ALLAN GRAY

Stewardship and Business Sustainability Reports

CALENDAR YEAR 2020

ENVIRONMENTAL

SOCIAL

GOVERNANCE

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People have wide-ranging opinions on what should be defined as a "sustainable" or "responsible" investment.

Tesla is a great example. Many view it as the flagship stock pick for those focused on environmental, social and governance (ESG) factors, believing it has revolutionised the car industry and accelerated the world's move towards a clean energy future. This was a substantial driver of its meteoric rise to join the S&P 500 in 2020.

However, deeper research shows a more complicated picture. Various ESG ratings providers have rated Tesla low on ESG issues overall, citing very low social scores due to concerns over labour management, as well as low governance metrics. In fact, some rank Tesla as higher risk from an ESG perspective than some of the traditional automobile makers. Knowing this, should Tesla's environmental contribution outweigh its social and governance considerations?

We think the bigger picture is always important. Companies have positive and negative ESG impacts and forming a holistic view based on these is far more complicated, and at times subjective, than it seems at face value. We attempt to illustrate this in our latest Stewardship Report, and in our responsible investing documents and policies, that are available on our website. At Allan Gray we value independent thinking and strive to do what we believe is right. We remain open to engaging with those with a different perspective and committed to improving our ESG processes year on year.

We also continue to engage with management and boards on improving governance and ensuring that incentives are linked to long-term value creation. This is an area where we believe we can add value to the underlying businesses that our clients are invested in. Because we recognise that there are sometimes complexities that are difficult for those outside the boardroom to know, we place a lot of weight on actual outcomes that can be measured and judged. Stronger governance tends to be linked to stronger environmental and social performance as well.

We hope you find value in this report and our Business Sustainability Report that follows on page 23. While 2020 will forever be synonymous with the COVID-19 pandemic, we expect the ongoing challenges of climate change, social inequality and biodiversity loss to lead the ESG agenda in 2021. If you have any questions or feedback, please email info@allangray.co.za.

Your sincerely
Duncan Artus
Chief investment officer

Stewardship Report

Duncan Artus, Raine Naudé and Vuyo Mroxiso

A. OUR APPROACH TO RESPONSIBLE INVESTING

Investment managers take different approaches to responsible investing. At Allan Gray, our approach is to integrate environmental, social and governance (ESG) factors into our investment process to better manage risk and improve returns. While our reporting on ESG matters has increased, we have been using this approach since the company was founded in 1973.

ESG is integrated into our investment analysis across all asset classes. In relation to equities, our ESG research and engagement efforts prioritise companies with a material weight in our clients' portfolios, as well as smaller holdings in which our clients collectively own a material percentage of the company. In this way, our engagements and proxy voting have a greater ability to influence change.

For our fixed income holdings, we consider factors such as policymaker/counterparty credibility, which includes governance considerations, as well as how environmental and social factors influence the macroeconomic environment. We also consider issuer-specific environmental and social factors.

Engagement can be more difficult on the fixed income side, as counterparties are often governments or parastatals. Our positions are generally small in relation to the market capitalisation of total debt. Furthermore, bondholders do not benefit from the same powers of ownership conferred on shareholders; for example, they cannot vote to remove directors.

We engage with debt issuers' management during periodic debt investor roadshows, which most frequently occur after financial results are published or before an issuer intends to come to market with a new issue. In the case of corporates and parastatals, where we may be a more significant lender, we may request conference calls with key management when specific issues arise. Most of the corporates in our investment universe are also listed on stock exchanges, allowing us to leverage off the equity process – because bondholders and shareholders broadly share the same ESG concerns. While we do try to have constructive engagements with governments and parastatals, our approach for these issuers is more heavily weighted towards research. In the case of governments, our ability to influence policymakers is limited by our comparably small size.

For both equities and fixed income, we continue to monitor ESG factors once we are invested. This is crucial because ESG issues are dynamic and sometimes concerns may only arise further down the line.

We always aim to do what we believe is right. This does not mean taking a binary view on whether investments are "good" or "bad" and making related portfolio exclusions or inclusions. Instead, we undertake fact-based, in-depth, and holistic research to inform our investment decisions. Where we are invested in instruments that have negative environmental or social impacts, we encourage a focus on minimising harm and take a firm line in holding management and boards to account.

We believe that good stewardship of our clients' capital requires truly active ownership. We engage frequently and meaningfully with company boards and management teams and think critically about how we vote on behalf of our clients at company meetings. In addition to engaging with our investee companies, we actively partake in initiatives that promote sound corporate governance and sustainable business practices. This includes participation in private- and public-sector discussions as well as formal commentary on public policy papers and regulatory updates.

While we use a multiple portfolio manager system – where each portfolio manager manages a slice of the portfolio, making their own investment decisions – and view it as key to our success, additional oversight is provided by the chief investment officer (CIO) and the Allan Gray board. Our CIO is able to veto investments by other portfolio managers in cases where he determines that the company's business practices are unethical in nature. The Allan Gray board further holds the CIO to account, including for his use of (or decisions not to use) this veto.

We strive to maintain a high standard of ESG integration and disclosure. We have been a signatory of the United Nations supported Principles for Responsible Investment (PRI) since 2013, which involves annual reporting on our ESG research and engagements.

For more information on our approach to responsible investing, please consult the following documents on our website:

