at a time when we are looking to management to use their balance sheet to capitalise on post-pandemic opportunities. The investment team were grateful to be able to communicate to management their support. This move will hopefully conclude in late 2020 with a positive shareholder vote. It will bring to an end an engagement that has dated back to 2018 and has demonstrated the power of shareholders to protect their rights.

Q3 2020

We have talked with many of you about our desire to better articulate our approach to ESG and indeed that was the driving force behind the creation of a quarterly engagement report. I do however think that it is important to note that the increasing length of these reports is not a reflection of our ability to 'better articulate' but rather a reflection of the fact that engagement has indeed stepped up at Lindsell Train. There is no doubt that Covid-19 has acted as a catalyst but in addition to that, company management are also taking engagement on ESG issues more seriously. Perhaps, like us, ESG has always been part and parcel of their overall management approach, but has had to be teased out over time. Either way, our companies are alert to what is expected of them and as such eager to keep us updated and to respond to our questions. So, similar to the first half of the year, it has been another busy quarter on the engagement front and we are pleased to share with you this summary of our activity.

Burberry Plc – Business strategy, supply chain controls and board diversity

We are long term owners of the global luxury fashion brand Burberry, having initiated a position in the company in 2008. Over the years we have engaged with management on various matters. Most recently, in both Q1 and Q2, we engaged with management regarding capital allocation. Specifically, we wanted to ensure that their capital allocation framework and priorities remained unchanged and continued to be implemented in the best interest of their corporate reputation. We support responsible and prudent capital allocation, including Burberry's decision to cut their dividend. It is imperative however that management use the retained capital wisely and ensure that valuation creation is tangible. As such, we continue to monitor management's progress and will engage where necessary. Meanwhile, in Q3, we spoke with Burberry chairman Gerry Murphy regarding the implications of Covid-19 on business strategy, supply chain controls and Board composition.

Covid-19 has magnified already existing trends - integrated digital and retail experiences, an emphasis on quality, authenticity and provenance, and a deeper customer interest in a responsible and sustainable approach. The trend towards ethical clothing was firmly in place before the crisis, however, a further shift to digital has meant that more and more consumers are thinking about the provenance of what they wear, especially if it's a high value, branded piece that customers want to wear proudly.

In terms of supply chain controls and against the backdrop of poor labour practices coming to light in Boohoo's UK supply chain, we asked about Burberry's own policies and controls. The Chairman explained that the business practices uncovered at Boohoo are largely confined to fast fashion, which relies on selling large volumes of product with thin margins. This is clearly not the case at Burberry. Nonetheless, Burberry has a robust supplier vetting programme and a tightly controlled supply chain to protect brand health. For Burberry, the key risk is rogue subcontractors as it's harder to watch what they do, even if the primary contractor is squeaky clean. As such, Burberry are alert to the risks of complacency and have the necessary framework in place to protect the business from reputation damage. The Chairman drew our attention to Burberry's evolving "statement of purpose", which aims to build on their assessment and response to such risks. We will review and monitor this going forward, however we concluded that there are no immediate areas of concern or action points for Lindsell Train.

With regards to Board composition, the Chairman noted two recent NED appointments that he believes have improved the quality, diversity and effectiveness of the Board. The appointees, Sam Fischer and Debra L Lee are more "relevant to Burberry's future" according to the Chairman. Specifically, Chinese consumption and the democratisation of fashion. Mr Fischer's experience and first-hand knowledge of leading iconic heritage premium brands will be an asset to Burberry's Asian growth story. Equally, Ms Lee is exceptionally qualified as an NED of leading global technology and service companies and also a former CEO of the world's leading African-American media network. Following these changes, Burberry is broadly comfortable with the balance of diversity on their Board, as are we.

Rathbone Brothers Plc – Board shareholder ownership & personnel turnover

We are long term owners of investment manager Rathbone Brothers Plc, having held a position in the company since 2005. During Q3 we engaged with Chairman of the Board, Mark Nicholls via email regarding NED share ownership and personnel turnover. The former was initiated by Mr Nicholls and the latter by Lindsell Train.

