NATURAL CAPITAL STRATEGY

SYCOMORE ASSET MANAGEMENT

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This document provides an overview of Sycomore AM's approach to **environment and natural capital-related issues**. This approach is fully consistent with our philosophy and our positioning as responsible investors. It is shared with all of our stakeholders: employees, clients, suppliers, institutions, associations, shareholders and companies within our investment universe. It governs how we engage with stakeholders and steers our proprietary initiatives and our investment strategy.

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Abstract

Sycomore AM's Natural Capital Strategy lies at the heart of our work as asset managers and is key to our investment decision making process. Sycomore AM's environmental impacts are mainly indirect as they come from the companies we invest in. Therefore, the Natural Capital strategy is **central to our professional and societal responsibility**. It is based on four pillars:

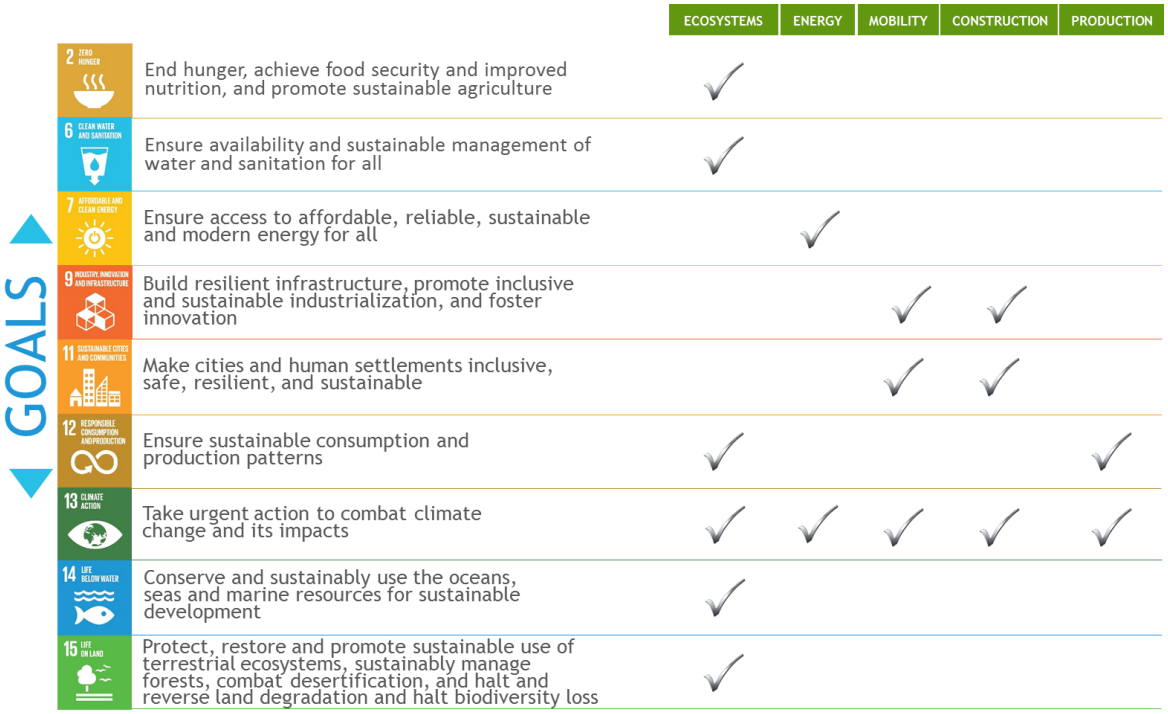
- **Engagement**: Sycomore AM supports the initiatives and best practices regarding the integration of environmental issues across the asset management industry as signatories of the United Nation's Principles for Responsible Investment in 2010, the Carbon Disclosure Project in 2013, the Montreal Carbon Pledge in 2015, as official sponsor of the COP21 summit in 2015, member of the GIIN since 2016, member of the IIGCC since 2017, member of the board of FIR, signatory of the TCFD recommendations in 2017, member of the FAIRR since 2018, and active in its voting policy.
- **Dedicated governance**: in 2015, Sycomore AM created a **Strategic Environment Committee** chaired by a **Head of Environmental Strategy**, bringing together qualified professionals with very diverse backgrounds: experts, investors, corporates and NGOs. This committee, which has a dozen members, meets twice a year to review and discuss aspects of Sycomore AM's strategy and more specifically how natural capital issues are taken into account. Acting as a steering and supervisory committee, it is a unique venue for discussion and debate, where members can express themselves freely on a personal basis;
- **Transparency**: Sycomore AM is committed to using simple, reliable and meaningful metrics for environmental performance when engaging with issuers, in its investment processes and with its clients. We therefore publish the following information every month for our main strategies and their benchmarks:
  - The **Environment rating** provided by our **SPICE** analysis model;
  - The **NEC, Net Environmental Contribution®**: a leading indicator measuring a company's contribution – on a scale of -100% to +100% - to the energy and environmental transition and the 2°C alignment;
  - The carbon footprint in tons CO_2 eq. covering scopes 1 and 2 and Tier 1 suppliers in scope 3, per year and per million € invested. The data is provided for information purposes, as the available footprint fails to include a comprehensive scope 3, as well as avoided emissions (scope 4).
- **Excellence**: Sycomore AM ensures it applies the best available standards, such as the environmental exclusion criteria set by the Austrian label **Umweltzeichen**, or positive selection criteria, such as those defined in the French **Energy and Ecological Transition for Climate Label (TEEC)** label. In May 2016, Sycomore Eco Solutions fund became the first strategy ever labelled by the French government when it was awarded the TEEC label.

