ABERFORTH PARTNERS

Compliance with the UK Stewardship Code

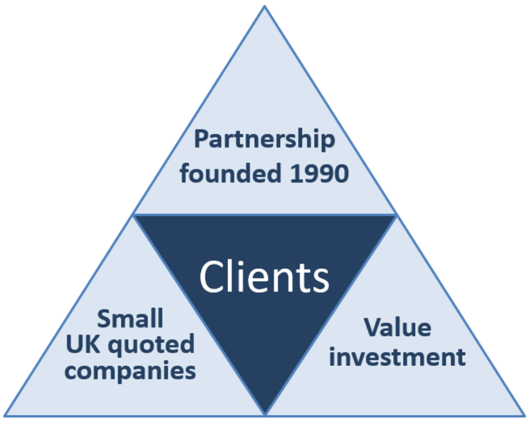
This document provides details of Aberforth's approach to stewardship and its compliance with the UK Stewardship Code in the reporting period to 31 December 2021. Those looking for more information can contact Sam Ford – the investment partner responsible for co-ordinating stewardship issues – by email at stewardship@aberforth.co.uk or by phone on 0131 220 0733.

Principle 1

Signatories' purpose, investment beliefs, strategy and culture enable stewardship that creates long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.

Context

Aberforth was established in 1990 and remains wholly owned by partners working at the firm. Since then, its purpose is unchanged and is encapsulated by the accompanying diagram. Specifically, the purpose is to deliver superior long-term investment returns for its clients and, by extension, for the ultimate beneficiaries of its clients' portfolios.



The target client base, detailed in Principle 6, is institutional or wholesale investors that want to give their own clients exposure to small UK quoted companies.

Three central aspects of the firm – partnership, a focus on small UK quoted companies and a value investment philosophy – support the pursuit of this purpose. The features set out below are described in more detail in Aberforth's investment philosophy document, which can be found HERE.

- Aberforth was designed by its founders to be a simple business in the belief that this would improve the investment outcomes for its clients. The firm has remained focused on one asset class and, aided by a self-imposed cap on its assets under management, avoids the complexity and proliferation of strategies that are associated with the asset-gathering model pursued by much of the fund management industry. Aberforth believes that its chosen asset class – small UK quoted companies – is relatively inefficient and, through fundamental analysis, lends itself to the active management of a diversified portfolio of stocks. Aberforth's investment universe is the Numis Smaller Companies Index (excluding investment companies) [NSCI (XIC)], which is the bottom ten percent of the main UK equity market by market capitalisation.

- All Aberforth's portfolios are managed in accordance with a value investment philosophy. Encouraged by historical evidence, Aberforth believes that this philosophy plays a central role in the achievement of superior long-term returns. Given this unwavering adherence to value investment, Aberforth's primary consideration in any investment decision is, unsurprisingly, valuation. Any matters that affect the valuation of an investee company are relevant to Aberforth's investment process. These matters include environmental, social and governance (ESG) issues. The firm believes that discreet engagement with the boards of investee companies – on matters such as governance, capital allocation, environmental impact and social policies – can improve investment returns, to the benefit of clients.

- Aberforth's success in remaining true to its value investment philosophy and in keeping its business simple has been facilitated by the firm's ownership structure: it is a limited liability partnership, wholly owned by partners who all work full-time in the firm. The interests of Aberforth and its clients are reinforced by the partners each investing a significant portion of personal savings in the collective funds managed by the firm. The partners' intention is to ensure the perpetuation of the partnership through transition to the next generations. The partners see themselves as guardians of a business at the centre of which are its clients: investment expertise, exceptional service and integrity combine to nurture strong client relationships and thus to extend the longevity of the business beyond the tenure of any individual.

Clients are at the heart of Aberforth's purpose and culture, but successful stewardship of clients' capital can also be of broader benefit. While small companies have a less significant impact than their larger peers on the economy, the environment and society, that is not a reason for such issues to be de-emphasised. Aberforth expects investee companies and their boards to consider ESG matters in their operational and strategic decision-making.

Except when requested by clients, Aberforth does not exclude investments from portfolios on the basis of ESG considerations alone. There is evidence that investment returns can be enhanced by investment in and engagement with companies that face ESG challenges and are already seeking to address them or can be encouraged to do so.

Activity

Aberforth ensures that its investment beliefs, strategy and culture enable effective stewardship by the "vertical integration" of all roles in the investment process. Each investment manager is responsible for several stockmarket sectors. For each holding within the allocated sectors, the investment manager undertakes company analysis, dealing, engagement and voting. The advantage of this approach is a coherent stewardship message to the boards of investee companies that is consistent with the initial investment thesis. The controls on this approach are twofold. First, investment decisions are made collegiately by the group of investment managers based on a portfolio approach to capital allocation. Thus, an individual investment manager always receives scrutiny, challenge and assistance when necessary. Secondly, stewardship as implemented by the investment managers is subject to review by the partnership through its Stewardship Group (see Principle 2).

