Engagement and Voting examples

Engagement

Amid the pandemic in 2020, Aberforth's engagement activity was focused on understanding how companies were dealing with the operational and financial implications of lockdown. The subsequent demand recovery, spurred by the vaccines, heralded a new set of challenges in 2021. The speed of this recovery increased pressure on supply chains, with implications for businesses' costs and working capital. Aberforth maintained high levels of engagement with investee companies, but the focus shifted to supply side dynamics (e.g. sourcing strategies, stock levels, ability to deliver orderbooks), alongside the impact of energy costs and broader inflation in profitability.

The year also saw an increased incidence of engagements related to environmental and social issues. Dialogue continues with companies about ESG disclosures, practices and commitments. This is particularly important for companies whose stockmarket valuations are materially affected by environmental and social risks. During the year, Aberforth enhanced its internal systems for recording and monitoring sustainability factors. These improvements are intended to aid the assessment of companies' intrinsic value and highlight engagement priorities.

Aberforth engages with board members of investee companies, both after results and on an *ad hoc* basis in between. There are also numerous engagements with non-investee companies as part of the usual investment due diligence process. In 2021, Aberforth conducted 380 formal meetings with executives, a number that excludes *ad hoc* interactions by phone or email. In addition to these meetings, Aberforth conducted 116 engagements with the chairs or non-executives of 73 investee companies. Beyond routine corporate governance matters, some of these meetings addressed relatively complicated issues that required multiple engagements. In several cases, these engagements are on-going.

Set out below are examples that illustrate the breadth and depth of engagements carried out during the year.

Example: Anglo Pacific

Anglo Pacific is a non-precious metals royalty company, which invests in high quality mining projects. Historically, its investments have been dominated by coking coal, through exposure to the Kestrel mine in Australia. The decline of the Kestrel royalty is well known, and the company has been replacing those cash flows with other royalty purchases for several years. During this period, Anglo Pacific consulted with Aberforth on a proposal for the strategic realignment of the portfolio away from polluting to more sustainable commodities.

In February 2021, Aberforth was taken inside to discuss Anglo Pacific's transformational acquisition of Voisey's Bay Cobalt stream, involving an equity raise. Aberforth engaged with the management team of Anglo Pacific to understand the merits of the deal from a financial and environmental perspective. Cobalt provides exposure to the fast-growing electric vehicle market and its Canadian domicile would raise environmental and social standards, compared to the other main producers of the metal, such as the Democratic Republic of Congo. These higher standards may allow cobalt to be sold at a premium, which would enhance the financial attractions of the deal. Aberforth's clients supported the transaction and participated in the equity raise.

Example: Card Factory

Greeting card sales over the past year have been significantly affected by extended periods of mandatory pandemic-related store closures. Although the business is well-positioned to achieve positive sales growth following re-opening, it will emerge with elevated debt levels and is unlikely to return to its target leverage until 2023. As such, the company requires additional flexibility from its banks to refinance.

Card Factory may be able to navigate the non-linear trajectory of the recovery and the structural changes in the industry through a debt-led solution, which currently appears to be the board's preference. Aberforth has not, however, ruled out the possibility that the company might need additional equity and has therefore signalled to the board potentially meaningful support should it look to raise equity capital. Engagement continues and the chair has committed to appropriate consultation as the refinancing plan develops.

Example: Charles Stanley

This wealth manager received a recommended offer during the year from Raymond James. The valuation represented 1.7% of discretionary funds under management (FUM). Wealth management businesses typically change hands for greater than 3% of FUM. The low valuation reflected a lack of strategic progress and poor execution over several years, with profitability remaining well below that of industry peers. Aberforth conducted numerous engagements with the executives, chairman and senior independent director to understand the scope for strategic and operational improvements. However, despite the significant stake held by Aberforth's clients, a large stake held by the chair's family ultimately blunted the ability to influence. Given the likelihood of continued dissatisfaction with the pace of strategic execution, Aberforth concluded pragmatically that the offer price represented reasonable value. The investment was subsequently sold into the market after announcement of the transaction.