In terms of NED share ownership, it is of the opinion of one or two of Rathbones' institutional investors that it should be made compulsory for NEDs to purchase a significant shareholding. Indeed one such institution has suggested that NEDs should purchase shares equivalent to two years' NED fees. Whilst Mr Nicholls, and indeed LT, recognise that the guidelines from the Investment Association encourage NEDs to own shares bought at market price, they do not set a compulsory level. Mr Nicholls shared his concerns with implementing such a policy, namely that the introduction of a compulsion to buy equity is unlikely to change the behaviour of NEDs that already operate to a high quality and professional standard. Secondly, looking to the future, Rathbones hope to introduce greater diversity to their Board and compulsory ownership could present an obstacle to hiring younger individuals. Rathbones believes that the skill sets that they will likely look for can probably only be accessed in younger people whose earnings derive wholly from portfolio careers, or whose main role is as a full time executive elsewhere. Either constituency is unlikely to relish mandatory shareholding policies. Furthermore, in many cases it may also be appropriate that some NEDs serve a maximum 3 year term and any compulsory equity policy would add considerable complexity that could act as a deterrent to certain pools of talent. From Lindsell Train's perspective, we like to see NEDs buying shares, but believe that this should be voluntary. We also noted the counter argument - that NEDs should be wholly independent of the Company they serve and that earning shares may make them less so. Ultimately we believe that NED share ownership should be left to the judgement of the individual and the company. In conclusion, we learned later in the quarter that most shareholders agreed with this stance, which is to encourage shareholding by non-executives but not to make it compulsory.

During this exchange of emails, we took the opportunity to discuss personnel turnover with Mr Nicholls, as it had come to our attention that a number of individuals had recently left Rathbones. We encouraged the Board to increase key employee share ownership as a means to providing an incentive and motivation to achieve success for all shareholders. Having the ability to offer shares is a competitive advantage that Rathbones should use to their benefit. Mr Nicholls said that the Board and company had been particularly disappointed by some of the departures, but he believes that the situation has now stabilised and confirmed that they are now attracting an encouraging flow of investment manager interest from competing organisations. Indeed they have added a handful of employees this year and are in ongoing positive discussions with a number of others. Mr Nicholls also confirmed that they are actively looking at ways to boost employee share ownership, whilst prudently managing margins.

Heineken NV – Environmental considerations & brand protection

We are long term owners of international beverages producer and distributor, Heineken NV having held a position in the company since 2005. During Q3 we engaged with Heineken's recently appointed CEO, Dolf van den Brink regarding his ambitions for the company, including his ESG and brand protection initiatives. Mr van den Brink has been with Heineken for 22 years and understands the importance of a long-term focus that ultimately protects a family business for the next generation, as well as its broader base of shareholders.

Mr van den Brink recapped on Heineken's success, in terms of continually renewing and revitalising their brand over the last ten years. He applauded management's decision to shift from a localised to a global strategy, which has worked brilliantly in terms of igniting the brand over the last decade, even in seemingly mature regions such as Europe. Additionally, much of their recent growth success can be attributed to the phenomenal sales of Heineken 0.0 (their non-alcoholic lager beer) which is now available in over 60 countries, making it the fastest scaling of a brand in the history of the company. The brand continues to see double digit growth overall, and growth in every region in which it operates. Mr van den Brink and Heineken management recognise the potential rewards from anticipating consumer demands, which in today's world are increasingly focussed on living a healthier and more socially conscious lifestyle. In his own words, "standing still is going backwards", a sentiment that we very much agree with.