Our strategy is based on a **Life Cycle Assessment** approach– i.e. **multi-challenge and for each individual product, use and solution**, and is based on the following technical characteristics:

- A **comprehensive** approach: looking at the full spectrum of environmental **impacts** (thereby multi-criteria, unlike the carbon-only approach) generated by a company's business, taking into account the positive and negative impacts of the product and service during the use phase such as energy savings, avoided emissions or tons recycled;
- A **quantified physical approach**, particularly through the **NEC,** Net Environmental Contribution®, which assesses the **physical pollution flows generated and/or avoided in relation to the physical units of functions provided,** such as the kWh of energy supplied, the km covered, or the ton produced;
- A **pragmatic approach:** we focus on the main material impacts, we focus on orders of magnitude but do not claim to offer absolute accuracy
- An **integrated** approach: the fundamental analysis performed in SycoValo for any of our investments systematically includes a SPICE review which covers**environmental** but also **social, societal and governance** issues.

International standards, Sustainable Development Goals and TCFD

In 2015, the United Nations adopted 17 Sustainable Development Goals (SDGs). These goals are gradually becoming recognised as a global benchmark for public and private sector players in measuring the progress made to improve the lives and future prospects of everyone, everywhere. Nine of these goals cover environmental issues: the 6th is about Water; the 13th concerns the Climate, numbers 2, 14 and 15 relate to ecosystems and the sustainable food supply these can produce. Goals 7, 9, 10 and 11 cover energy consumption, production and systems, both industrial and urban. As shown in the table below, our impact analysis – based on 5 key areas – fully covers these 9 SDGs.



In June 2017, following a request by the G20 and Central Bank governors and addressed to the Financial Stability Board (FSB), the **Task force on Climate-related Financial Disclosures** (TCFD) drew up a set of recommendations[1] with a view to developing information disclosure on **climate-related risks and opportunities** that would be of use to investors when making investment decisions.

The Task Force's report establishes recommendations for disclosing information about the risks and opportunities presented by climate change and how they are taken into account in the core elements of how organizations operate: governance, strategy, risk management, and metrics and targets.

French and European standards

In France, article 173 of the French Energy Transition Law for Green Growth[2] marks a turning point in climate-related disclosure requirements for issuers, asset managers and institutional

[1] See https://www.fsb-tcfd.org/publications/final-recommendations-report/

[2] Voted on August 17th 2015 with implementing enactment n°2015-1850 setting out measures for the enforcement of article 173, and published on December 29th 2015.

investors, with effect from 2016. These entities now have to publish information on the integration of environmental, social and governance (ESG) criteria to their investment policy, but also on their **own strategy and contribution to the energy and environmental transition** and to **the fight against climate change**.