Example: Company A

As part of its regular engagement, Aberforth reminds directors of a strong preference to be consulted on matters that could have significant implications on clients' capital. This can involve being "wall-crossed" to become an insider. A particularly relevant example is when an investee company finds itself in receipt of an unsolicited offer for the company. During the year Aberforth was approached at a usefully early stage by an investee company board that had received an opportunistic bid from an industry peer at a large premium to the prevailing share price. The valuation was, however, considerably short of the estimation of fair value and of historical transaction multiples within the industry. The board cited Aberforth in their rejection letter.

Example: Crest Nicholson

Pressure has been building on the UK housebuilders to help fund cladding remediation liabilities. The fair extent of redress is an evolving topic, which involves on-going discussions between the government, industry participants and residents of affected buildings. Crest Nicholson is at the heart of this issue. Aberforth was contacted directly by a resident of a building that was completed in 2007 by Crest Nicholson and found to have combustible insulation and missing fire barriers. The communication suggested a lack of adequate response from the company. Following this, Aberforth engaged with both the management team and the board to assess their approach to identifying the scope of remediation, engaging with the stakeholders to negotiate a resolution, and provisioning. Reassurance was forthcoming that the company is considering this social issue seriously and thoughtfully, and that there is a robust governance framework for monitoring the utilisation of the provisions to ensure that the affected properties are fixed. Engagement on the cladding issue will continue through to next year as the government provides more clarity on the funding scheme.

Example: EnQuest

EnQuest is an oil and gas producer with mature assets mostly located in the UK North Sea. Aberforth engaged with the company in 2021 to establish whether it could go further with its emissions reduction targets. Aberforth believes there may be an opportunity to commit to a carbon reduction strategy that is aligned to the remaining life of its producing assets, most of which will be depleted by the early 2030s. Aberforth sees significant value in the life left of EnQuest's existing production, which would allow the company to realise UK tax losses and pay down debt to the benefit of equity owners. This is the basis of Aberforth's investment thesis, which does not involve the development of "greenfield" sites in the North Sea.

EnQuest has agreed that the strategic focus should be on maximising the production of existing assets whilst lowering emissions. While the company has aligned with the UK North Sea transition deal, which targets a 50% reduction in production emissions by 2030, it has yet to link its emissions reduction strategy to the life of its asset base. Engagement is ongoing.

Example: FirstGroup

FirstGroup is a transport company and has been a longstanding holding of Aberforth's clients. The investment has been challenging, with several false starts and disappointments. However, fresh impetus was provided by the appointment of an industry veteran, David Martin, as chair in 2019. At the time, FirstGroup was a sprawling transport conglomerate with substantial operations in the UK, US and Canada, and was struggling to generate attractive returns for shareholders.

Aberforth built a strong relationship with the chair since his appointment, encouraging him to simplify the business and improve the financial returns of the company. In response, and with pressure from other major shareholders, the US and Canadian assets were sold. This enabled FirstGroup to resolve a number of legacy issues, including the pension deficit and insurance liabilities, leaving the balance sheet in a strong position.

Subsequent engagement turned to how best to return excess capital to shareholders. With the shares still attractively valued, Aberforth supported a tender offer, whereby the share count reduced by c.39%. Aberforth's clients did not tender any shares and their ownership of the more focused company increased.