Our investment team asked about Heineken's ESG endeavours more generally and whether the driving force behind these initiatives was cost efficiency, or to protect and improve brand health. Mr Van den Brink explained that their initial ESG efforts, some ten years ago, were mostly motivated by the risk of reputational damage and he admitted that these efforts were secondary to their mainstream corporate agenda. This is no longer the case. Heineken now has a new generation of Managing Directors that are very personally engaged in these issues. Mr van den Brink counts himself as one such example. He learnt first-hand about water scarcity during his stint in Mexico (2015). Environmental considerations had been central to the construction of their new brewery Meoqui in Northern Mexico, demonstrating the benefits of a dramatic reduction of the usage of water and a strategically located bottling factory that captured the brewery's energy, resulting in a 35% reduction in the usage of external energy. In many cases, including this one, positive environmental practices and good business sense are not mutually exclusive and they are certainly no longer a box ticking exercise or "nice to have". Similarly, Mr van den Brink remarked on the cost benefits of renewable energy. Indeed, it should be noted that some of Heineken's most successful operating companies are those which have driven sustainability agendas – for example, in Vietnam they won the award for being the most sustainable company in the country – which, fortuitously, is also good for brand protection.

Pearson Plc – Remuneration & business strategy

Lindsell Train is a long-term holder of Pearson, the world's largest education company, having initiated a position in the company in 2001. Pearson plays an important societal role by providing educational materials around the world and we continue to believe that the company has a real opportunity to stake its claim as a global leader in the digitalisation of education services. Since 2001 we have engaged regularly with management regarding Pearson's capital allocation. During Q3 2020 our minds turned to remuneration, an area to which we pay careful consideration, ahead of the announcement and appointment of new CEO, Andy Bird. We also started discussions with fellow investor and activist, Cevian Capital who have recently purchased a 5+% stake in Pearson.

During August, our investment team engaged via conference call with Chairman of the Board, Sidney Taurel and Business Development manager, Jo Russell. At this point in time, the Board had identified a preferred candidate with the requisite experience, leadership skills and interest in education. To attract this candidate (spoiler alert! - Andy Bird), Pearson were required to offer a highly competitive remuneration package, one aspect of which fell outside Pearson's current remuneration policy and thus required shareholder approval. Mr Taurel shared with us the details of the out of scope co-investment policy, which was as follows:

The candidate will spend $3.75m (300% of salary) of his/her own money on Pearson shares (to create immediate alignment with shareholders) and to recognise this, the company will also spend 750% of his/her salary or $9.375m (i.e. at a 2.5 to 1 ratio) to match the candidate's investment. This will vest 1/3rd at the end of 2021, 1/3rd at the end of 2022 and 1/3rd at the end of 2023 (unusual in the UK but common in the US) subject to continued investment from the candidate i.e. if the share price increases, the value of the award goes up with it (the shares are all pre-purchased) and it's this (expected) uplift that brings the award to a level in-line with the candidate's previous US employment. If various underpins (mostly shareholder return related) aren't met then the remuneration committee can at their discretion lower the awards. There are no buyout costs.

Having reviewed the details of the proposed policy we confirmed to management our support of such a package. We believed that the salary was competitive relative to the cost of high quality technology talent and more importantly the co-investment, at 300% of salary, aligns interests. Whilst we would have welcomed a longer term vesting and holding period, we felt that investor concerns over the quantum of salary and the award of shares were misplaced.

During Q3, we also engaged with Paul Myners, Martin Olaf and Hans Zimmerman from activist investor Cevian Capital, who have recently purchased a 5+% investment in Pearson.

Cevian takes significant holdings in investee companies with the intention of working with their Boards to improve performance. They are labelled activist but prefer to view their engagement as constructive not confrontational. With regards to Pearson, they believe that the company has placed too much emphasis on centralisation, with digitalisation being the opportunity cost of such a strategy. We acknowledged the digital challenge but view the centralisation of the company as a necessary step in pulling together so many fragmented businesses. We would welcome further conversations with Cevian, assuming they are constructive and are in shareholders' best interests.