At the same time, the French government launched the certification, Energy and Ecological Transition for Climate, EETC, based on impact metrics, a green taxonomy of eco-activities and strict exclusions of fossil fuels and nuclear energy.

In March 2018, based on the recommendations provided by the **High-Level Expert Group on Sustainable Finance**, the European Commission released a Sustainable Finance Action Plan – which involved establishing EU labels for green financial products based on a taxonomy for sustainable activities, with a focus on climate change and environmental challenges.

Key principles

Sycomore AM views the environment **as a key stakeholder – the very foundation of resilience of mankind** as a species and as a civilisation. The environment as a stakeholder covers the full spectrum of the biosphere's common goods, as an ecosystem services provider**,** based on the Millennium Ecosystem Assessment's definition in 2005. It is our natural capital, enjoyed by all forms of life and passed on to future generations.

The global economy is shifting to a more environmentally sustainable growth pattern, a trend that is as inevitable as it is essential. The shift towards **a green and low carbon economy** - referred to in France as **the Energy and Ecological transition for Green Growth** - is under way across the world, in very diverse forms and at different paces, generating new risks and opportunities. Against this complex and evolving background, identifying **negative environmental impacts** and **associated risks**, as well as **positive impacts** and **associated opportunities**, is key for us as asset managers.

To achieve this, we favour bottom-up approach, starting with company activities and including the full spectrum of environmental issues – with no prior ranking, as:

- Environmental impacts are usually **interlinked**. For example, deforestation and land degradation will amplify climate change, and vice-versa.
- Single polluting substances often have **multiple impacts**. For example, sulphur dioxide (SO_2) is a clear gas that is toxic when breathed and causes the acidification of rains. Another example would be chlorofluorocarbons (CFC), greenhouse gases that also destroy the ozone layer.

Furthermore, any solution or response to an environmental issue is **never without externalities** and the outcomes can imply shift pollution from one area to the other. As an illustration, diesel vehicles have a positive effect on climate change, as they emit 10% to 20% less CO_2 per km than a gasoline vehicle. However, they produce more NO_x and fine particles, with immediate harmful effects on air quality in urban areas. Similarly, the development of electric vehicles in a country where the electric mix has a high carbon content is not a solution for climate change, but it does generate tangible improvements in air quality in cities.

Mapping the issues

Sycomore AM's environmental analysis is structured around 5 key issues: **climate, biodiversity, waste, water and air.**

These five environmental issues are derived from the cross-analysis of four categories specific to the Life Cycle Assessment methodology – climate change, depletion of resources, deterioration of ecosystems and threats to health – and the three forms of physical interaction with the environment: gas, liquid and solid.

These are mapped below by pollutant type:

Issues	Scope	Gas	Liquids	Solids
Air quality	Air at ground level, aerosols, non-climate related atmospheric phenomena	Volatile organic components, NO_x, SO_2, gas destructive of ozone layer, …	Sprays, fine liquid particles	Solid particles in air: smog, dust, fine particles (PM10 and PM2.5)
Climate	Absorption or emission of pollutants with impact on climate regulation, conventional and non-conventional fossil fuels	Greenhouse gas emissions, GHG: CO_2, CH_4, N_2O, Halogenated hydrocarbons (HFC, PFC, SF_6, …)	Pollutants impacting the carbon or nitrogen cycle, oil, GPL, GNL	Coal, lignite, peat Shale sands
Waste	Natural resources, solid and liquid waste, including hazardous and radioactive	Gas derived from decomposing organic waste	All liquid waste	All solid flows, excluding fossil fuels All solid waste
Water	Fresh water (stress and availability), water cycle, groundwater and aquatic environment contaminants	Gas contributing to the acidification of oceans (CO_2, nitrogen oxides, sulphur oxides)	Freshwater withdrawal Liquid waste	Aquatic environment and water table contaminants
Biodiversity	Land use, deterioration of terrestrial or marine ecosystems, diversity of species, deforestation	Gas generating acid rains (SO_2, SO_3, NO, NO_2, …), endocrine disrupters, …	Pesticides, eutrophic substances, endocrine disruptors, …	Waste impacting terrestrial ecosystems (biocides, nitrogen fertilisers …) and marine ecosystems (plastics…)