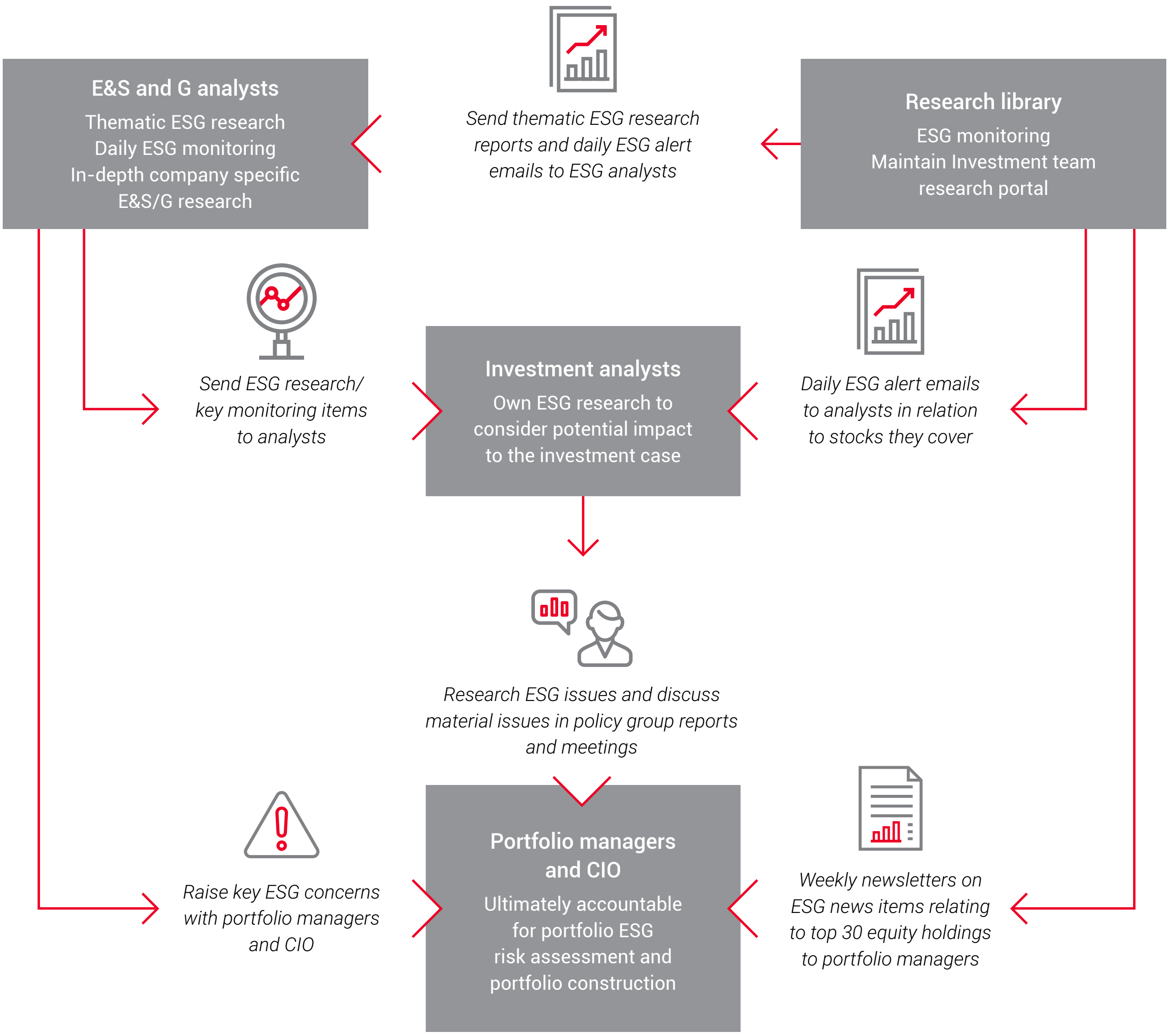
- Policy on incorporation of sustainability considerations
- Policy on ownership responsibilities
- How we think about climate change and investing

B. ESG PROCESS OVERVIEW

Our ESG research is conducted inhouse. Investment analysts are responsible for researching material ESG issues relating to the instruments they cover and highlighting these in their research reports. It is compulsory to include an explicit "Management, board and ESG" section, but the extent of coverage depends on materiality. Key ESG issues are debated in policy group meetings, at which we discuss investment opportunities and vote on buy or sell recommendations. ESG risks are further factored into company valuations, either by adjusting earnings or cash flow if the risk is quantifiable, or by valuing the company or division on a lower multiple if the downside risks are significant but uncertain.

The Investment team includes both a governance (G) analyst and an environmental and social (E&S) analyst, who perform additional monitoring, in-depth research into identified risk areas, and thematic ESG research. We also have a research library, which monitors company-specific ESG news and sends relevant news items to the analysts and portfolio managers. **Figure 1** is a diagrammatic illustration of the process.

Figure 1: ESG process overview



C. THE BIGGER PICTURE AND OUR ROLE

Sustainability is a key part of the Allan Gray investment philosophy. We believe that businesses and governments that do not operate in a sustainable and responsible manner will struggle to deliver favourable results over the long term. In South Africa, this means taking the social context into account: Transformation is an important part of business sustainability.

HOW DO WE FACTOR TRANSFORMATION INTO OUR ANALYSIS AND REPORTING?

As part of our investment process, we consider the board composition and governance structures of our investee companies. This includes assessing the diversity of the board and attempting to influence change where we can. We also assess B-BBEE schemes that are put to vote by our investee companies. We generally recommend that our clients approve the adoption of these schemes when structured in a way that truly aims to achieve broad-based transformation, while balancing this with the responsibility we have of ensuring minimal dilution to our clients' portfolios.

D. ESG PROCESS ENHANCEMENTS

- The Allan Gray Group board of directors has increased their oversight of the Investment team's ESG approach and processes. Please see section E "Accountability and oversight" for more detail.
- We began quarterly ESG meetings with our offshore sister companies, Orbis and Allan Gray Australia, effective Q3 2020. We hold two meetings per quarter: 1) Investment case updates and 2) Regulatory and reporting updates.
- Commencing in Q4 2020, the Investment team keeps track of politically exposed persons (PEPs) who serve as directors at our investee companies. While political exposure does not necessarily warrant a dissenting vote from us, we apply extra scrutiny and due diligence when deciding how to recommend our clients should vote.
- There have been ongoing improvements in our day-to-day ESG processes, for example, improvements to ESG data stored in our research portal and additions to the ESG section of our company contact notes where external engagements are recorded.
- We monitor ESG global best practice and changes in the ESG reporting landscape. While this provides a useful form of benchmarking, we continue to value independent thinking and at times may deviate from perceived best practice where we believe it is in our clients' best interests to do so.

E. ACCOUNTABILITY AND OVERSIGHT

Each equity policy group meeting held by our Investment team has two objectives:

1. Evaluate the company's investment case to form a view on the stock's intrinsic value versus current market price and vote on whether the stock is attractive or not.
2. Factor in all risks, including ESG risks, to vote on the stock's risk rating. The policy group's overall risk rating in turn limits the stock's maximum position size in our clients' portfolios.

While all Investment team members vote on the company's buy/sell strength and risk rating, votes are weighted according to seniority. Portfolio managers are ultimately accountable for the ESG risks in their slice of our clients' investment portfolios.

Our fixed income policy group meetings have a similar format but different voting system. We assign an internal issuer rating to each interest-bearing instrument prior to purchase, which is based on our view of its risk. The rating in turn affects the maximum allowed position size in the portfolio.

The Investment team has been preparing bi-annual ESG reports for the Allan Gray Social & Ethics Committee (SEC) since 2017. These reports include a discussion of key external ESG engagements held in the prior six months, internal ESG meetings held by the team, and a summary of material ESG risks to the portfolios at reporting date. Commencing in Q4 2020, the CIO and an ESG team member attend these SEC meetings to further discuss issues raised. During 2020, the Investment team also began reporting to the Allan Gray Group Audit Committee on ESG matters. These meetings will take place regularly going forward. This strengthens board oversight of our ESG function.

F. ENGAGEMENTS

Engagement is an integral part of our investment and proxy-voting processes. From an ESG point of view, our engagements typically include high-level information sharing with investee companies; our analysts requesting deeper insight into ESG issues; third-party meetings to obtain independent views on companies' performance; strategic engagements with company boards or management teams to attempt to influence change when deemed necessary and participation in industry initiatives that promote sound corporate governance and sustainable business practices. **Table 1** reflects the ESG engagements that took place in 2020.

In **Graph 1** we highlight our ESG engagements by key themes. Under the environmental category, climate change-related topics were our primary engagement theme. Not surprisingly, our 2020 social engagements focused on how management was prioritising workplace safety and managing their workforce under the exceptional circumstances presented by COVID-19 and various lockdowns. These engagements also extended to the “customer & societal considerations” category, in which COVID-19’s impacts on investee companies’ customers and broader society were discussed.