Outcome

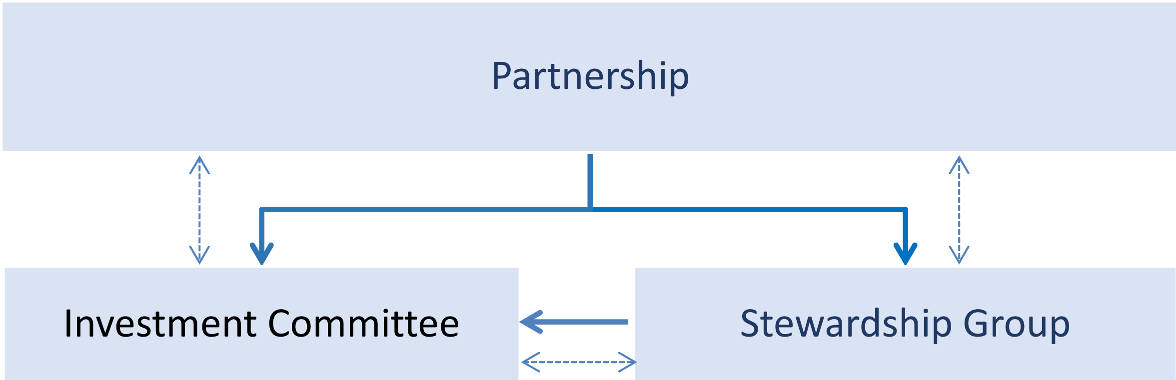
Influenced by the value investment philosophy and a belief that individual directors can have greater effect on the fortunes of a small company, stewardship permeates Aberforth's investment process and culture. This is demonstrated by data provided in the responses to Principles 9, 10, 11 and 12. Aberforth's emphasis on stewardship is reinforced by the fact that its clients, in aggregate, are significant investors within the universe of small UK quoted companies, often holding significant stakes in investee companies. Accordingly, governance considerations and engagement are one of the principal topics at Aberforth's investment meetings. Interactions with the directors of investee companies are discussed, as are significant voting issues arising from general meetings. The competence and performance of the chair are subject to particular scrutiny since that role is the most important within the UK's governance framework as described in the 2018 UK Corporate Governance Code. Voting is undertaken at all shareholder meetings and is reported to clients. The firm's voting policy can be found HERE. Strategies for engagement with companies in which Aberforth's clients own meaningful stakes are regularly reviewed, with escalation tactics developed and additional resource dedicated to more complex situations. The firm's engagement policy can be found HERE.

An assessment of Aberforth's effectiveness in serving its clients and beneficiaries may be conducted with reference to the firm's purpose of delivering superior long-term investment returns. The longest standing client – Aberforth Smaller Companies Trust plc – launched on 10 December 1990. From then until 31 December 2021, it had produced a compound annual NAV total return of 12.7%*. This exceeded the 10.7%* return from small UK quoted companies, as measured by the NSCI (XIC). Part of the superior return was attributable to the value investment philosophy, as value stocks outperformed the index as a whole*. Over the same period, the total return of larger UK companies, as measured by the FTSE All-Share Index, was 8.3%*. This size premium therefore supports Aberforth's focus on small UK quoted companies.

* Sources: Aberforth Partners LLP; FTSE International Limited; Numis/Paul Marsh and Elroy Dimson – London Business School.

Principle 2

Signatories' governance, resource and incentives support stewardship.



Activity

The organisational structure and processes that support stewardship within Aberforth are inextricably linked. Stewardship starts with the partnership model itself, which places the client at the centre of Aberforth's business, as described in Principle 1. The commitment to stewardship is demonstrated in the leadership by a partner, Sam Ford, for all stewardship activities. He chairs the Stewardship Group, on which he is supported by three others including the partner responsible for operations. Having the operations partner as a member provides an additional, diverse perspective, independent from the investment function. As described below, day-to-day stewardship decisions are taken by the investment managers. These decisions are made within a framework set by the Stewardship Group, which reports to the partnership.

Among its peers of investment houses addressing small UK quoted companies, Aberforth has a relatively large team of experienced investment professionals. At 31 December 2021, the team comprised six members, with average industry experience of 20 years. Early in 2022, a seventh investment manager was recruited. The investment managers have a deep understanding of the sectors and companies they cover. This means that the boards of investee companies, who have a single point of contact at Aberforth, can be more receptive to stewardship engagement. The firm therefore believes that its investment process lends itself well to an integrated approach of stewardship: stewardship decisions are taken by the investment manager responsible for individual investments with input from other members of the investment management team. Further detail on Aberforth's investment philosophy and process can be found HERE.

In implementing its stewardship policies, Aberforth's principal investment is in its investment management team, who conduct their own research, analysis and engagement. The firm recruits experienced individuals, whose diversity of knowledge and experience accumulated elsewhere can contribute to the refinement of its processes. Further training and support are provided to investment managers who wish to strengthen their knowledge of stewardship principles and practices. In 2021, one member of the stewardship group completed the certificate in ESG investing, which is issued by the CFA Institute. Another member was enrolled for examination in 2022 and has subsequently passed.

To support its investment and stewardship activities, Aberforth has invested in and developed bespoke internal IT systems. A series of proprietary data applications, linked to a SQL database (the Aberforth proprietary database), are tailored to the firm's approach and are integral to its investment process.

To complement these systems, Aberforth takes data and analysis from third-party providers. These include relationships with a proxy voting adviser and a supplier of carbon data. The former is long standing and subject to annual effectiveness review. The relationship with the carbon data provider has been extended to allow for a period of longer evaluation. Experience with third party providers of ESG analysis has been disappointing to date. Through two reviews over the past three years, the firm has found that the coverage and quality of data relevant to small UK quoted companies remain inconsistent and incomplete.

The structure and ethos of the partnership mean that separate reward structures to incentivise stewardship are not necessary. Aberforth's model is for all its investment managers, and therefore all those with responsibility for enacting stewardship policy, to become partners in the firm. Investment managers are rewarded on the basis of the firm's overall performance, rather than being tied to the investment results of individual sectors or funds. This aligns Aberforth's activities with clients' interests. All operational staff have a specific ESG performance objective as part of their remuneration.

Outcome

Aberforth has consistently applied its approach to stewardship since the foundation of the business in 1990. This task is made easier by the firm's relatively flat hierarchy and by the fact that its principals are directly responsible for implementing the stewardship policy. The voting policy (found HERE) and the engagement policy (found HERE) attest to the rigorous implementation of Aberforth's approach to stewardship.

Although existing governance structures are established and working, there are ways in which its processes, particularly regarding environmental and social considerations, can be enhanced. Several improvements have recently been or are currently being implemented.

- The development of the Stewardship Group has focused on increasing its diversity and encouraged the continuing education of members.

