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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Value Approach to Emerging Markets with Industry-Specific ESG Integration

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SECTOR — GENERAL INVESTING

TWST: Could you tell me about the firm?

Ms. Xu: Letko Brosseau is a global investment firm founded in 1987. We have offices in Montreal, Toronto and Calgary. Our research team is made up of 23 investment professionals. Roughly 40% of the team were born and grew up in emerging countries such as India, China, the Philippines, etc. We adopt a long-term value investing philosophy and invest on a global scale.

TWST: And you work on specific funds there?

Ms. Xu: I am the co-PM for the Emerging Market Fund.

TWST: Do you work on ESG products too?

Ms. Xu: We don't have a seperate ESG product per se but ESG evaluation is seamlessly integrated into every investment thesis at our firm. ESG integration is done by each analyst at Letko Brosseau.

Our team is organized along global industries and sectors. Each analyst has an industry-specific ESG analysis framework. That's the first level of ESG integration. The second level, which is at the company level, we have an ESG Committee, which drafts the ESG integration guidelines, proxy voting policies for the portfolio, monitors the portfolio carbon footprint and undertakes various projects to continuously improve our ESG integration process and portfolio ESG scores . I am also a member of the ESG Committee. Lastly, we have an ESG leader who does an extra layer of independent evaluation of the ESG practices at the company level and the portfolio level.

TWST: In what you work on, how would ESG be involved in evaluating and reviewing holdings?

Ms. Xu: ESG analysis starts at the very beginning of an investment analysis. Each analyst at our firm has an industry-specific framework. As sector experts, they are most familiar with the most relevant and critical ESG factors facing the companies of their sectors. And we apply the same analysis framework to both developed country companies and emerging market companies.

Let's take the mining industry, for example. Our mining analyst would look at the labor relationship with local communities, the regulatory environment, the safety policies of the company, the safety track record, and then all the way to the environmental footprint, like waste intensity, water pollution, and CO2 emission. It's a very comprehensive framework, but very particular to that industry.

Since such analysis needs industry-specific knowledge and experience. We believe the analysts are the best people to integrate this ESG analysis, which means we do not simply layer on external reports or third-party ratings for ESG analysis and conclusions.

TWST: Maybe you could give examples of a company or two that you've worked on where ESG has been important and has led you to invest in the company?

Ms. Xu: Sure. I would mention **Copel (NYSE:ELP)**. It's the third largest power distribution company in Brazil. If you look at the energy mix of this company, 85% of their power generation assets are based on hydro and 14% of the assets are from wind and solar.

They have a joint venture in a natural gas plant. In **Copel's** 2030 net zero target, they plan to eventually divest their stake in that gas plant to be net zero by the end of 2030.

In the meantime, they have a very rich pipeline of new power generation capacities, mostly concentrated in renewable energy. In terms of corporate governance, they recently undertook several changes and migrated to a higher level of corporate governance in the Brazilian Stock Exchange. If we look at their track record of shareholder return policy (dividend policy), board composition, and the level of board independence, **Copel** is really a role model in emerging country companies from the ESG perspective.

TWST: Did you want to mention another company?

Ms. Xu: Another company that I can think of is **China Water Affairs** (HKG:0855). It's one of the largest privately owned water utility companies listed in Hong Kong. At the very beginning, we liked the company because they are involved in providing clean water treatment and key water service for residents in China.

Over time, we have engaged with the company on the energy intensity of their business as water and wastewater treatment is very energy intensive.

What we liked about the company is their commitment to reduce their carbon footprint, despite China's dependence on coal power. The company targets reducing their energy intensity by 1.5% per year up to 2030. The company has plans to put solar panels on the rooftop. They have also deployed efficient technology in terms of saving energy in the treatment of wastewater, which makes them one of the most efficient operators in China if you look at their profitability and cash flow generation. So these are the ESG characteristics that we like about the company.

When it moves on to individual stock selection, we integrate ESG analysis from the very beginning by examining the track record of those companies in terms of governance, social practice and environmental footprint, whether they have had some bad accidents, whether they have had minority shareholder unfriendly practices in the past, before we really dig into the fundamental business model. We also look for the companies' long-term ESG targets and strategies.

If a company doesn't have a strategy or the company doesn't even publish annual ESG or sustainability reports, that will raise the question for us whether we should invest in that company in the first place.

But before drawing any conclusion or making decisions, we always believe in communication and engagement. If we find a company interesting and want to look for more ESG information, we would talk to the management, arrange for onsite due diligence, and double-check with different sources of reference, including third party reports, sell-side analysts, industry experts, and even their suppliers and customers. Through in-depth due diligence, we try to get an idea of the quality and ESG practices of those emerging market companies.

"When looking at developing countries, we think top down or macro analysis is very important, such as the country's institutional environment, the legal framework, the regulatory environment, the business friendliness of the government, the upcoming election, and then macroeconomic indicators to identify potential financial imbalance at a macro level."

TWST: And from those two examples what lessons can we learn?

Ms. Xu: These two companies may not be the source of lessons per se for emerging market investors. They are examples of companies that directly contribute to the energy transition and to the environmental benefits in emerging countries.

For other companies that may not be directly involved in environment-related business, we pay attention to their overall environmental footprint as well as the social and governance practices. We try to avoid companies that are not compliant with regulations or have no plan to be aligned with best ESG practices .

As long-term investors, we believe in engagement. We regularly talk to the companies and raise our concerns regarding different ESG issues, including labor relationship, board independence, acquisitions and business combination, dividend policy, etc.