While executive remuneration remained our top theme for governance engagement in 2020, the pandemic brought about some unique engagements. Please see section G “Impact of COVID-19 on ESG factors” for more detail on this. We also provide detail on our key engagement case studies in section I “Key research, engagement and proxy-voting case studies”.

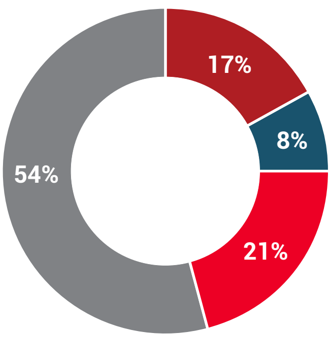
While 2020 was a year of fewer ESG engagements given the unique circumstances presented by the pandemic, we are pleased to note that since 2016 there has been an increase in our ESG engagements as a percentage of total engagements held with management teams, board members, and third parties. This is not a perfect measure but serves as a useful sense check to ensure we are moving in the right direction.

Table 1: ESG engagements

		Occasions when ESG issues were discussed		
Type of engagement	**Total number of engagements**	**Environmental**	**Social**	**Governance**
Meetings	213	35	67	101
Written correspondence	18	0	0	13
Site visits	2	0	0	0
Other forms of engagement	179	16	28	15
Total	412	51	95	129

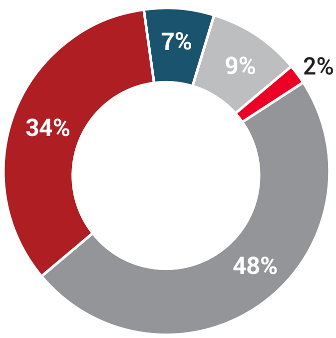
Source: Allan Gray

Graph 1: ESG engagements by theme



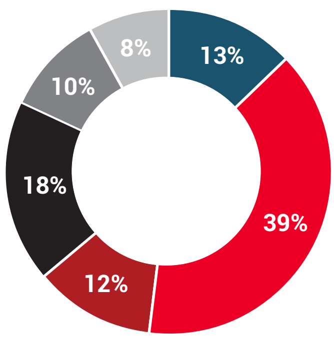
Environmental engagements

- Climate change, renewable energy & related
- Environmental considerations in mining sector
- Policy, regulation, legal & compliance
- Other



Social engagements

- Workforce & supplier considerations
- Customer & societal considerations
- Transformation / B-BBEE
- Community relations
- Policy, regulation, legal & compliance



Governance engagements

- Executive remuneration
- Board composition, appointments & resignations
- Executive management matters, leadership changes & succession planning
- Governance structure, strategic partnerships & related parties
- Company ethics, corruption allegations & regulatory compliance
- Other

Source: Allan Gray

G. IMPACT OF COVID-19 ON ESG FACTORS

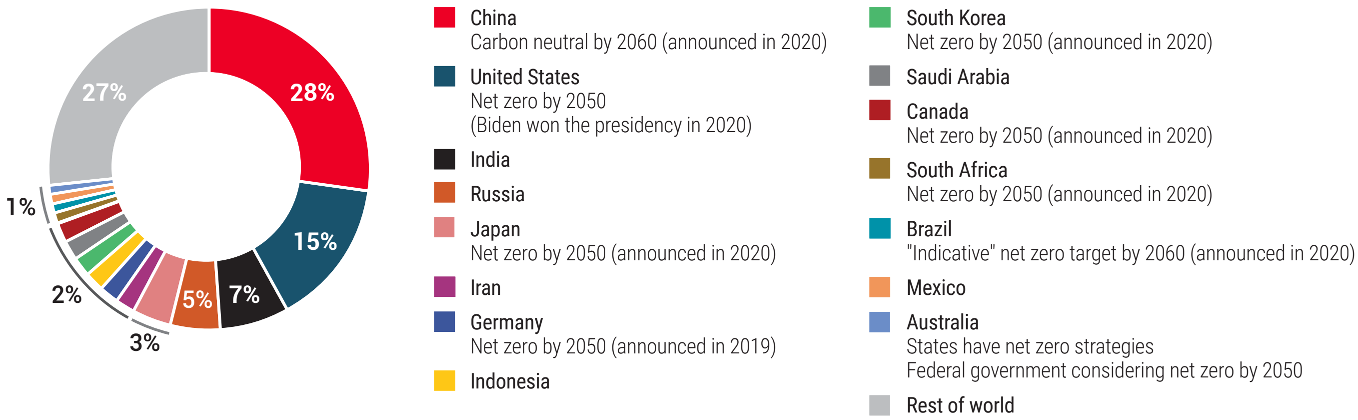
Over the last year, dealing with the impact of COVID-19 has been at the top of company and government agendas. We spent a lot of time considering the potential impact on our clients' portfolios and evaluating our positions, given heightened uncertainty. Our analysis and engagement topics therefore included the impact of the pandemic on business operations, both over the short and long term. For more context, below we discuss some ESG factors that were impacted by, or arose as a result of, COVID-19.

IMPACT OF THE PANDEMIC ON ENVIRONMENTAL FACTORS

While initial fears were that COVID-19 would set back action on climate change as the world focused on economic recovery, governments and corporates seem to be taking the opportunity to reflect on how to "build back better". In fact, 2020 saw the acceleration of climate change commitments around the world. The most noteworthy of these were long-term net zero carbon targets announced by China, the US, Japan, South Korea, and Canada, which together account for 50% of global carbon dioxide emissions (see **Graph 2**). By 31 December 2020, over 100 countries, including South Africa, had pledged to achieve net zero carbon emissions by 2050. While most of these targets are voluntary, and in some cases seem far removed from what is happening on the ground, they are still instructive. Action on climate change is on the global political agenda and governments' COVID-19 recovery strategies and stimulus packages are incorporating a green transition. **Figure 2** on page 7 explains what "net zero" refers to, while **Figure 3**, also on page 7, shows how progress is reflecting at a regional and city level.

Similarly, corporate climate commitments, including commitments from hard-to-abate emitting sectors such as steel, cement, shipping, and aviation, have escalated. In **Figure 4** on page 8 we highlight some prominent names that have joined the race to net zero. Again, the devil is in the detail, and it remains to be seen how aspirational targets will be turned into clearly defined strategies and actions over the short, medium and long term.

Graph 2: Carbon dioxide emissions per country and related climate commitments



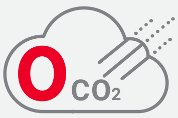
Sources: Allan Gray research; World Resources Institute

Figure 2: Net zero commitments

THE RACE TO NET ZERO

Net zero carbon targets refer to the global goal to reduce net global carbon dioxide emissions by **±45%** by 2030 (from 2010 levels) and reach net zero by 2050 to have a chance of limiting median global warming to **1.5°C**.

Net zero commitments vary based on the scope of emissions included. These include:



1. **Scope 1 emissions:** Direct greenhouse gas (GHG) emissions from company operations (i.e., on-site fuel combustion).
2. **Scope 2 emissions:** Indirect GHG emissions from energy consumed by the company (purchased electricity).
3. **Scope 3 emissions:** Indirect GHG emissions in the value chain, mostly from end use of products sold.