Example: Forterra

Forterra is the second largest brick manufacturer in the UK and one of the most carbon-intensive holdings in the portfolio. Clay brick manufacturing is emission-intensive owing to the burning of gas in kilns and the release of embodied carbon from the clay during the firing process. On the back of the company's inaugural sustainability report in 2020, Aberforth has been in dialogue with management to understand the approach to achieving their carbon reduction target. While near-term actions such as using alternative fuel for vehicles and reducing plastic packaging will have both immediate environmental and financial benefits, the longer-term aspirations, such as incorporating hydrogen-fired kilns and carbon capture, are still not yet economically and technologically viable. This engagement was part of determining whether continued investment was appropriate on behalf of clients. We were assured that the company is focused on exploring solutions for reductions in gross emissions beyond merely purchasing offsets to flatter the net measurement. Forterra's initiatives so far include investment in energy-efficient facilities and procurement of most of its energy from a dedicated solar farm at financially attractive rates.

Example: Hyve

Hyve is an international events company whose trading was severely affected by the pandemic. The operational effect was exacerbated by elevated levels of debt from the previous acquisitions of two events portfolios. The combined effect precipitated a rights issue during 2020 and Aberforth invested in the "stick" placement of unsold shares.

As the world emerges from the pandemic, demand for events is expected to normalise, thereby supporting a profit recovery. Nevertheless, Aberforth is concerned that the company wished to use the economic hiatus to pursue further consolidation and accelerate its omni-channel strategy, at a time when its ability to fund growth ambitions remains challenged. Aberforth engaged to express opposition to using equity as currency at depressed prices. The board is aware of these concerns and the engagement continues.

Example: Just Group

The company has struggled in recent years with the pension reforms announced in the 2014 budget and the imposition of the Solvency II regulatory regime. Its efforts to reduce costs and the capital intensity of its annuity products now allow the board to consider its capital allocation priorities. Aberforth engaged with the executives and the chair to argue the risks of a strategy prioritising high growth and to state the case for the capital discipline that an ordinary dividend would bring. These issues were also discussed other shareholders, as well as how the company might best demonstrate its underlying economic progress. Engagement on these issues is likely to continue in 2022 as the company's thinking progresses.

Example: McKay Securities

Engagement on McKay was with the executives, the chair and other shareholders. It was focused on the company's predicament as a small REIT whose ability to grow is inhibited by the wide discount of its share price to net asset value. The discount is affected by McKay's office portfolio, whose value has been affected by the working-from-home trend that emerged from the pandemic. Another influence is how climate change awareness affects demand for older and less efficient offices: tightening EPC regulations threaten to accelerate the obsolescence of older office properties without additional capital investment. We were encouraged that the board is alive to the issue and asked for further disclosure on the cost involved in moving the portfolio up through the EPC bands. Our engagement on this and on broader capital allocation questions continues.

Example: REA Holdings

As a producer of palm oil, the company imposes considerable environmental risks such as deforestation, production of greenhouse gases, contribution to climate change and potential labour exploitation. Given the significance to the value case of the investment, Aberforth is engaged with the company on these issues. REA's environmental risks are mitigated through several actions, not least its membership of the Roundtable on Sustainable Palm Oil ("RSPO") since 2007. The RSPO was formed in 2004 in response to increasing concerns about the impact of palm oil on the environment and on society. It sets best practice standards for producing and sourcing palm oil. Further, palm is a relatively efficient crop, which produces more oil per land area than any other equivalent vegetable. Aberforth is satisfied that the company takes its approach to sustainability seriously and is in the top decile of palm oil companies as measured by the Zoological Society of London in the Sustainable Palm Oil Transparency Toolkit ("SPOTT"). This supported the investment thesis and clients remain shareholders in the company. On-going engagement seeks to ensure these high standards are maintained.

Example: Restaurant Group

Restaurant Group was a challenging investment for Aberforth. The original investment thesis of a former growth darling transforming under a new chair and executive team was thwarted by the 2018 acquisition of Wagamama, which was presented to shareholders as a *fait accompli*. The main concern was the funding of the deal, which, owing to the level of dilution incurred by a standby rights issue, was misaligned with the interests of shareholders. Engagement escalated at this time and culminated in a loss of confidence in the chair and a vote against her re-election. Restaurant closures brought on by the pandemic were a further headwind. The resulting debt level was duly exposed, to the extent that further equity was required to ensure the group could survive the crisis.