Integrating into fundamental analysis with SPICE

Furthermore, and as shown in the table below, our **SPICE**[3] fundamental analysis – also referred to as ESG for Environment, Social and Governance – covers the key stakeholders. Our environmental assessment is carried out from the perspective of the biosphere, based on the module **E – for Environment**. Our approach strives to be as little anthropocentric as possible, with mankind considered as one of ten million other living species. The direct impacts on people and broadly speaking, the anthropocentric and economic viewpoints, are considered in the other modules:

- In modules S, P and C for **Social and Societal** factors;
- In the **Governance** module under **Investor I** for the integration of sustainable development into governance and strategy;

[3] S for Suppliers and Society, P for People – i.e. employees, I for Investors, C for Clients and E for Environment, as described in Sycomore AM's ESG Integration Policy available on www.sycomore-am.com.

- In the **Business Model** module under Investor I for the analysis of strengths, weaknesses, threats and opportunities.

Modules	Stakeholders	Types of environmental analysis
S	Suppliers and Society/ Supply chain	Impacts on human health and quality of life (residents, users, suppliers, …)
P	People/employees	Impacts on employees' health and quality of life
I	Investors / shareholders Governance + Business Model	Sustainable development governance, risks and opportunities relating to the energy and environmental transition
C	Clients	Impacts on clients' health and quality of life, reputational risks
E	Environment	Impacts on the biosphere, environment and climate-driven risks and opportunities , including physical and transition risks

For instance, when looking at food: the impacts on public health and safety are analysed under pillars C and S, while the pillar E focuses on impacts caused by the production of commodities (impacts of farming and livestock on water resources, soils, biodiversity and climate), the food processing and packaging.

To use another example, the depletion of fossil fuel reserves does not threaten the resilience of the biosphere or living species per se. However it is the extraction, processing and combustion of oil that is a major issue for the environment and these aspects will be analysed in E, while the resource depletion will be an issue for future human generations and is therefore considered under the Business Model module of I.

Since 2015, Sycomore AM has invested a great deal of time and resources in improving the way climate issues are integrated to the SPICE analysis model; Climate is one of the 5 issues systematically reviewed in the Environment module and is also assessed within the Investor module as a component of companies' governance and business models. The **SPICE** analysis model now includes the specificities of **article 173** and the recommendations issued by the **TCFD**, and in particular the following:

- The risks associated with the transition towards a low-carbon economy or **transition risk**, and broadly speaking, the issuer's strategic alignment with the 2°objective: these risks are systematically quantified using the **NEC** and are then integrated into the E module;

- The exposure to the physical consequences of global warming or **physical risks**: these are monitored in the Environment module.

Mapping the contributing activities

Convinced that companies are generating pollution, but also offering solutions, we have integrated the negative and positive impacts by looking at the functions provided. These functions have been classified into 5 key areas, with each representing a group of activities, uses and functions:

- **Construction:** covers all activities relating to land use planning, infrastructure and living areas;
- **Ecosystems:** covers businesses active in the exploitation of living terrestrial or aquatic resources, soft water, farmland, forests and soils;

- **Energy:** covers the production and management of energy in the form of fuel, heat or electricity;
- **Mobility:** covers the transportation of people and goods;
- **Production**: covers all other business activities that support consumer spending.

This classification helps to distinguish and explain the activities in which we focus our investments. For each area, examples of business models with negative and positive contributions are shown in the table below.

Area	Functions/uses	Negative models	Positive models
Construction	Access to a home, shelter, personal space	Thermal "disaster" buildings, concrete and cement-based building solutions	Renovation, thermal insulation, timber framing, home exchange
Ecosystems	Access to food, use of water, exploitation of living resources	Pesticides, nitrogen-based inputs, intensive farming, animal protein	Vegetable-based and organic foods, sanitation, sustainable forestry
Energy	Access to energy: fuel, heating and electricity	Thermal coal, non-conventional oil & gas, carbon-rich electricity	Renewable energy, smart electricity grids, energy storage
Mobility	Personal travel and freight	Air travel, vehicles with high fuel consumption, road freight	Car-sharing, bicycles, public transport, railways
Production	Consume, produce, extract, recycle, …	Linear economy, mine extraction, disposable goods, cotton	Circular economy, green chemistry, recycling, function-driven economy