Source: Allan Gray research

Figure 3: Global progress in net zero commitments from 2019 to 2020[i]

Net zero commitments by sector 2019 – full calendar year			2020 – 9 months to 30 September 2020		
Regions	Cities	Companies	Regions	Cities	Companies
11	100	500	101	823	1 541

Source: i. Data-Driven EnviroLab & New Climate Institute, 2020

Figure 4: Notable commitments to net zero by 2050 (as at December 2020)

Notable corporate commitments

US S&P 100 companies	UK FTSE 100 companies
26% have set net zero goals ↑ (2019: 6%)[i]	**45% have set net zero goals** ↑ (2019: 20%)[ii]

Noteworthy commitments by fossil fuel producers

COAL	**40% of global carbon dioxide emissions** **28% of global GHG emissions**	**Glencore**, the world's largest seaborne coal producer, committed to a 40% emissions reduction by 2035 and net zero by 2050, including in scope 3 emissions (December 2020).
OIL & GAS	**55% of global carbon dioxide emissions** **39% of global GHG emissions**	As far as we are aware, **Repsol** is the only oil major to have committed to net zero emissions that includes a 100% reduction in its scope 3 emissions by 2050 (December 2019). However, still-noteworthy commitments in 2020 included **BP**, **Shell**, and **Total** committing to net zero on scope 1 & 2 emissions (February – May 2020), aligning Total with European peers. On scope 3 emissions, their commitments were: BP – a 50% intensity reduction, Shell – a 65% absolute reduction and Total – a 60% absolute reduction, all by 2050.

Noteworthy commitments within high emitting/hard-to-abate sectors[iii]

IRON & STEEL	**6.0% - 7.2% of global GHG emissions**	**ArcelorMittal**, the world's largest steelmaker.
CEMENT	**3.0% - 4.0% of global GHG emissions**	**LafargeHolcim**, the world's largest cement producer, became the first building material supplier to commit to this (September 2020).
ROAD TRANSPORT	**11.9% of global GHG emissions**	**Ford**, the third largest automaker globally by market share (June 2020). By the end of 2020, many of the world's top automakers such as **Volkswagen**, **BMW**, **PSA Group**, **Groupe Renault**, **Volvo** and **Mercedes-Benz AG** had approved science-based targets, while **Toyota** and **Nissan** have committed to set these targets.
AVIATION	**1.9% - 3.0% of global GHG emissions**	**IAG**, parent to British Airways, became the first airline group to commit (October 2019), closely followed by **Qantas** and **Air France**. In 2020, 10 more airlines followed suit, including **Delta** and **American Airlines**.
SHIPPING	**1.7% – 2.7% of global GHG emissions**	**A P Moller-Maersk**, the world's largest container shipping company, was first to commit (2018) and in 2020 co-launched a "Transform to Net Zero" initiative with some of the biggest companies in the world, encouraging cross-sector collaboration to meet emissions reduction pledges.

Sources
i. Yale Centre for Business and the Environment, "Net zero: the next frontier for corporate sustainability", December 2020.
ii. EcoAct, "The sustainability reporting performance of the FTSE 100", September 2020.
iii Ourworldindata.org, "Global greenhouse gas emissions by sector - 2016"; Shell, "Greenhouse gas emissions in shipping"; Allan Gray research.

What is the outlook for fossil fuels?

Considering that fossil fuels still account for 84% of primary energy demand, the climate commitments being made today require a complete rewiring of the global economy. 55% of global oil demand and 46% of gas demand are from countries that have already committed to net zero by 2050 (or 2060 in China's case)[1], but this transition needs to be structured in a way that is socially conscious and economically sensible given associated disruption costs. This is no mean feat. However, what is becoming clearer is that political momentum, rapid technological progress, and growing consumer preference for green alternatives will continue to push the boundaries of what was previously considered impossible.

Together with climate action, COVID-19 has likely accelerated the decline of fossil fuels. Today, global oil demand is still six to seven million barrels of oil per day (bbl/d) lower than the total 100 million bbl/d consumed in 2019, as oil demand slowly recovers. Whereas previously most analysts were forecasting peak oil after mid-2030, several recent energy outlooks have brought this forward to anywhere between the early 2020s and early 2030s. In the short term, COVID-19 continues to negatively impact emerging economies (previous growth regions for oil consumption) and may result in permanent changes in travel-related behaviour globally, while the potential longer-term impact of electric vehicles (EVs) replacing internal combustion engine vehicles (ICEVs) remains the greatest threat.

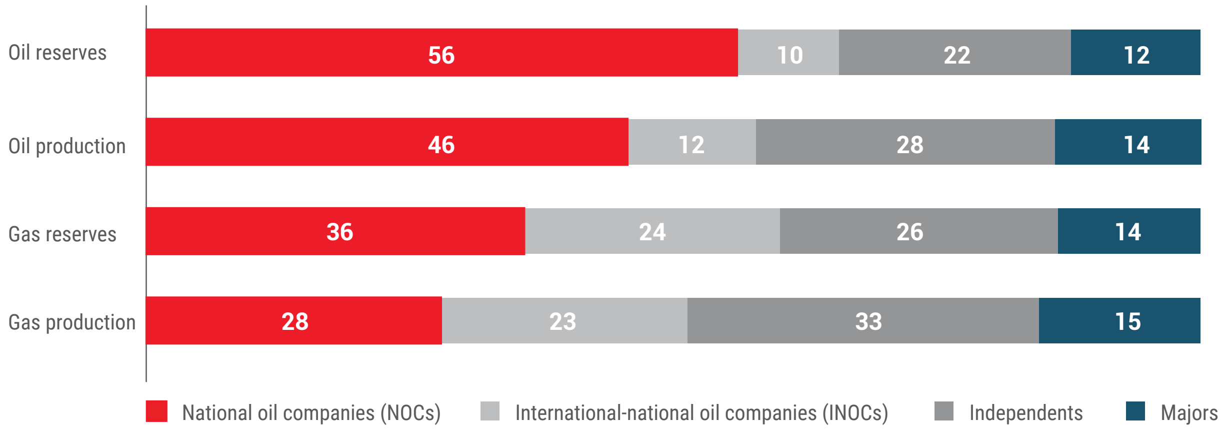
Most "base case" outlooks for gas still forecast consumption expanding into the late 2030s. This contrasts with a 2050 net zero scenario, in which it would peak in the 2020s and decline rapidly post-2030[2]. The superior outlook for gas is largely due to its flexibility versus coal, making it a better baseload power generation match to support growing variable renewable energy in the grid, as well as its lower greenhouse gas (GHG) emissions profile – a gas fired power plant emits roughly 50% less than a coal power plant. It will also continue to be used in industrial applications. However, there is concern over whether it should be used as a transition fuel, given its significant methane emissions during extraction. It remains to be seen how this will play out.

The reality is that fossil fuels will continue providing baseload grid support while the world adjusts to increasing penetrations of variable renewable energy, as seen in Germany. We need to work on planning for grid infrastructure upgrades, further development of stationary storage, adjusting our grids for potential changes in the shape of grid loads (for example, incentivising EV charging at renewable energy peak times versus evenings, to act as storage for their excess generation) and adjusting pricing mechanisms, amongst other things. The recent polar vortex in Texas and subsequent grid failures, which left millions without power, were in some cases incorrectly blamed on renewable energy. While it was actually a broader system and planning failure, which included heavy reliance on natural gas, it does show that 1) grid diversification is an important anti-failure mechanism and 2) adequate planning is critical to avoid crises as we move forward.