During 2021, the company announced it would seek to capitalise on the woes of its competitors by raising further equity to emerge stronger from the pandemic. Fortunately, the market responded favourably to this announcement. Aberforth considered that the board remained oblivious to the dilutionary impact of this equity issuance, having already endured a near trebling of the share count since Wagamama's acquisition was first announced. The investment was subsequently sold.

Example: Smiths News

Engagement has been on-going with the board regarding a clear articulation of the company's dividend strategy following the pandemic. Encouragingly, the board has since announced that dividends would be reintroduced and surplus capital would be returned. Engagement with the chair continues as the company's turnaround progresses.

Example: Vesuvius

As an industrial manufacturer, Vesuvius is one of the most carbon intensive companies in the portfolio. Engagement on this issue revealed that it is also among the most thoughtful about sustainability, which comes through in the detailed disclosures within the annual report. An important aspect of their approach is that target returns on capital deployed on new investments are calculated after taking into account a cost of carbon. This principle is extended into the sustainability-linked elements of the executives' remuneration packages. Such measures have given the board confidence to commit to net zero by 2050, with various intermediate targets under development. The increased focus on climate change may also be seen as an opportunity for the company, since its products are designed to improve the efficiency of its customers' steel manufacturing processes. Engagement on sustainability continues as the company's disclosures develop.

Collective engagement

Working with other shareholders can be an important option in Aberforth's approach to stewardship with its investee companies. In 2021, there were nine examples of collective engagement involving dialogue with other institutional investors. Topics of engagement were capital allocation priorities, alternative options for companies subject to a proposed takeover, and credit refinancing. Several of these engagements will continue into 2022. There are instances that remain sensitive in nature and disclosure at this time would be counterproductive to the engagement objectives. Therefore, the examples below are of concluded collaborative engagements.

Example: Vectura

Vectura, a specialist in inhaled medicines and devices, had been an investment for Aberforth's clients for approximately 15 years. In the formative years of ownership, the burden of lengthy and costly research and development (R&D) programmes in respiratory drug development resulted in poor earnings visibility and volatility. After the appointment of a new executive team in 2018/19, the strategy refocused on the faster growing specialist inhaled contract development and manufacturing market. This shift improved profitability through lower R&D expenditure, and over time was expected to diversify development risk across a broader portfolio of inhaled medicines with lower initial capital requirements.

In late May, Aberforth became an insider on a takeover approach from a US private equity company. The subsequent meeting with Vectura's chair was less a consultation on the merits of the acquisition than the presentation of a fait accompli. Aberforth believed the offer price to be below intrinsic value and attempted to communicate this view to other shareholders. After approaching three of the larger institutional shareholders, only one was prepared to meet. With the board having recommended the private equity offer, and with seemingly little other shareholder appetite for the company to retain its independence for lack of a higher bid, the decision was taken to realise the premium. This outcome saw the investment in Vectura sold before a subsequent bid from Philip Morris was made.

Example: Hostelworld

Hostelworld operates a platform to connect travellers with hostels all over the world. With the impact on revenues of curtailed travel during the pandemic, a strong balance sheet became perilously weak. Despite an equity raise in 2020, demand for travel remained subdued and it became clear that the company would need to find additional liquidity. As engagement progressed in 2021, Hostelworld consulted on a plan to use an unconventional debt provider to avoid diluting shareholder interests. Aberforth engaged with the chair to evaluate all refinancing options for the company and signalled support for equity as a more permanent fix, which would allow the company to emerge from the pandemic without the burden of expensive debt. During this time, Aberforth met another shareholder to advocate an equity raise, which would be an expensive solution because of the low share price but would offer greater certainty for the company. The shareholder was persuaded by the board's arguments and opted to support a debt solution. The engagement concluded with the company raising debt and so far there has been no further equity issuance.