- Aberforth has an internal proprietary system for identifying, analysing and tracking important ESG issues. It was improved during the year to facilitate monitoring of companies' risks and their mitigation practices change over time. Further developments saw the creation of a framework for analysing ESG opportunities and for assessing the impact of ESG issues on a company's value.
- After improvements made in 2020 to improve the recording of environmental and social issues, a project was started later in the year to develop the internal IT systems to link ESG issues with the recording of engagements. This project remains in development.
- Aberforth invests in training and resources to enhance knowledge and expertise in stewardship and diversity. In 2021, staff increased their knowledge by participating in courses including the CFA certificate in ESG investing, by attending ESG seminars run by the Investment Association, and by participating in other industry conferences. Additionally, the firm commissioned bespoke training delivered by the Diversity Trust to increase all staff awareness and to improve knowledge of diversity matters.
- In 2021, the firm improved its system for capturing engagements with investee companies conducted by email. The results contributed to the examples detailed in Principles 9, 10 and 11.
- A review of the quality and usefulness of providers of ESG analysis providers was undertaken in 2021. This work concluded that the depth and breadth of ESG coverage by third parties of small UK quoted companies remain inadequate, although such services will continue to be assessed regularly. The relationship with an external provider of carbon data has been extended through 2022.
- During the year, Aberforth performed a comprehensive survey of all investee companies to establish accurate, consistent and comparable data on climate related disclosures and diversity practices in investee company boards. This is a valuable source of primary data for the Aberforth proprietary database.

Principle 3

Signatories manage conflicts of interest to put the best interests of clients and beneficiaries first.

Context

As an independent limited liability partnership, whose sole specialisation is investment in small UK quoted companies, many of the traditional conflict of interest scenarios faced by larger, more diverse investment management entities do not apply or are less relevant to Aberforth.

The firm has a policy, refreshed annually, for the identification and management of conflicts of interest, with the objective of ensuring that clients are not adversely affected. Any conflict of interest that arises is duly considered by senior management, including the compliance team. The conflict is recorded and managed in a way that ensures that all clients are treated fairly. Where it is impractical to manage such a conflict it will be disclosed to the relevant clients. Aberforth's conflicts of interest policy is shared directly with clients and can also be found HERE.

The policy describes situations in which conflicts of interest may arise. From the stewardship perspective, the most relevant are conflicts that can arise (a) between Aberforth's interests and those of its clients, (b) among its clients or (c) between the interests of the firm's partners or employees and its clients.

Activity

The points below explain how Aberforth has identified and managed conflicts of interest relevant to stewardship.

- In buying and selling shares, the firm only ever deals as agent on behalf of its clients and never as principal on its own account.
- The firm's bespoke order management system is designed to deliver fair allocation of aggregated orders between multiple clients. This is subjected to regular compliance monitoring.
- The firm has controls in place to ensure that mandate restrictions directed by clients are known by investment managers and are reflected in systems.
- The firm's policy on gifts and hospitality prohibits the giving or accepting of gifts that may give rise to a conflict of duties owed to clients or the firm and may otherwise only be accepted where the gift or hospitality is modest and infrequent.
- Aberforth encourages long-term savings and investment by partners and employees. Personal dealings in investments are generally permitted, subject to compliance with the personal dealing policy. That policy requires all personal dealing to be approved by a partner and generally prohibits investment in any company that is a constituent of the investment universe.

- Private wealth managers, on behalf of their clients, are significant investors in the collective funds managed by Aberforth. Some of these wealth managers are constituents of the investment universe and the firm can invest its clients' funds in them. On such occasions, the investment decisions are taken in a manner consistent with clients' mandates and Aberforth's purpose and investment philosophy, as described in Principle 1.

- Clients' interests are represented directly with the investment managers through the independent boards of the investment trusts, the independent non-executive directors of the unit trust management company (on behalf of the unit trust) and directly by client representatives on behalf of the segregated charity clients.

- Aberforth's partners are not permitted to take board positions on investee companies or to sit on the boards of two investment trusts that the firm manages.

- A conflict may arise should a director of an investment trust managed by Aberforth be invited to join the board of a company in which the firm's clients invest. How this situation is addressed is described in one of the examples below as an outcome.

Outcome

Examples of the management of conflicts in practice are noted below. In 2021, updates were conducted to the risk, compliance and control framework, from which no matters of concern arose.

Example: client board conflict

It is not unusual for directors of the boards of the two investment trusts managed by Aberforth to be sought as potential board members of other organisations, which may give risk to potential and/or actual conflicts with stewardship of clients' capital. Whenever this has occurred, it has been addressed through consultation and consideration by the director in question, the board's chair and Aberforth. Although there were no incidences of this conflict in 2021, there was an example in 2020. After it was thoroughly assessed, it was concluded that there was no direct conflict of interest. Subsequently, it was determined that any potential indirect conflicts arising could be managed and mitigated with transparency and safeguards. Such instances are considered on a case-by-case basis. In a previous occurrence, it was considered that the conflicts could not be mitigated to an acceptable level and the board director in question withdrew from the process.

Example: client engagement

Aberforth takes time to ensure that its corporate philosophy HERE and investment approach HERE are understood when building and maintaining a relationship with any client. During this process, Aberforth takes time to discuss and understand clients' stewardship principles and requests. Consistent with this approach, the firm discussed with one client its specific stewardship requirements after the client introduced a 2050 deadline for its investment portfolio to achieve net zero. With a good understanding of these requirements, Aberforth provided additional feedback on how a value investment philosophy could be compatible with these goals. The feedback from the client was supportive and an inaugural environmental report will be produced in 2022.

Principle 4

Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system.

Activity

Fundamental research is one of the main components of Aberforth's investment process. Market-wide and systemic risks are directly relevant to the valuation of investee companies and are identified by the investment managers in the course of their industry and company analysis. Additionally, within the bottom-up research process, there is a top-down check in place: two investment managers are charged with keeping abreast of developments in the macro-economy and financial markets. Emerging systemic risks and their impact on companies or industries are discussed at investment meetings. Target valuations for investee companies may be adjusted in light of these discussions, which might lead to changes to holdings. If a market-wide issue has relevance to Aberforth itself, it is discussed by the partners and actions are taken as appropriate.

Aberforth's partners and employees participate in industry forums, both to help identify risks and, if relevant, to influence how the risks are addressed. Such action is undertaken with the aim of improving how financial markets, usually the market in small UK quoted companies, function. It was another year where Covid-19 continued to limit physical attendances of forums or in-person meetings. During the year Aberforth participated in meetings, interactions or forums with CFA UK, The Investment Association, the Financial Reporting Council, the UNPRI and the Financial Conduct Authority. The objectives of engagement with these forums are: (i) identification of industry issues, such stewardship regulation and regulatory change; (ii) engagement on Stewardship and ESG matters, particularly around application to smaller businesses and in the listed small cap sector; and (iii) economic and market conditions, including regulatory responses.