TWST: Do you have some guidelines for investors who might be looking at the developing economy and looking for ESG type investments?

Ms. Xu: At Letko Brosseau, we have a macro economist dedicated to emerging economies. When looking at developing countries, we think top down or macro analysis is very important, such as the country's institutional environment, the legal framework, the regulatory environment, the business friendliness of the government, the upcoming election, and then macroeconomic indicators to identify potential financial imbalance at a macro level.

Macro research is important even for bottom-up stock pickers, because for certain countries, for example Argentina and Turkey, we may find imbalances that make the investment case not feasible overall.

To conclude, I think some general guidelines are detailed fundamental analysis, in-depth due diligence and active engagement with the companies.

1-Year Daily Chart of Companhia Paranaense de Energia

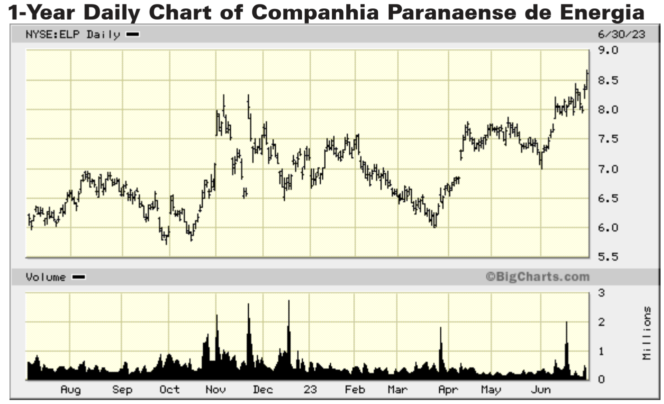

Chart provided by www.BigCharts.com

TWST: When you're looking at emerging market companies, would you judge them differently than, let's say, when you're looking at companies in industrialized nations like the U.S. as far as ESG topics?

Ms. Xu: That's a very good question. At Letko Brosseau, we use the same ESG evaluation framework for companies regardless of the geography. However we do acknowledge some common challenges to emerging market companies. Like you said, compared to some industrialized countries, some emerging markets may not have shifted as a country to a greener energy mix.

Countries like Poland, the Philippines, China and India — their energy mix is still highly dependent on coal. So for companies in those countries, their carbon footprint would be naturally higher because they buy electricity from the government. In that case, we might be more realistic and practical when we look at companies in those emerging market countries.

Meanwhile, we want to know the company's specific strategy to address those issues and to find investable companies that can contribute to the energy transition in that country.

When it comes to social and governance aspects and proxy voting, we apply the same policies to both DM and EM companies. We want to use the same stringent kind of criteria, for example, board independence, compensation scheme, dilution to shareholders. Even if, for some emerging market companies, the local laws allow a certain practice but we are not satisfied with that, then we will use the same criteria and vote against that particular proxy item.

So I would say, the ESG evaluation is really case by case for EM companies.

TWST: And did you want to talk more about the emerging markets fund you work on?

Ms. Xu: Sure. Our Emerging Market Fund was created in 2011, but our investment in emerging market companies started in 1992. From investing in individual companies to forming a fund and to getting a lot of concentrated effort on finding stock ideas, we applied the same kind of company philosophy when it comes to stock selection in emerging market countries, which is really based on independent fundamental analysis over a long-term horizon.

We rely on each industry specialist and experts to contribute the best ideas to our emerging market funds. We are long-term investors who want to benefit from the growth of emerging economies and create sustainable value for our clients. And the ESG factors, as I mentioned before, were taken into account in equally stringent ways as with our other mandates.

TWST: What are some of the types of companies that you've got in the fund?

Ms. Xu: For the EM Fund, we typically prefer companies with high visibility on cash flow, companies that provide quality products and are market leaders in their respective industries. We like companies that can generate both earnings growth and sustainable cash flow — or returns — to shareholders via share repurchases and dividends.

Valuation is also important, because we think reasonable valuation is one way to protect investors from the downside and volatility in those emerging market countries.

TWST: How would the fund work in a diverse portfolio, and why should investors include it as part of a diverse portfolio in the current economy?

Ms. Xu: I think the most important contribution from the EM Fund is the enhancement of value through growth. If you look at the valuation and growth forecasts of the developed country markets, they are trading at a high-teen PE with low-single-digit or mid-single-digit topline and EPS growth. In comparison, the MSCI EM index trades more towards ten to eleven times PE, growing at a double-digit rate. We believe there are plenty of opportunities to create value by investing in emerging countries. It's really about the value enhancement to the overall investment portfolios of global investors.

Geographically, investing in emerging markets provides diversification, but what we focus on is more the growth and value for the money. We want growth at a good attractive valuation together with a visible cash flow that will give us a good dividend yield.

Our EM fund, whether from a valuation perspective, growth perspective or dividend perspective, is accretive to the overall portfolio of our firm.

TWST: And any general advice to investors for the rest of this year into next year as to what they might want to do to prepare for whatever the economy might do?

Ms. Xu: I think people should look less — or focus less — at headlines, such as recession next quarter, soft landing versus hard landing, etc. I think to be successful, especially in emerging markets, it's very important to do independent research and diligent bottom-up analysis. As long as the country doesn't have structural imbalances at the macro level, then it's really the bottom-up work that can generate alpha opportunities.

This is my personal opinion — not to focus too much on the headline risk, but to do the work, and you will find interesting opportunities.

TWST: Thank you. (ES)

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