Voting

Voting principles

Aberforth:

- Votes to maximise the value of its clients' capital, taking into account all relevant factors, including environmental and social issues.
- Votes on all resolutions put to shareholders.
- Does not automatically follow the recommendations of the board, or of proxy advisers, but aims to engage with the board before voting against or abstaining.
- Believes that abstention – or withheld votes – can be a useful signal in on-going engagement with a company.
- Expects to be consulted on contentious issues before they are brought forward for voting.
- Expects companies to comply with the Corporate Governance Code 2018 or explain otherwise.
- Retains a flexible and pragmatic approach recognising that the requirements of smaller companies do not always conform with "one-size-fits-all" policies.

Voting	**12 months to 31 December 2021**
Shareholder meetings at which our clients' shares were voted	116
Shareholder meetings at which our clients' shares were voted against or abstained (1)	13
Number of resolutions voted	1,712
Number of resolutions voted against	3
Number of resolutions abstained	22

Notes:
(1) On one or more resolutions

The table above shows the breakdown of how Aberforth voted during 2021. The examples below provide more detail on the rationale behind certain voting decisions. They demonstrate the importance of combining voting decisions with proactive engagement.

Votes AGAINST or ABSTAIN

Votes in this category are purposeful and planned. Aberforth views voting against as an important tool for when engagement is unable to facilitate change, while abstain votes can be a useful signal in on-going engagements. Intentions to vote either against or abstain are usually communicated to the boards ahead of time. Notable examples of votes against and abstentions are provided below.

Example: Mitchells & Butler

Vote AGAINST re-election of the chairman

Aberforth has engaged with the chair in his capacity as chair of another company. These previous engagements were unsatisfactory. Furthermore, his tenure at Mitchells & Butler extends beyond ten years and succession plans do not appear well advanced. These concerns were communicated to the board.

Despite this engagement, the resolution passed with 75.2% of votes FOR.

Example: SIG

Vote ABSTAIN on re-election of two directors (CDR representatives)

Private equity company Clayton Dubilier & Rice (CDR) became a c.28% shareholder in SIG following the equity issue in 2020. The accompanying shareholder agreement granted two board seats to CDR, which were up for re-election. Though Aberforth's clients' interests are aligned with CDR's in the present recovery phase, this may not always be the case and CDR's board positions could prove detrimental to clients' interests in certain circumstances. Aberforth's decision to not vote against the reappointment of CDR's directors followed a reassuring engagement with the chairman who is alive to the risks. In this regard, the chair has ensured that there is a clear majority of independent non-executives on the board.

The re-election of the two CDR directors passed with 99.9% and 86.7% of votes FOR.

Example: TI Fluid Systems

Vote AGAINST remuneration policy

Vote ABSTAIN on re-election of two directors (Bain representatives)

As in previous years, the very high variable element of the remuneration package is a concern. This could see the executives earn seven times their base salaries. Engagement with the new head of the remuneration committee on the topic was encouraging – it is to be hoped that some change might be forthcoming.

Additionally, votes were withheld on the re-election of two non-independent non-executive directors who are representatives of Bain. Bain is the private equity firm that owned the company before IPO and that retains a 37% stake. The risks associated with investing alongside a shareholder with such a stake were highlighted in 2020, when, at the last minute, Bain withdrew their support of a dividend to be paid by the company in respect of 2019. Abstention, rather than a vote against, was appropriate in view of the circumstances of the second quarter of 2020, when uncertainty about the pandemic was at its most intense.

The company's remuneration policy passed with over 75% of votes FOR. Meanwhile, the re-election of two Bain representatives as directors passed with 99.9% and 82.8% of votes FOR.

Votes FOR deemed significant

Whilst voting FOR a resolution does not usually merit explanation, there are circumstances in which such votes are significant. The examples below demonstrate the importance of combining voting decisions with proactive engagement.