Considering the extreme diversity of activities and the complexity of environmental assessments, Sycomore AM has chosen a **pragmatic** approach:

- By focusing on the **main impacts identified**: only the largest positive and negative impacts will be analysed, using an 80/20 approach – looking at 80% of impacts generated by 20% of pollutants;
- By **scaling our analysis proportionally**: the degree of analysis will be higher for material environmental impacts – whether negative, positive or both.

A dedicated leading indicator, the NEC

Beyond the systematic integration of environmental issues into our SPICE analysis model, Sycomore AM has developed a methodology to measure the contribution to the ecological and energy transition. As a result, to strengthen our analysis capabilities, our engagement, our transparency and our accountability, we have built, tested and implemented our own specific indicator called **Net Environmental Contribution®**, **NEC**, based on work conducted for the Sycomore Eco Solutions fund, in partnership with I Care & Consult, Quantis and since 2017, BNP Paribas Securities Services.

The NEC is a new generation metric that measures the extent to which a company's business model is aligned with the energy and environmental transition and the climate change mitigation. It ranges from **-100% for businesses that are highly damaging to natural capital, to +100%** for companies with a strong positive net impact, **offering clear solutions to environmental and climate-related challenges**. The NEC covers the five impact categories (issues) by group of activities (contributing areas) as follows:

5 ISSUES / 5 AREAS	CLIMATE	WASTE	BIODIVERSITY	WATER	AIR QUALITY
ECOSYSTEMS	✓		✓	✓	
ENERGY	✓	✓	✓		
MOBILITY	✓				✓
CONSTRUCTION	✓	✓			✓
PRODUCTION	✓	✓	✓	✓	

✓ Key issues for the impact domain

Important issue, but hard to quantify (lack of reliable data)

Greenhouse gas emissions are now among the most documented impacts, particularly in Europe; as a result, the NEC is able to include the climate impacts for all 5 group of activities. Furthermore, within the NEC, climate-related issues often carry the largest weightings: for instance, they weigh 50% for transportation and energy, and 33% for food. Consequently, the NEC **systematically includes a climate component** so that there is a correlation between the **degree of alignment** with the environmental and energy transition the NEC measures and **the 2°C alignment**.

Furthermore, given that different business lines have different impacts, often related to the final uses or end-markets, the analysis is carried out **at the business units or segment level** and at the end-market level when impacts are identifiable and significant. This enables us to consider the full **value chain** when analysing opportunities and transition risks. For example, a service provider dedicated to coal-fired power stations will display the NEC associated with coal-fired power plant electricity production, i.e. -100% and will be classified under Energy, irrespective of the services provided (engineering, maintenance, controls…).

To summarise, the NEC's main features are the following:

The NEC…	is	is not
Maturity	a prototype tested on a large scale (1200+ issuers)	a test on a limited universe, nor a fully-standardised methodology
Scope	applicable to all businesses and industries (cross-asset)	limited to the listed universe or to stocks only
Type of data input and sources	based on physical data per functional unit derived from Life Cycle Assessments for individual projects or uses, surveys, databases or certification from third parties and data published by the companies	a metric for measuring carbon footprints or carbon intensity based on agency ratings or extra-financial data suppliers
Integration of Climate considerations	focused on multiple issues and systematically includes Climate considerations, often with high weightings	Carbon-only based
Validity	A snapshot of the company based on the most recent available data for year Y-2 Y-1 or Y, and updated every year	a prospective approach based on theoretical future scenarii

The NEC offers an **aggregate measure of transition risks and opportunities** as well as a straightforward **impact metric**, mapped across five key group of activities. This additional insight enables our analysts and fund managers to structure their engagement with companies; it also provides information for the monthly and annual reports delivered to our clients, in line with the **article 173** of the French Law on Energy Transition and the **international recommendations of the TCFD**. In practice, this new advanced metric has proven its ability to act as a strategic **compass for navigating the energy and environmental transition**.

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