Under Principle 7, more detail is provided as to why Aberforth sees climate change as a systemic risk to economies and financial markets. It takes this into account when assessing the prospects and valuations of individual companies. Aberforth engages with the boards of investee companies when their stances on climate change are affecting their valuation. It has not engaged in public advocacy. This reflects the complexity of the topic, with nearer term economic and social impacts a likely consequence of meaningful remedial action on climate change. The scope of the judgement required here is broad and prioritisation is a matter for broader society as mediated by government. This stance does not shift responsibility from Aberforth: it considers the impact of potential government action on climate change when assessing the prospects and valuation of investee companies.

The proliferation of climate change regulation and recommendations from governments and other official bodies may itself be a market-wide risk. Any resulting confusion may complicate and delay the implementation of climate change policies by companies, particularly smaller companies with less resource available. This general risk may be a source of individual investment opportunities in companies that are slow but willing to comply. The regular engagement embodied in Aberforth's stewardship model can help identify such companies and help them on their journey. In order to assess this risk, the firm sought better qualitative and quantitative evidence through a survey of its investee companies conducted in 2021. This is described in the example below.

Example

Climate change is a systemic risk to economies and financial markets. Historically, a lack of common standards in ESG disclosure has made comparison across investee companies challenging. As a result, Aberforth conducted an ESG survey of investee companies during 2021. The survey specifically addressed companies' climate change policies, emissions reduction targets and their verification by third parties. In addition, companies provided qualitative commentary on both risks and opportunities resulting from emissions reductions consistent with the Paris Agreement. In total 88 companies were surveyed with a 98% response rate. The responses were integrated into Aberforth's proprietary database. The data will be used to enhance and direct engagement with companies on ESG matters.

Example

The pandemic led to the widespread cancellation of dividends, including cases in which companies had already moved ex dividend. There was often little or no consultation with shareholders ahead of these decisions. Aberforth wrote to the chairs of all its investee companies in 2020 to remind them of the role and importance of dividends and the impact of cancellations on the ultimate beneficiaries such as ordinary savers, pensioners and charities. A copy of this letter can be found on the website and is linked HERE. Aberforth does not advocate the payment of dividends were they to threaten companies' financial viability. However, dividends play a crucial role in attracting capital to companies and are therefore important to the resilience of the small cap sector and broader economy.

The importance of this engagement on dividends was highlighted in 2021. Following the vaccine breakthrough in November 2020, investee companies started to reinstate dividends. The recovery became well established in 2021, as dividends from small UK quoted companies came through more strongly than forecast.

Outcome

Aberforth's approach to investment, based on fundamental analysis, puts it in a good position to identify and assess systemic and market-wide risks. These risks have been considered through the investment process and have, in some cases, led to adjustments to target valuations of investee companies and changes to holdings. The data gathered from the ESG survey of investee companies in 2021 are a valuable additional input into the assessment and prioritisation of engagement with investee companies in 2022. While acknowledging its small size in an industry dominated by asset-gathering giants, Aberforth will continue to engage with other stakeholders on systemic and market-wide risks where such action seems likely to improve the investment outcomes of its clients or, consistent with Principle Five of the FCA's Principles for Businesses, the functioning of the financial system.

Principle 5

Signatories review their policies, assure their processes and assess the effectiveness of their activities.

Activity

Aberforth's approach to the assurance of its stewardship policies is based on internal review. This approach has been adopted since the small size of the firm and its ownership structure mean that its principals are able to scrutinise and amend as appropriate stewardship policies and their implementation. Providers of external assurance are considered, but it is not yet clear that they would add the value provided by third parties in other areas of the firm's activities, such as the AAF 01/20 framework issued by the Institute of Chartered Accountants in England and Wales.

There are three layers to the internal assurance approach: two are formal – the Stewardship Group and the partnership as owners of Aberforth – and one informal. The informal layer is a benefit of the firm's size and simplicity. The investment managers, who put stewardship policies into practice, work together in the same room. Contentious issues may be discussed as they arise and with reference to policy, which increases the likelihood of consistent implementation. At the formal level, the Stewardship Group is charged with formulating the firm's policies and reporting on their implementation through the investment managers' stewardship activities. Important inputs to the group's work are dialogue with industry peers and participation in relevant industry forums. The group reports to the partnership annually, which gives the ultimate approval to the stewardship policy and its implementation.

An additional level of external assurance is provided by the boards of the collective funds managed by Aberforth. The firm presents its stewardship report, together with voting records, to these boards annually. The boards review and challenge the reports, as well as providing an additional check on whether they are fair, balanced and understandable. Summarised updates to stewardship policies and practices are set out in disclosures in the Annual Report and Financial Statements of Aberforth's collective funds. These are approved by the boards and subject to review by external auditors. Aberforth's other clients benefit indirectly from this scrutiny.

Outcome

The assurance approach described above has resulted in the following recent developments in Aberforth's stewardship policies and processes.

- The stewardship policy is structured around the UK Stewardship Code 2020. It is reviewed and updated annually for relevant examples, current activity and outcomes.

- The Stewardship Group, which is tasked with the oversight of policies and their implementation by the investment managers, has evolved with a change in chair and expanded through the addition of a further investment manager.

- As set out in Principle 4, an ESG survey of investee companies was undertaken to obtain consistent and comparable data on climate change risks and opportunities, including practices and disclosures. A second objective was to evaluate boards' progress on gender and ethnic diversity.
- Enhancement continued of Aberforth's proprietary database to improve recording and measurement of stewardship activities. These improvements are intended to help in the assessment of a company's value and in the focusing of engagement. A secondary benefit should be more detailed external reporting.
- Members of the stewardship group participate in industry forums, hosted by the Investment Association, the Association of Investment Companies and a variety of professional service firms. Such activities are useful in assessing the effectiveness of Aberforth's policies and practices.
- Following an internal review and assessment of net zero requirements, the firm has joined the Institutional Investors Group on Climate Change to gain peer insights into reporting and developments in stewardship.
- Aberforth commissioned a sustainability consultant to assist in measuring the firm's own environmental impact and strategy for the energy transition. Following this, the firm voluntarily reported Scope 1 and Scope 2 greenhouse gas emissions, under the Streamlined Energy and Carbon Reporting framework. It allowed the development of a carbon reduction plan, part of which was to complete the transition of electricity requirements to renewable sources during 2021.