Example: McBride

Voted FOR capital allocation

McBride's board decided to repurchase shares over the course of the year, citing undervaluation and strong balance sheet as primary reasons. Given balance sheet leverage and the illiquidity of the shares, we opined against share buybacks in favour of more prudent capital allocation. With unexpected inflation in raw material prices and supply chain bottlenecks culminating in a challenging trading backdrop, McBride reversed course to protect its balance sheet. The buy backs were suspended and a covenant waiver from its lenders was negotiated in the second half of the year. Engagement with the chair offered reassurance about the strategic use of cash. Therefore, in support of the board's ability to allocate capital, Aberforth's clients voted for the standard authorisation for the company to be able to repurchase ordinary shares as per the Listing Rules.

The motion to authorise market purchase of ordinary shares passed with 99.9% of votes FOR.

Example: Vitec

Voted FOR remuneration policy

Aberforth's clients voted in favour of the Remuneration Report despite concerns about the amended terms of the LTIP. Specifically, the revised EPS threshold was undemanding in view of the level of EPS before the pandemic. Engagement was undertaken with the head of the remuneration committee, the chair, the chief executive and other shareholders. The justification for the threshold was the retention of important employees within the Creative Solutions division, which is based on the west coast of the US. Acknowledging the risks outlined, a pragmatic decision to vote in favour was taken. Engagement on remuneration continues.

The approval of the Directors' remuneration report passed with 80.1% of votes FOR.

Example: Wilmington

Voted FOR remuneration policy

Under a new management team, Wilmington is refocusing its services on core competencies in governance, risk and regulatory compliance. Helped by modest non-core disposals, the business has returned to growth and generated strong cashflow throughout the pandemic. Consequently, debt has been repaid. With the business now on its front foot, Aberforth expects acquisitions to be considered for 2022 and beyond. To ensure that this growth is value accretive, engagement with the chair of the remuneration committee was focused on the inclusion of ROCE as a KPI for the Performance Share Plan. The proposal was accepted and clients of Aberforth voted to approve the remuneration policy.

The company's remuneration policy was approved with 97.9% of votes FOR.

Votes DIFFERENT from proxy adviser recommendation

During 2021 there were 77 resolutions on which Aberforth voted differently from ISS's recommendations. Examples are set out below.

Example: CMC Markets

Voted FOR re-election of Chair of nomination committee – proxy adviser was AGAINST

The proxy adviser recommended a vote against the re-election of the Chair of the Nomination Committee, on the basis that less than 33% of the board currently consists of women. Whilst the current profile is not in line with emerging practice and the recommendation to the Hampton-Alexander Review, Aberforth was satisfied that the board's policy considered diversity in its broader sense, and that 50% of the independent non-executive directors are women.

The motion passed with 91.0% of votes FOR.

Example: Hollywood Bowl

Voted FOR remuneration policy – proxy adviser was AGAINST

Against the COVID-19 backdrop, the board proposed a retrospective reduction to the LTIP's performance period. The changed terms would effectively enable a payment to the executives, to which the proxy adviser was opposed. However, Aberforth's engagement with the chair and the head of remuneration committee yielded a significant concern that the highly rated executives would be poached by private equity. In light of the company's strong operational performance, Aberforth believed support for the motion was warranted and pragmatically voted in favour of the remuneration changes.

The remuneration policy passed with 52.3% of votes FOR.

Example: Ricardo

Voted FOR remuneration policy – proxy adviser was AGAINST

Aberforth's clients voted in favour of the remuneration report despite the proxy adviser's concern about the generous termination arrangements for the outgoing CEO who had served in his role for 16 years. Engagement with the board revealed that ensuring continuity was of utmost importance, particularly as the company grapples with a shift in its strategic focus towards the decarbonisation agenda and away from the legacy internal combustion engine business. Aberforth supported the board's efforts to keep the outgoing executive engaged during the transition period by voting in favour.

The remuneration policy passed with 64.6% of votes FOR.

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