Taisho Pharmaceutical – Capital Allocation

Lindsell Train is a long-term holder of Japanese pharmaceutical company, Taisho Pharmaceutical, having initiated a position in the company in 2005. In recent years, we have engaged regularly with management regarding capital allocation. Having not been satisfied by their response or actions, during Q3 2020 we escalated our engagement and wrote to President and CEO, Mr Akira Uehara to express our concerns.

We believe the company has exceptional business characteristics that should make it a rewarding investment over time. However, this has not proved to be the case to date, with the share price today below its price in 2005 and the return on shareholders' equity averaging just 5% per annum over that period. As such, we have had regular meetings with members of Taisho's corporate planning department to express our concerns and to seek corporate actions to improve returns. Specifically our concerns relate to the following three business areas:

- a subscale prescription pharmaceutical business that, given its size and the trend of falling sales in recent years, probably has limited profitability (this is not disclosed);
- a large business selling tonic drinks, included in the company's self-medication division, that has diminished in size over the years;
- considerable cash and investment resources earning low returns.

The poor returns from these activities have detracted from the value of the company as a whole and we have sought clarity on the justification for maintaining excess cash and investments on the balance sheet, rather than making the necessary investments needed to revive the tonic business and increase exposure to over the counter (OTC) drugs. Having not received a satisfactory response to date, during Q3 we wrote a detailed letter to management to press on them our concerns and request additional clarity on the underlying strategy behind their M&A decisions and their general approach to capital allocation. We are awaiting a response.

Kirin Holdings – Human Rights

Lindsell Train is a long-term holder of Japanese beverages company, Kirin Holdings, having held a position in the company since 2007. We have engaged previously with company management regarding the company's diversification into 'health science'; however during Q3 2020 our spotlight turned to its investment in Myanmar. To date, we have engaged with company IR via conference call and email.

Kirin's investment in Myanmar was originated in 2015 when the company bought Fraser & Neave's 55% stake in Myanmar Brewery. Soon after the company also acquired a majority stake in Mandalay Brewery. Now they own 51% of both with their joint venture partner MEHPCL holding the other 49%. At the time the country was democratising and opening up to foreign investment. Buying the local brewery is usually a surefire way of benefiting from the increase in prosperity brought about by such fundamental changes, particularly as together these breweries supply more than 90% of beer in Myanmar and until the outbreak of the coronavirus pandemic, had been growing sales and profits progressively in the way we would have expected.

Unfortunately Myanmar's progress towards democratisation has been marred by continued military control of the economy and, worse, human rights abuses committed by the military particularly against the Rohingya people. The UN and Amnesty International have evidence that the military is financed by state owned companies such as MEHPCL. Kirin's joint venture agreement with MEHPCL specifically prevents cashflows from the breweries to be used for any military purpose but MEHPCL is a sprawling conglomerate and it is not clear how its cashflows from the joint venture can be credibly isolated from its other operations. Kirin have engaged with Amnesty International and have appointed Deloitte to verify these assertions. Deloitte are expected to report in the New Year.

Clearly, we are uncomfortable investing in a company that has any association with a regime committing human rights abuses. This is both from a moral perspective and an investment perspective, given the potential damage to the company's reputation and the knock-on effect on the market's and consumers' perception of the company's brands. Following our initial engagement with Kirin IR we believe the company takes these accusations seriously and wants to pursue the right course of action to protect its reputation. As an indication of the gravity of the situation Kirin has announced that it is exploring structural options, which it said to us could involve withdrawing from the investment entirely or arguably taking more control. The company has to balance both the social and financial impact of any decision on the multiple stakeholders involved. Given the potential negative impact on its brands and reputation in much bigger markets than just Myanmar, it may be that any decision is more closely aligned than it seems at first glance.

We have sent a series of questions to IR, which they responded to in letter format, and have now also hosted a call with members of their IR Department and Corporate Planning department. Having not been overly satisfied with the response we received we are now considering how best to escalate our engagement.