Principle 6

Signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them.

Context

As described in Principle 1, Aberforth's portfolios are managed in accordance with a value investment philosophy. Historical evidence suggests that this philosophy plays an important role in the achievement of superior long-term returns for clients. The firm believes that effective engagement with the boards of investee companies – on matters such as governance, capital allocation, environmental impact and social policies – can improve investment returns, to the benefit of clients. Where ESG matters impinge upon the investment case, the investment managers engage with investee companies to understand how these issues may be addressed. The Managers are well placed to undertake this activity, since engagement has always been fundamental to their investment process.

Aberforth's intended clients are institutional or wholesale entities that seek to give their own clients exposure to small UK quoted companies. Aberforth's assets under management are invested entirely in small UK quoted companies. These are companies with a market capitalisation, at the time of purchase, equal to or lower than that of the largest company in the bottom 10% of the main UK equity market or companies in the Numis Smaller Companies Index (excluding investment companies). At 31 December 2021, the firm managed four funds: three collectives and one segregated fund for a charity. All four funds are managed in a similar way in keeping with the value investment philosophy, though client specific variations allow classification into sub-strategies: **Standard Value**, **Value and Income** and **Standard Value with Client Restrictions**.

- **Standard Value:** Aberforth Smaller Companies Trust plc (ASCoT) has been a client since its inception in 1990. It is an investment trust listed on the London Stock Exchange, with assets of £1,565m* at 31 December 2021. Its underlying investors are overwhelmingly institutional, primarily private wealth managers. Retail investors, including execution-only platforms or non-discretionary stockbrokers but excluding current and former partners of Aberforth, represent circa 13%* of the fund. Non-UK investors represent circa 9%* of the fund.

- **Standard Value:** Aberforth UK Small Companies Fund (AFund) has been a client since its inception in 1991. It is an authorised unit trust scheme, with assets of £219m* at 31 December 2021. Its underlying investors are overwhelmingly institutional, primarily private wealth managers. Retail investors, including execution-only platforms or non-discretionary stockbrokers but excluding current and former partners of Aberforth, represent circa 9%* of the fund. Non-UK investors represent circa 2%* of the fund.

- **Value and Income:** Aberforth Split Level Income Trust plc (ASLIT) has been a client since its inception in 2017. It is a split capital investment trust listed on the London Stock Exchange, with assets of £235m* at 31 December 2021. Its underlying investors are overwhelmingly institutional. Retail investors, including execution-only platforms or non-discretionary stockbrokers but excluding current and former partners of Aberforth, represent circa 11%* of the fund. Non-UK investors represent circa 9%* of the Ordinary Shares. This fund has a limited life, with a planned winding-up date of 30 June 2024.

- **Standard Value with Client Restrictions:** Charity A is a segregated fund managed by Aberforth for one of the UK's largest charities. A client since 2002, assets at 31 December 2021 were £280m*.

* Sources: Aberforth Partners LLP; Richard Davies Investor Relations.

Aberforth considers that a long-time horizon, of at least five years, is appropriate to meet the needs of its clients and their underlying beneficiaries. Over a shorter period, there would be a greater risk of volatility from economic and stockmarket cycles. In particular, the value investment philosophy followed by the firm can have prolonged periods out of favour. A longer time horizon also accords with how Aberforth assesses the prospects of the companies in which its funds invest. Several companies have been held by the funds for over a decade, though the average holding period is shorter. This reflects opportunities presented by the stockmarket to realise profits and recycle the proceeds into more attractively valued companies, a process Aberforth terms the "value roll".

Activity

The three collective funds – ASCoT, ASLIT and AFund – are overseen by boards of directors, who receive detailed quarterly reports and attend board meetings with representatives of Aberforth present. These meetings give the directors the opportunity to scrutinise the firm's chosen approach, its stewardship activities (including a record of significant votes), its stewardship code and investment horizons. Additionally, Aberforth's investment managers meet the funds' largest investors twice a year to explain performance against investment objectives and to set out factors relevant to the investment strategy. Engagement activity with investee companies is addressed, as long as it does not breach confidentiality. During the most recent round of visits in November 2021, the firm conducted 115 investor meetings, covering a majority of the holder registers of ASCoT, ASLIT and AFund. This biannual exercise is an opportunity for investors to give feedback and for the investment managers to understand investors' requirements. Appetite for Aberforth's investment offering is formally tested every three years when ASCoT's Annual General Meeting contains an ordinary resolution to wind the company up, with the last occurrence being the March 2020 meeting. Individual shareholders are kept informed through annual and interim reports, monthly fact sheets and research produced by Kepler Partners.

The charity fund receives quarterly reports and meets representatives of Aberforth regularly throughout the year. The relationship, including investment policy, is covered by the investment management agreement. The client does not operate an exclusions list. It is, though, concerned about exposure to fossil fuels and has recently committed to a net zero strategy for its wider investment portfolio by 2050 at the latest. In addition to consulting the client before proceeding with a potentially sensitive investment, Aberforth will engage with the client to support its journey towards a carbon neutral portfolio.

All relevant reports and disclosures made to clients are reviewed by the Stewardship group. At least two members of the group attend all fund board meetings to present progress, consider feedback and understand the client position and needs. Aberforth has supported all funds in enhancing their approach on stewardship matters in 2021. Consultation with investors is undertaken each year following publication of the funds' annual report and financial statements. The feedback from investors is shared with the board routinely during board meetings. Additionally, the chair of each fund writes to the top twenty shareholders or unitholders offering a meeting and requesting feedback.