The future of fossil fuels relies not only on demand, but also on supply-side dynamics. Oil is a depleting resource, meaning that constant investment is required to maintain the status quo. According to the International Energy Agency (IEA), global production from existing fields declines at roughly 8% per annum in the absence of any investment[3]. As oil & gas companies come under increasing scrutiny and struggle to spend more capital on replenishing declining reserves, there is a credible scenario in which supply declines quicker than demand, leading to higher oil prices and a better outlook than the markets are pricing in. OPEC+ behaviour is also a big factor in the future of oil, particularly because state-controlled/national oil companies (NOCs) in these countries have some of the lowest cost reserves and face different pressures to publicly listed companies. NOCs accounted for 66% of global oil reserves and 58% of production in 2018, while the oil majors, which face the most scrutiny on climate action, accounted for 12% and 14% of global reserves and production, respectively[3] (see **Graph 3** on page 10).

As for coal, even before COVID-19 the field was mixed on whether demand had peaked in 2013. This now seems fairly certain, although recent developments in China are worth watching. The future of coal is most relevant to the Johannesburg Stock Exchange (JSE), given that coal-exposed companies on the JSE include Sasol, Glencore, BHP, Anglo American, Exxaro, South32 and African Rainbow Minerals. **Graph 4** on page 10 shows historical global coal consumption based on IEA data. While global coal demand dropped by an unprecedented 5% in 2020 due to the impact of rolling COVID-19 lockdowns, the IEA projects a partial bounce-back of 2.6% in 2021 due to increased

Graph 3: Percentage share of oil & gas reserves and production by company type



Sources: International Energy Agency, Allan Gray

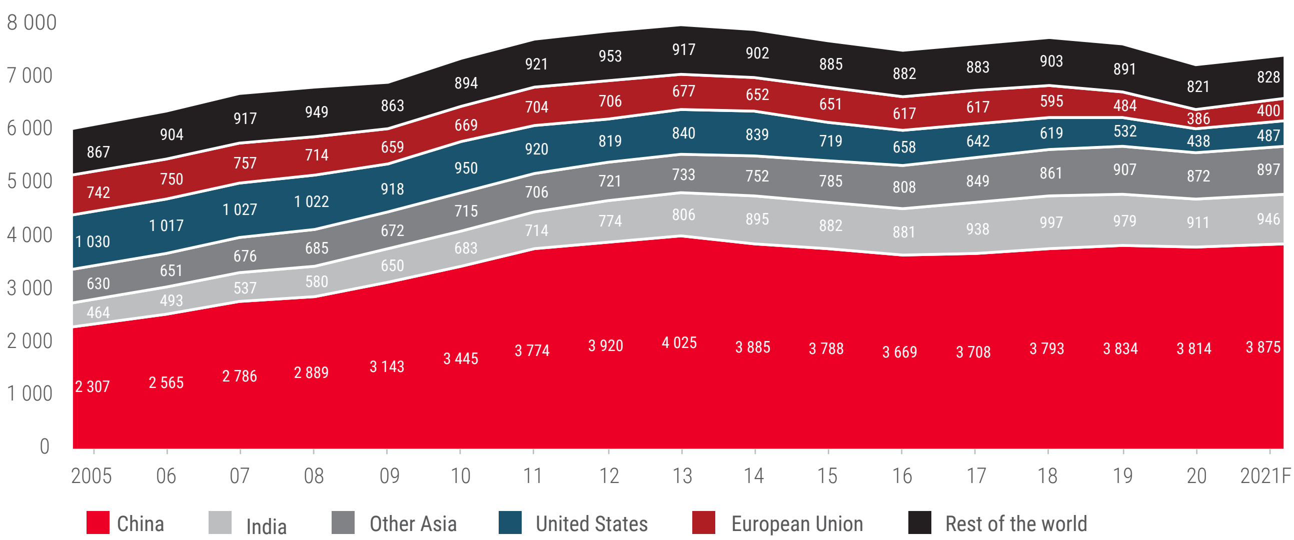
demand from China, India and Southeast Asia[4]. We still have a long way to go to get to zero. China and India together consume 65% of the world's coal[5], making their actions amongst the most important in the world's response to climate change.

Graph 4 includes thermal coal, used primarily in coal power generation, and metallurgical coal, used primarily in the most common steelmaking process. Coal use in steelmaking is an interesting example when it comes to thinking about the energy transition. Steel is a critical material in construction, transport, machinery and much more, making it the world's second largest commodity value chain after crude oil[6]. It is also an essential part of global decarbonisation. For example, steel and iron materials account for 80-89% of a wind turbine's mass, with a 2 megawatt (MW) onshore wind turbine weighing around 240 000kg and a 3.45MW turbine weighing 600 000kg[7]. Currently the majority of global steel production requires metallurgical coal, ironically making it an essential part of decarbonisation today. This is not to say that it should or will always be this way – research and development is ongoing – but it demonstrates the complexities involved in the energy transition and why we believe in constructive engagements to transition our economies as opposed to fossil fuel divestment.

What does all the above mean for the future of fossil fuel-related companies?

From an investment perspective, most important to note is that not all coal and oil is made equal. While there will undoubtedly be losers as the world shifts away from fossil fuels, and we are already starting

Graph 4: Global coal consumption by region (million tonnes)



Sources: International Energy Agency, Allan Gray to see this, the following considerations are critical to the investment case of each company:

- **The price you are paying**. This is the single most important factor in any investment. Every investment involves risk and reward. To mitigate risk, you ensure that the price you pay more than compensates for this. In some cases, we may view the risk as too great for the company to be investable.
- **Geographical location.** Asia, for example, now consumes over 75% of the world's coal[5]. Large importers include China, India, Japan and South Korea. Australian coal producers are at an advantage versus Colombian coal producers: Europe and North America have accounted for the bulk of Colombia's coal exports and demand is now in decline. That said, the recent tension between China and Australia raises different concerns, so geopolitical risk is an important consideration too.
- **How diversified the company's revenue is**. All else being equal, it would be far less appealing to invest in a 100% thermal coal miner versus a diversified miner with 20% coal exposure but also strong exposure to critical metals needed for the energy transition.
- **Where these assets are situated on the industry cost curve and, increasingly importantly, the carbon intensity curve.** High carbon intensity assets are likely to become less competitive sooner as carbon prices increase globally, which is unanimously viewed as the most essential policy tool to achieve the energy transition.
- **The company's contribution to climate change.** It is estimated that in the 28 years between 1988 and 2015, the fossil fuel industry's cumulative carbon dioxide emissions were equivalent to its emissions in the 237 years before this[8]. From 1988 to 2015, just 25 companies have been responsible for 51% of industrial GHG emissions. Extending this coverage by another 25 companies, the top 50 emitters have contributed over 60% of industrial GHG emissions. This split is roughly 45% from NOCs, and 18% from publicly listed companies, of which 2.3% is from JSE-listed companies[9]. We have isolated these because they are in our investment universe. These companies are BHP, Anglo American, Glencore and Sasol and as a result have been the focus of our climate-related research efforts.
- **How the company is adapting its strategy to survive in a changing world**. The commitments made by some of the world's hardest-to-abate sectors shows that substantial research and development is taking place and innovation is likely to accelerate. For example, oil majors such as ENI, Equinor and BP have committed 18-20% of their capital expenditure budgets to low carbon projects between 2021 and 2025[1], while Wood Mackenzie recently reported that European oil majors accounted for nearly a third of offshore wind project investment decisions in 2020 and 30% of offshore wind merger and acquisition transactions[10]. Considering that in 2019, leading oil & gas companies were allocating less than 5% of their capital expenditure to low carbon businesses, while the industry average was less than 1%[3], the changes we are seeing now are noteworthy.