Q4 2020

We have always believed that we serve our clients best by taking a patient, supportive and long-term approach when making investments. After all, the original purpose of the investment industry was to help providers of capital to find return-generating ideas in which to invest, not to try to outdo other market participants. So our philosophy has always emphasised protecting and growing our clients' real capital over the long-term through the consistent application of our well-defined investment process, which seeks to invest in companies that are truly durable. Despite the global pandemic, 2020 was no exception.

For a start, portfolio activity continues to be conspicuous in its absence. We have not disposed of a single existing holding since the start of the crisis and across our three investment strategies we have made only two new investments this year (Experian, for our UK equity portfolios and Yakult, for our Japanese equity portfolios). As Nick Train explained in a client report earlier this year, this inactivity is significant and there are two reasons for it. Firstly, we hope Lindsell Train's investment principles and process mean we were already owning the right sort of company for a crisis, as the starting point of our investment approach is the "survivability" of a company. Secondly, we have no special insight as to the duration or severity of the pandemic.

Our energy has therefore been focused on ensuring our companies' financial health. As strategic, long-term owners, it is imperative that we remind management of their responsibility to their shareholders (our clients), to ensure that there is no untoward change in strategic direction; urge management to consider and protect their company reputation; and encourage responsible financial management. Indeed, we have continued to favour dividend cuts where liquidity is under pressure and support continued investment through the downturn to ensure businesses emerge in a strong position.

We have also continued both proactively and reactively to engage with company management on other ESG related matters. As a reminder, we define our 'engagement' activity as those interactions with company managements which "have intent" and are usually incident based, risk based or are specific to a particular area of interest. During the fourth quarter, over and above the examples cited below, this included ongoing conversations with the management of Unilever, Fever Tree and Rathbones regarding remuneration and incentive plans; an update from Burberry regarding the £300m they have raised through a recent sustainability bond; and good news from portfolio company Kao Corporation, who have been selected by the Carbon Disclosure Project (CDP) for inclusion in their A List for climate change, safeguarding forests and water security. Kao is one of the first two companies in Japan to receive a Triple A score and, according to Kao, one of only 10 of the 5,800 firms evaluated to have been selected for the A List, the highest rating, in all three categories. Finally, in accordance with our escalation process, we continued to engage with the management of Taisho Pharmaceutical regarding their approach to capital allocation and specifically how they intend to improve returns on capital.

Kirin Holdings – Human Rights

Lindsell Train is a long-term holder of Japanese beverages company, Kirin Holdings, having initiated a position in the company in 2007. We have engaged with company management regarding the company's diversification into 'health science'; however during the second half of 2020 our spotlight turned to its investment in Myanmar. Having engaged with company investor relations (IR) via conference call and email during Q3 (as reported on in our Q3 Company Engagement Examples) , we have since escalated our engagement by writing to Mr Walker, Chairman of Kirin's International Advisory Board to express our concerns surrounding Kirin's continued involvement with the Myanmar Economic Holdings Public Company Limited (MEHPCL).

By way of a brief recap for any new readers, in 2015 Kirin Holdings acquired 51% stakes in Myanmar Brewery Limited and soon after they acquired a majority stake in Mandalay Brewery Limited that together supply more than 90% of Myanmar's beer. We discovered subsequently that this acquisition linked Kirin to state owned company MEHPCL, which owns the remaining 49% stake. MEHPCL has been accused by Amnesty International and the UN of using the proceeds of this joint venture to finance a military that has been associated with human rights abuses. Kirin's joint venture agreement with MEHPCL specifically prevents cashflows from the breweries to be used for any military purpose but MEHPCL is a sprawling conglomerate and it is not clear how its cashflows from the joint venture can be credibly isolated from its other operations.

Our initial conversations with company management confirmed that Kirin has engaged with Amnesty International and has also appointed Deloitte to verify these assertions, with Deloitte expecting to report back in early 2021. Whilst we appreciate that Kirin should wait for the Deloitte report, we also believe that once it is published it is essential that they act swiftly. As such, we have continued to engage with Kirin in order to encourage them to expedite their resolution of this matter.