Outcome

Aberforth's approach to taking account of the needs of clients and beneficiaries is founded upon regular reporting, contact and dialogue with the clients and underlying investors in the collective funds. This monitoring is undertaken proactively by the investment managers, through twice yearly shareholder visits, and by the board chairs, through annual meetings and feedback. Given the diverse underlying ownership of the collective vehicles, there is inevitably a range of views on investment strategy and stewardship. Therefore, it is not possible to accommodate the preferences of all beneficiaries at all times. The boards of the collective vehicles scrutinise Aberforth's stewardship policy and monitor compliance with it. In the case of the segregated charity fund, consultation with its investment committee has led to potential investments not being made. Over the past year Aberforth has followed its stewardship and investment policies for all its investments and clients.

Principle 7

Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities.

Context

Aberforth's investment process encompasses all issues that its investment managers judge to be relevant to a company's valuation. An investee company's journey through the process – from pre-purchase analysis to final exit – is determined by the interplay between Aberforth's valuation of the company and the price attributed to it by the stockmarket. Any environmental, social or governance issue could, therefore, be of importance particularly as the increased profile of ESG affects stockmarket valuations. Consideration of these issues is integrated into Aberforth's investment process, alongside a broad range of other factors. Aberforth believes that a company's system of governance is crucial to how its environmental and social policies are designed and implemented. It is therefore important that boards describe their approach to managing these issues. Except when requested by clients, Aberforth does not exclude investments from portfolios on the basis of ESG matters alone. There is evidence that investment returns can be enhanced by investment in, and engagement with, companies that face ESG challenges and are already seeking to address them or can be encouraged to do so.

The following ESG topics are of particular relevance and interest at the current time.

- Aberforth's environmental framework is built on the view that climate change is a systemic risk to economies and financial markets. The analysis of companies includes an assessment of how strategy and operations affect climate change, and *vice versa*, and evaluates plans to mitigate these effects. Companies that can invest proactively to diminish climate change could see improved recognition by the stockmarket. True to the value investment philosophy, it is also possible that other investors might overreact to perceived risks and reduce company valuations such that attractive investment opportunities become apparent.

- Aberforth have spent time considering the indirect implications of the energy transition. A risk that has become more apparent in recent months is the social cost of higher oil prices. With resurgent demand coinciding with production shortfalls and low investment in new supply, there would not appear to be an obvious short-term remedy. Mitigating climate change risks and containing energy related inflationary pressures will require delicate management.

- Staying with the social perspective, the durability of a business is dependent on it treating its customers, employees and suppliers with care and respect. Aberforth looks for evidence of how companies treat stakeholders and believes that can inform on the culture, which ultimately affects valuation.

- Aberforth considers diversity and inclusiveness when assessing governance structures. Those companies able to create and sustain cultures of inclusion are likely to attract and retain the best talent. Diversity is likely to improve decision making and so improve investment outcomes. Pragmatism, particularly for smaller companies, and fairness are also important considerations.

How Aberforth engages and votes on these issues is described in Principles 9 to 12. Further information can be found in the engagement and voting policies, linked HERE and HERE respectively.

Activity

Integration of stewardship and investment is straightforward, facilitated by Aberforth's ownership, client engagement and portfolio management structures. As described under Principle 2, all investment managers are normally also partners of the firm. This ensures that the importance placed by the firm on issues such as ESG flows directly into company analysis, engagement and the management of clients' portfolios.

In practice, the firm divides the stockmarket by sector between its investment managers. Therefore, for the purposes of company analysis and the implementation of stewardship, one manager has lead responsibility for each company. In challenging and time-consuming situations, or when the clients' combined stake in a company exceeds 10%, a second investment manager is appointed to support the lead. A similar approach is taken to client engagement, with each client relationship led by two investment managers. Decision-making, whether at the portfolio management or client engagement level, is undertaken collegiately by the investment management team or, if relevant, by the partners including the operations partner.

Moreover, engagement with clients is also undertaken by the investment managers and so there is no barrier to the implementation of clients' objectives, time horizons and instructions into the investment process. This degree of integration is possible because of Aberforth's small size, the experience of its investment managers and its relatively flat hierarchy.

During the year, Aberforth enhanced its proprietary database to improve the assessment of ESG risks and opportunities for investee companies. This followed an exercise to evaluate the offerings of third-party service providers, the conclusion of which was that a bespoke internal system would provide more complete and comparable data on small UK quoted companies. The framework is now embedded in the bottom-up process and is expected to aid the judgement of companies' intrinsic value. Both risk and opportunities are considered, and insights are drawn from the research of external providers such as the Sustainability Accounting Standards Board (SASB) and the CFA Institute.

To support the population of the proprietary database and to understand progress on relevant ESG matters for individual companies, Aberforth conducted an ESG survey across its investee companies during 2021. The primary objective was to enhance the investment managers' understanding of the risks and opportunities that climate change brings to portfolio companies. The survey also addressed the diversity policies of investee companies' boards. Analysis of the responses will inform engagement agendas for investee companies in 2022.

Integration of stewardship into the investment process, including the ESG risk framework, is subject to an annual review by the Stewardship Group, whose role is set out more fully under Principle 2. The first annual review is scheduled to occur in the third quarter of 2022.

Outcome

Aberforth has a long record of frequent and in-depth engagement with investee company boards, which, together with its voting commitment, demonstrates the importance of stewardship to the investment process.

Given the frequency of engagement, stewardship considerations affect the overwhelming majority of investment decisions, from new purchases to exit decisions. These investment decisions are always taken in the interests of long-term value for clients and investors, though, as described above, benefits to the economy, environment and society are also considered. The monitoring examples below pertain to engagement on ESG issues with existing holdings. From next year, the enhancements to Aberforth's internal systems should enable incremental disclosures on ESG matters.

Example: Anglo Pacific [Environment – monitoring/ decision to purchase]

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: Crest Nicholson [Social – monitoring]

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 [Environment – monitoring]

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: Forterra [Environment – monitoring]

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: McKay Securities [Environment – monitoring]

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 [Environment – monitoring]

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: Vesuvius [Environment – monitoring]

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.

Principle 8

Signatories monitor and hold to account managers and/or service providers.