As mentioned earlier, we do not believe in blanket divestments of fossil fuel-related companies; instead we base our investment decision-making on a bottom-up analysis of the investment case, including the above and other factors. We accompany this with engagement on investee companies' strategies to adapt to a changing world, including how they are reducing their emissions. As long-term investors, it is in our clients' best interests that these companies remain competitive.

While the JSE has limited clean energy investment options, clean energy companies are growing globally and have strong growth prospects in a decarbonising world. However, many appear to be in green bubble territory, where general exuberance for clean energy stocks has inflated valuations and, in many cases, led to prices that we believe are disconnected from the underlying fundamentals. Our concern is capital loss in the event of a correction.

IMPACT OF THE PANDEMIC ON SOCIAL FACTORS

COVID-19 has elevated the global conversation on social inequalities and will lead to an increased focus on the "S" in ESG going forward, particularly in relation to the United Nations Sustainable Development Goals. In South Africa, socioeconomic transformation is a critical part of reducing inequality. As a result, we have begun reporting on our transformation/B-BBEE engagements as a distinct category under social engagements – please see section F "Engagements".

A widely publicised social issue during 2020 was the dispute between South Africa's insurers and the tourism and hospitality sectors, which suffered heavily during the government-imposed lockdowns and continue to struggle with significantly decreased international and domestic travel and leisure volumes. Tourism and hospitality companies sought relief from insurers by claiming payment under their business interruption (BI) cover. These claims were initially denied. BI cover typically addresses client-specific events such as fire, hail or other natural disasters. However, some include a contingent BI extension for infectious or contagious notifiable disease within a certain radius, which has been the point of contention. Insured companies claimed that their losses were as a result of COVID-19, while insurers claimed that the losses were due to a government-imposed lockdown rather than the disease itself, and that the notifiable disease clause was intended to cover localised disease outbreaks rather than global pandemics.

We discussed this issue internally and in July 2020 decided to contact the insurers in our clients' portfolios, being Momentum Metropolitan (in relation to Guardrisk) and Old Mutual. We asked the insurers to provide further explanation for rejecting the contingent BI claims, how they were thinking of the consequences (from an ESG perspective), and for an estimate of the total potential quantum and associated reinsurance cover (from an investment perspective). We also looked to similar debates and lawsuits in the UK to see what precedent was being set, as there are many similarities between the SA and UK insurance markets.

This was an incredibly difficult situation, and we have empathy for all businesses involved. However, given that the Financial Sector Conduct Authority was engaging with the sector and providing guidelines on conduct, we felt that there was appropriate attention on the issue and did not engage further. A few weeks later, the insurers began announcing interim relief settlements on contingent BI claims (subject to qualifying criteria, with a focus on small-to-medium enterprises), while still seeking to obtain certainty via the courts on the interpretation of the contingent BI cover and whether they were legally obliged to pay the full amount. Clients were entitled to keep these interim relief payments even if the courts ultimately ruled in the insurers' favour, although local court rulings have subsequently been in favour of the insured parties.

IMPACT OF THE PANDEMIC ON CORPORATE GOVERNANCE

Governance is a key consideration for us when determining a business's value. We believe that management teams cannot function effectively without robust boards to provide oversight and counsel, particularly when things go astray. The COVID-19 crisis has reinforced this belief and has been a clear demonstration of how critical it is to have skilled directors.

In 2020, many of our corporate governance engagements centred around the impact of the pandemic on executive management incentive schemes. Of specific focus was how boards should go about retaining and motivating key employees with long-term incentives (LTIs), having lost a significant portion of their value because of the pandemic; the use of discretion in adjusting performance targets that were set in a pre-COVID-19 world, and what remuneration committees (remcos) should consider in setting forward-looking performance targets when the future remains so uncertain.

Our overarching beliefs on executive remuneration remain unchanged: We advocate for remuneration schemes that are closely aligned with shareholder interests, clearly linked to the strategic objectives and long-term performance of a company, and in line with best practice standards. However, we have aimed to be constructive during these extraordinary times and this has meant we have had to be reasonably flexible when evaluating remuneration schemes.

Below we discuss the most prevalent engagement points in 2020 and detail our views, as shared with several boards and management teams of our investee companies.

Retention of key talent

The pandemic resulted in many LTI awards being either underwater due to the COVID-19-induced sell-off in the first quarter of 2020, or highly unlikely to vest due to having unattainable targets (set before COVID-19) attached to them. The prospect of LTIs not vesting for the next 12 to 24 months, or even longer, depending on how much time it takes economies to recover, solely as a result of exogenous factors, has been cited as a significant retention risk by a number of boards and reward teams. We appreciate that this is a real risk and understand the importance of retaining key talent during these unprecedented times, yet we believe remcos should follow a pragmatic approach and only consider the introduction of retention schemes when it is deemed necessary. In our view, there is no "one size fits all" solution; rather, companies should consider the merits of introducing retention schemes in the context of their current remuneration structures.

The scenarios on page 13 highlight some of the factors we would typically consider when evaluating the merits of a retention scheme.

Scenario 1: Companies A and B are comparable peers. They operate in the same industry and have a similar size, geographic footprint, scope and level of operational complexity. The remcos of companies A and B have proposed the same retention scheme: a restricted share plan (RSP) subject to a 5-year continued employment condition, with cliff-vesting thereafter. There are no performance conditions attached to the award other than continued employment during the five-year period. The weighting of the RSP will be 30% of the total annual LTI award. The remaining 70% is a conditional share plan (CSP) that is subject to performance conditions at both company A and B.

In each case, how do we consider whether or not to support the retention scheme?

Company A

- Quantum of executive remuneration: Median of peer group
- History of pay-performance correlation: Strong positive relationship between executive pay and company performance
- Remuneration scheme structure: Pay mix is geared towards the long-term; targets are sufficiently stretching
- Overall assessment: Good remuneration policy and implementation thereof; well-aligned with shareholder interests
- Likelihood of us supporting the retention scheme: High

Company B

- Quantum of executive remuneration: Upper quartile of peer group
- History of pay-performance correlation: Weak positive relationship between executive pay and company performance
- Remuneration scheme structure: Pay mix is short-term focused; targets are soft
- Overall assessment: Subpar remuneration policy; poorly aligned with shareholder interests
- Likelihood of us supporting the retention scheme: Low

Scenario 2: Companies X and Y are comparable peers. They operate in the same industry and have a similar size, geographic footprint, scope and level of operational complexity. Our overall assessment is that both companies have fair remuneration policies. However, we are generally concerned about the high quantum of executive remuneration in this industry. This is not a company-specific concern, but an industry-wide one.