We have spoken to senior management and have now heightened our engagement by writing to the Chair of Kirin's International Advisory Board (IAB), which is responsible for providing the Board with strategic advice pertaining to the Group's global growth strategies, risk management and corporate governance. We sought clarification as to the advice given by the IAB and have also urged the IAB and management to consider the various eventualities of the Deloitte report in order that they can ready themselves and be in a position to move fast following the publication of Deloitte's findings.

We have been encouraged that Kirin seems to take their responsibilities in Myanmar seriously and appear committed to taking necessary action to ensure that their business activities adhere to the highest standards of corporate and social responsibility. For example, Kirin management wrote to us in November 2020 to inform us that that all dividend payments from Myanmar Brewery Limited and Mandalay Brewery Limited to Kirin and MEHPCL have been suspended in view of the significant lack of visibility regarding the future business environment for their Myanmar joint-ventures.

Mondelez International, Inc. – ESG strategy

Lindsell Train is a long-term holder of Mondelez, having inherited the position in 2012 after Kraft Foods, which bought our holding in Cadbury in 2010, spun off Mondelez. During November 2020, we spoke to Mondelez management regarding their response to Covid 19 and, more broadly, their ESG agenda.

Mondelez have worked hard to ensure that the company emerges stronger from the crisis. They have focused on looking after their people, maintaining the supply chain and supporting local communities. These efforts have been rewarded, as the company remains "on target" despite the disruption. In terms of their ESG agenda, efforts are concentrated on issues and areas where they can have most impact, for example cocoa sourcing and health and wellness. Mondelez is committed to working with consumers to support mindful snacking, and to show that indulgent treats can still fit into a healthy diet and lifestyle. Mondelez are also looking at ways to tilt their portfolio increasingly towards health and wellness product, an approach we support. More broadly, their four-pillar ESG strategy addresses the following: (1) sustainable ingredients, (2) reduction of environmental impact (including carbon commitments, water and energy usage), (3) packaging innovation, and (4) social sustainability (including supply chain monitoring).

Following our call, we followed up with Mondelez to confirm whether it was their intention to report in line with the Task Force on Climate-Related Financial Disclosures (TCFD), an initiative that in principle we support. Mondelez have confirmed that they have recently mapped their existing disclosures to the TCFD framework for the first time and they are working on improving their disclosures for future years.

PayPal

Lindsell Train is a long-term holder of PayPal, having inherited a position in the company in 2015 after it was spun out of eBay. In past years we have engaged regularly with PayPal regarding remuneration matters. In November we participated on a call with PayPal IR on all matters relating to ESG.

On remuneration, we reminded PayPal of our general principles and specifically noted our main issues with their approach: we oppose the use of non-GAAP figures; believe 3-year performance periods to be too short; and usually prefer to see some form of return on capital/investment metric utilised. PayPal reminded us of the pressures they are under, in terms of attracting the best talent. We will continue to engage with PayPal on this matter, as we firmly believe that 3 years is too short a period to fully appreciate the outcome of certain capital allocation decisions.

On other matters, PayPal have recently undergone a comprehensive review of their approach to ESG, to determine what issues are critical to their business and its shareholders. As expected, cybersecurity (in relation to secure transactions) is the biggest ESG risk to the business and thus where they are investing the lion's share of their energy and budget. In terms of ESG opportunities, PayPal spoke about the opportunity they have to empower entrepreneurs, small businesses and non-profits, and also the ability to further the financial health of their client base.

Having digested the call, we emailed PayPal with several follow-up questions. Specifically, we asked about their carbon footprint targets and the penetration of their 'Give at Checkout' programme. On the former, PayPal confirmed that they have made good progress with regards to their goal of 100% renewable energy for their data centres by 2023, having achieved 65% in 2019. For their Giving Platform, their 'Give at Checkout' experience supported over 2 million donations to non-profit organisations in 2019. Finally, PayPal confirmed that they are exploring ways in which to make their ESG reporting even easier for investors to digest, having reported in line with TCFD for the first time in 2020.

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