Context

Aberforth has few third-party service providers in the area of stewardship and has instead chosen to conduct most of these activities internally and directly. The firm has a long-standing relationship with a proxy voting adviser and has also contracted with a provider of carbon data since 2020 following a review of various environmental data vendors.

All other third-party services such as custodianship, audit, IT and cyber risk management are covered by wider company policies and risk management documentation.

Activity

External data provider relationships are subject to formal annual review but in practice are assessed continually throughout the year based on the timeliness and quality of their individual reports.

To date, proxy voting service provided has been satisfactory. Further information on Aberforth's voting policy can be found HERE.

The contract with the carbon data provider has been renewed for 2022. The report is informative and has been particularly useful for understanding the broad carbon characteristics of the portfolio versus the benchmark.

Other third-party providers of ESG information and data are kept under periodic review. As part of the enhancement of the ESG component of Aberforth's proprietary database in 2021, the firm conducted a formal review of the data providers again.

Outcome

While Aberforth employs the services of a proxy voting adviser, investment managers are under no obligation to follow its recommendations and on many occasions take a different view. It is also the case that interaction with companies on issues raised by the proxy adviser can lead to a change in the investment manager's original voting decision. Internal reporting systems have been modified during 2021 to ensure the capture and recording of instances in which the firm has voted against the proxy advice recommendation.

As in previous years, the review of external ESG data providers has informed Aberforth's view that the measurement and evaluation of relevant factors cannot reliably be outsourced to a third-party. This is because of the lack of consistent methodology and inadequate coverage of the small UK quoted companies amongst the data providers. As a result, Aberforth has enhanced its proprietary database. Inputs are taken from engagement with companies, from ESG disclosures within annual accounts. These are supplemented by external carbon data.

Principles 9, 10 and 11

Signatories engage with issuers to maintain or enhance the value of assets.

Signatories, where necessary, participate in collaborative engagement.

Signatories, where necessary, escalate stewardship activities to influence issuers.

Context

Aberforth's policy on engagement can be found HERE. Responses to Principles 9, 10 and 11 have been combined to avoid repetition and to reflect the related nature of the three components.

Regular, open and constructive engagement with the executives and boards of investee companies has always been an essential element of Aberforth's investment philosophy and process. Aberforth engages directly and believes that its clients and investee companies benefit from a policy of discretion on live engagements. The firm's experience is that ill-timed disclosure and public confrontation hinders the chances of successfully effecting change.

A flexible approach to engagement is important. This reflects the diversity of business models and differing specific circumstances facing individual businesses, particularly within the universe of small UK quoted companies. Moreover, Aberforth is conscious that the broader economy benefits from a thriving smaller companies sector and that this may be stifled by a one-size-fits-all engagement policy.

While determined to encourage high standards of stewardship and corporate behaviour, Aberforth does not wish to burden small company boards unnecessarily with engagement guidelines that can appear to have been designed for larger companies. This, for example, might mean taking a pragmatic view on compensation in acknowledgment of the considerable competition for executive talent.

Activity

Aberforth's clients in aggregate often hold significant stakes in investee companies. The investment managers tend, therefore, to have good access to executive and non-executive directors. The preference is for face-to-face meetings, particularly when addressing sensitive topics. Meetings at the firm's Edinburgh office makes it easier for several members of the investment management team to participate. In practice, much of Aberforth's engagement is conducted through phone calls and e-mail.

The prioritisation of engagements is undertaken by the investment committee at its formal weekly meeting and *ad hoc* as required. Engagement is conducted by the investment managers. Their number and experience allow multiple engagements to occur at any given time. The investment manager with responsibility for the company presents the investment case to the investment committee and, if necessary, proposes an engagement strategy. The ensuing discussion, which takes into account the holding size and the ability to influence, results in the agreement of an engagement strategy and objectives. In common with the context and activity outlined in Principles 1 and 6, the objective of this engagement will be to either preserve or enhance value for clients. This way of operating is consistent across all Aberforth's client mandates.

As part of on-going due diligence and appraisal of the investment universe, Aberforth typically meets executive directors of each investee company at least twice a year. The format for meetings is typically in-person at Aberforth's Edinburgh office, but the investment managers also travel to London or companies' headquarters as needed. These meetings address operational and financial performance, competitive positioning in the context of broader industry developments, outlook, strategy and capital allocation, all of which might involve environmental, social and governance issues. The outputs from these engagements are used to inform a view on a company's underlying value, which allows it to be considered in the broader capital allocation process.

Interaction with executives helps to understand a company and the issues affecting it, but the chair's role is pre-eminent within the UK's governance regime. The chair has oversight of the executives and is responsible for strategy and capital allocation. Accordingly, Aberforth's engagement approach emphasises contact with the chair. The frequency and depth of engagement with the chair increases proactively as the stake held by the firm's clients rises and reactively should the investment case deviate from its expected path. Aberforth also values engagement with the senior independent non-executive director (SID) and other non-executives. This becomes particularly relevant when the chair's performance is in question. In addition to the topics raised in executive meetings, engagement with non-executives can address upcoming votes, remuneration, executive performance, board succession, corporate strategy and capital allocation.

As part of its engagement approach, Aberforth operates a formal "significant stakes" process, which commences when clients' collective interests exceed 10% of the voting rights in an investee company. This triggers a review of the investment case pertaining to the company and engagement requirements, though becoming a "significant stake" is not in itself a reason to escalate engagement. An additional investment manager is assigned to the company. That manager may participate in meetings with directors and provides additional rigour and challenge to the existing investment case. "Significant stakes" are reviewed collectively and formally at least once per year. The upper limit for a "significant stake" is 25% of the voting rights of an investee company. Such a stake brings great influence, though Aberforth does not seek board positions. Rather, its *modus operandi* is to work with and through the company's executives and independent non-executives.

Since Aberforth's clients are often large holders of investee companies, the investment managers are usually able to engage directly and effectively with board members. There are, however, instances when a collective approach to engagement may be appropriate. These collective engagements can occur when Aberforth considers the cumulative holdings of the firm's clients insufficient to effect change. The firm's interaction with other investors is influenced by the terms of the Takeover Code. Beyond specific engagements, Aberforth sees value in the sharing of views with other industry practitioners and in participation in industry forums.