In each case, how do we consider whether or not to support the retention scheme?

Company X

- Proposes a once-off retention award equivalent to 150% of total guaranteed pay for executives, vesting in equal tranches over three years following the grant date. This award is in addition to the normal LTI.
- Likelihood of us supporting the retention scheme: Low. Quantum of total pay is already high in absolute terms; we are therefore unlikely to support additional awards, especially when these awards are not subject to sufficiently stretching financial and strategic performance conditions.

Company Y

- Proposes a once-off retention award equivalent to 150% of total guaranteed pay for executives, vesting in equal tranches over three years following the grant date. This award will only kick-in in if Company Y's in-flight LTI awards do not vest due to COVID-19-related impacts.
- Likelihood of us supporting the retention scheme: Moderate. Quantum of total pay is already high in absolute terms so even though these are not "additional awards" per se, we would strictly assess whether the COVID-19 retention award is warranted. This assessment would primarily be done as the retention/in-flight award vests over the three years under review.

Use of remco discretion

In principle, we are not opposed to the application of remco discretion. We understand that setting performance targets and evaluating outcomes in an uncertain environment are not easy tasks. However, discretion can be misused as a tool to inappropriately reward executives in periods of underperformance, a practice we think undermines the concept of "pay for performance". As a result, we usually discourage the use of discretion and instead encourage companies to provide clear disclosure of how executives performed against preset performance targets. This level of transparency enables us to assess whether executives are being incentivised to act in shareholders' best interests, and to determine whether a reasonable relationship exists between executive pay and company performance.

However, we also realise that a completely formulaic approach to determining pay outcomes might not be the right solution for incentivising and retaining competent executives in this climate: Management teams may have been working hard, but their efforts are not being reflected in financial results due to the impact of COVID-19. With this in mind, we do not oppose remcos using their discretion to adjust performance targets to ensure that incentives adequately motivate and fairly reward executives, however, this discretion should be exercised in a manner that is consistent with management's performance and aligned with the best interests of shareholders. We think the remuneration outcomes of the next few years will truly highlight good versus "average" remcos.

Limiting the upside of executive remuneration

We recognise that there will probably always be some element of chance in share-based remuneration. We encourage companies to attempt to control this where possible. In line with best practice standards, we advocate for regular and consistent granting of share-linked awards, as opposed to large ad hoc/once-off awards. We believe this reduces the risk of unjustified windfalls. Even with all our attempts at being forward-looking, the COVID-19 crisis and the magnitude of its impact on stock markets and economies worldwide have shown that not everything can be foreseen. And, while we still believe that there is merit in regular and consistent awards, we realise that this might result in undue windfalls if awards were allocated when share prices were at historic lows.

We therefore urge remcos to follow a pragmatic approach and put measures in place to ensure that awards which eventually vest are reasonable. This can be done either at the time of granting the awards or at the end of the performance/vesting periods. Examples of measures that can be taken include introducing a cap to the value of LTI awards that stand to vest, reducing the quantum of allocations at grant date, or applying remco discretion to reduce the value of the vested awards if they are unreasonable.

Disclosure

Where discretion is applied to either allow for vesting of awards where performance targets are not met, or to adjust the value of vested awards, we encourage remcos to provide a clear indication and adequate justification of how they arrived at the adjusted outcomes.This disclosure should be made available to all shareholders via annual reports. This level of transparency enables shareholders to adequately assess the appropriateness of the discretion to determine whether it has been duly exercised.

H. PROXY VOTING

We provide voting recommendations for general meetings of all companies in which either the value of our clients' aggregated holding exceeds 1% of the total value of South African equities under our management at the time; or our clients' aggregated holding exceeds 4% of that company's shares in issue at the time. We also make recommendations for shareholder meetings of companies which fall below these thresholds if we believe that special circumstances warrant such action. We publish our voting recommendations, together with the outcome of the shareholders' vote on each relevant resolution, quarterly on our website. All our proxy-research and voting recommendations are conducted inhouse. We apply our minds and think critically about the resolutions that are put to vote by our investee companies.

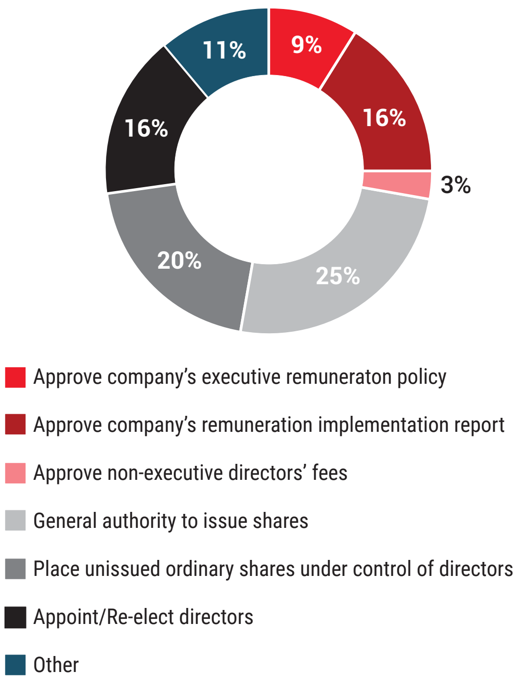
Over the 12 months to 31 December 2020, we made voting recommendations on 2 615 resolutions tabled at shareholder meetings meetings, as shown in **Table 2**. The majority of resolutions where we recommended a dissenting vote relate to the provision of general authority to issue company shares, placing unissued ordinary shares under the control of directors, executive remuneration and the appointment or re-election of directors, as indicated in **Graphs 5** and **6**.

Table 2: Proxy voting record

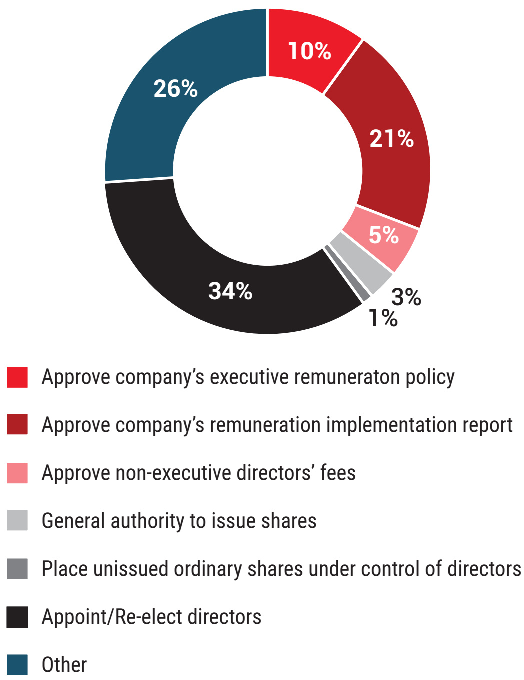
Quarter	Number of meetings	Resolutions ' for'	Resolutions 'against'	Resolutions 'abstained'	Total resolutions
Q4 2020	64	790	83	27	900
Q3 2020	42	528	17	6	551
Q2 2020	56	701	49	26	776
Q1 2020	34	361	24	3	388
Total	**196**	**2 380**	**173**	**62**	**2 615**

Source: Allan Gray

Graph 5: Breakdown of voting recommendations "against" on a per resolution basis in 2020



Graph 6: Breakdown of "abstention" voting recommendations on a per resolution basis in 2020



Source: Allan Gray

GENERAL AUTHORITY TO ISSUE SHARES AND PLACING UNISSUED SHARES UNDER THE CONTROL OF DIRECTORS

We typically recommend voting against resolutions which grant the company's directors general authority to issue new shares (even if only in limited quantities) or placing unissued shares under their control. We believe such authority diminishes the scarcity value of the shares our clients hold. We prefer companies to engage with shareholders first if they believe a share issue is necessary. This enables shareholders to adequately assess and consider the merits of each transaction before it is approved. In our view, this approach reduces the risk of the value of our clients' shares being diluted by an ill-advised issue of new shares.