Escalation of engagement normally occurs when an investment thesis starts to stray from the expected path. The escalation process exists to protect the interests of Aberforth's clients. The weekly investment meeting is the forum for formal consideration of the status and effectiveness of live engagements. The investment manager responsible for the company in question leads the discussion, which involves analysis of the situation and the progress made to date. In discussion with the rest of the investment management team, an escalation plan is formed. The plan seeks to address the concerns of Aberforth and propose how, and in what time frame, they might be remedied. The first move in an escalation is usually to engage with the chair, but, if the chair is considered part of the problem, the focus turns to the senior independent director. Aberforth may also contact the company's advisers and other investors to inform them of concerns. Other options include a formal letter expressing concerns and expectations to the board, as well as the requisition of an Extraordinary General Meeting. In practice, the "significant stakes" process described above often overlaps with, and forms part of, an escalation plan.

Outcome

Meetings with board members of investee companies are an important element of Aberforth's investment process. Each year, there are several meetings with each holding. During 2021 Aberforth conducted 380 executive level meetings and 116 non-executive meetings with companies held in its portfolios. These numbers compare with 396 and 125 respectively during 2020. Covid-related restrictions meant it was another year in which most meetings were by video conference. Whilst remote formats have a place in broader engagements, Aberforth values a return to in-person meetings, which can be more effective in building relationships with executives and boards.

Engagement may also happen by e-mail and phone call. Such formats are often more spontaneous, which means not all engagement activity of this sort was fully captured in 2021. Therefore, the numbers reported above under-state the degree of engagement conducted.

As companies began to recover from the impact of the pandemic, engagements in 2021 took on a different theme from the defensive one of 2020.

- M&A activity returned to UK markets as international acquirers sought to capitalise on valuation opportunities created by the pandemic. This saw Aberforth support bids where full value could be realised, but also encourage the rejection of unsolicited offers where fair and full value was not reflected.
- There was little equity issuance as company balance sheets proved resilient even under the impact of the pandemic. The few instances of equity raises about which Aberforth was consulted pertained to companies looking to fund a growth strategy amid competition that had been weakened by the pandemic.
- The trajectory of recovery was challenged by growing supply chain problems as companies struggled to match the pace of the demand recovery. Engagements therefore explored individual companies' sourcing strategies, stock levels and ability to deliver orderbooks.
- Linked to the demand recovery and the supply chain challenges is the potential for rising inflation. This was another theme of engagement as Aberforth tested its research against companies' appraisal of their pricing power.

Principle 7 referenced the development of Aberforth's proprietary database to improve the assessment of ESG issues and their effect on companies' valuations. A secondary benefit is to enhance the monitoring and reporting of trends within the portfolio related to specific ESG factors. This is likely to see the number of environmental and social engagements increase in future years.

The engagement examples below demonstrate the range of issues addressed in meetings with investee companies during the period.

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: 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: 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: 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: 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: 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: 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: 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.

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.

Principle 12

Signatories actively exercise their rights and responsibilities.

Context

There are three main methods by which Aberforth exercises its rights and responsibilities.

- The investment managers engage with the boards of investee companies in order to understand the companies' strategies and governance and, if necessary, to effect change. The ability to engage is improved by Aberforth's willingness to take meaningful stakes in investee companies. On most occasions, issues of board structure, dividend policy, remuneration and share issuance permissions will have been discussed before these issues are put to shareholders for approval at a General Meeting.
- Voting is a fundamental right for shareholders and is an important means by which Aberforth exercises stewardship on behalf of its clients. The firm's policy is to vote on every resolution put to shareholders at a General Meeting. Aberforth voted on all items at all general meetings over the past year, in line with its policy. Because of the depth and frequency of engagement with the boards of investee companies, Aberforth will have had the opportunity to influence important issues before they are put to shareholders at a General Meeting. This results in fewer votes against the board or abstentions than might otherwise be expected.
- The third method is to sell a holding – a basic concept but one that sets listed equities apart from some other asset classes. When an investee company encounters operational difficulties, Aberforth will typically engage to understand if a change of strategy or of personnel on the board might plausibly contribute towards an improvement in the company's prospects. If that does not appear forthcoming, Aberforth will typically exercise its right to sell the holding.

Aberforth manages four client funds, as described under Principle 6. Three of the funds follow the firm's voting policy, with the firm exercising the voting rights. The segregated charity account retains its own voting rights and, while it receives voting advice from Aberforth, may choose to override Aberforth's policy. Aberforth's three collective funds do not engage in stock lending. The segregated charity fund may do so.

Research from Aberforth's proxy adviser, ISS, is considered, but the firm does not automatically follow ISS' recommendations. Aberforth takes a pragmatic, rather than a prescriptive one-size-fits-all approach, which has proven beneficial over time. This acknowledges the heterogeneous nature of the universe of small UK quoted companies and the proportionately greater governance burden on the typical small company.

Further information on Aberforth's engagement and voting framework can be found HERE.

Activity

Votes were cast on all resolutions in respect of all shares held under Aberforth's voting control. No voting decisions were taken by another entity on behalf of these shares. Shareholdings and voting rights are monitored through in-house fund accounting systems and ISS, which are reconciled with custodians' records.

	For	Against	Abstain
Aberforth Partners	1,687	3	22
ISS Voting Guidance	1,640	65	7
Aberforth Partners	98.5%	0.2%	1.3%
ISS Voting Guidance	95.8%	3.8%	0.4%

The above table summarises Aberforth's voting statistics during 2021 and compares them with ISS voting guidance. Of the 1,712 resolutions voted, Aberforth was for 1,687, against 3 and abstained on 22. As previously explained, Aberforth's lower proportion of votes against or abstentions compared to ISS' guidance reflects the regular dialogue with investee companies. This often results in Aberforth being consulted on major issues and being able to influence them before they are put to a resolution. Throughout the year, Aberforth voted at 116 meetings with 95 portfolio companies, of which 93 were general and 23 were special meetings.

Outcome

Votes AGAINST or ABSTAIN 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.

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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