EXECUTIVE REMUNERATION

The JSE Listings Requirements make it mandatory for a company with a primary listing on the JSE to table separate non-binding advisory votes on the executive remuneration policy and implementation report at the company annual general meeting (AGM). These are important resolutions as they provide shareholders with a direct say on pay.

The key factors we consider when evaluating remuneration schemes include quantum of pay, how well-aligned the remuneration scheme is with shareholder interests, the strength of the pay-performance correlation, the extent to which executives are, in their personal capacities, invested in the companies that they serve on ("skin in the game") and whether the remuneration policy and implementation report are transparent enough to enable shareholders to make adequate assessments of the scheme.

By recommending a vote against a company's remuneration policy and/or its implementation report, we are not necessarily suggesting that we lack confidence in the company's executive directors. Our views are solely driven by what we believe to be in the best interests of our clients, and we recognise that these may differ from those of other shareholders.

APPOINTMENT OR RE-ELECTION OF DIRECTORS

We usually recommend an abstention or vote against the election of a director where we have concerns that the election may not be in the best interest of shareholders. In forming these assessments, we typically consider the director's individual performance at the company in question and/or other company boards, the overall performance and composition of the board of the company, and whether the director has previously been involved in fraudulent, corrupt, or unethical activities.

For more information on the factors we consider in forming our views on voting recommendations, please refer to our Policy on ownership responsibilities on our website.

I. KEY RESEARCH, ENGAGEMENT AND PROXY-VOTING CASE STUDIES

Historically we have only reported on case studies of our external ESG engagements with company boards and/or management. This year we have extended our reporting to include research case studies, which showcase our internal engagements on and coverage of important ESG matters. In our view, detailed research is an essential part of holding meaningful engagements.

When engaging with company directors, our aim is to further the best interests of our clients by encouraging the directors to act in a way which enhances or preserves shareholder value. We prefer to engage with boards and management teams in private, as we believe this is more constructive and has a higher probability of yielding positive outcomes for our clients than public discourse. Notwithstanding the above, we are committed to being transparent about our investment stewardship activities and this section of our report details our key engagements over the 12 months to 31 December 2020.

KEY ENVIRONMENTAL RESEARCH AND ENGAGEMENT CASE STUDIES

Climate change and the related energy transition have material implications for investors. As a result, our analysis and reporting include:

- Remaining up to date on the latest climate science and information for policymakers, as well as related global policy and regulatory changes.
- Keeping track of which JSE-listed companies are setting 1.5°C-aligned emissions reduction targets, including those that have been independently verified by the Science Based Targets initiative (SBTi). We pay close attention to climate change commitments and disclosures by large emitters and financiers of high-emitting industries.
- Reporting on the emissions of our clients' top 30 holdings. Please see the Appendix on page 27 for our 2020 emissions analysis.

How does the energy transition impact our investments?

Climate change presents two categories of risk that impact different sectors to varying extents. As defined by the Financial Stability Board's Task Force on Climate Related Financial Disclosures (TCFD), these are:

- **Transition risks**: Policy, legal, technology and market changes as the world transitions to a lower carbon economy, which pose financial and/or reputational risk to organisations and economies.
- **Physical risks**: Acute events such as natural disasters or longer-term shifts in climate patterns that may directly damage an organisation's assets or indirectly affect them.

Case studies demonstrating how we consider climate-related transition risks

PGM companies: The automotive sector is the single largest source of demand for platinum (40%), palladium (81%) and rhodium (83%)[11], which are used in the autocatalysts of ICEVs to reduce harmful exhaust emissions. Palladium and rhodium have had a stellar run of late, as increasingly stringent emissions standards in China and Europe have increased their loadings in autocatalysts and pushed up demand as supply falls short. Short-term demand should remain strong as emissions standards continue to tighten in key markets and hybrid EVs, which have similar PGM loadings to ICEVs[12], remain popular. However, over the longer term there is a real threat from EVs, which do not require PGMs. Development of the hydrogen economy will in part offset this. Hydrogen-based fuel cell electric vehicles (FCEVs) use more than twice the amount of platinum as ICEVs, and proton exchange membrane (PEM) electrolysers, one of the technologies involved in the production of green hydrogen, require platinum and iridium. It has been estimated that if just 50% of heavy-duty vehicles and 15% of light-duty vehicles shifted to fuel cell vehicles, this would require roughly six million ounces of PGMs – 75% of global demand today[13].

We do not think that FCEV uptake will be this significant, particularly because battery EVs should remain more competitive than FCEVs in the light-duty vehicle category. However, there is greater potential for hydrogen usage in heavy-duty transport applications and we continue to monitor developments. We also monitor EV-related government policies, incentives, and ICE phase-out dates; EV fleet commitments being made by the world's main auto manufacturers; and potential constraints to a rapid roll-out to determine potential EV fleet penetration over the short, medium and long term.

Internally, our 2020 research reports and policy group meetings on PGM companies all included discussion of EVs. Meanwhile, in Q1 2021, our Investment team held another internal meeting to discuss the future of platinum demand, which included a discussion of both EVs and hydrogen developments.

Impala Platinum (**Implats**) is a top 20 holding for our clients. During 2020, we appreciated that Implats reached out to us to engage on their sustainability reporting and initiatives. In this meeting, we discussed that more disclosure on the outlook for PGMs under different energy transition scenarios would be interesting. Implats' Annual Reports and ESG Reports already include some discussion on the potential for the hydrogen economy.

Sasol: In our 2019 Stewardship Report, we provided detail on our engagements with Sasol since 2017 and subsequent outcomes. In 2020, we had another environmental meeting with Sasol. We discussed their climate change reporting, further detail on South Africa's carbon tax and implementation thereof and projects being implemented to reduce Sasol's GHG emissions. We also asked for an update on their sulphur dioxide emissions compliance progress. We are pleased to note in Sasol's 2021 interim results that Sasol, in partnership with Air Liquide, has committed to procuring 900MW of renewable energy in its Secunda complex by 2030 – a significant increase from the 600MW commitment made in early 2020.

Case studies demonstrating how we consider climate-related physical risks

Sappi: The ESG section of our 2020 research report highlighted that Sappi considers climate change a key business risk, especially for their South African plantations. This is due to the impact of temperature increases on fresh water sources and tree species, as well as an altered climate elevating other risks such as insect outbreaks. Climate change also increases the potential for plantation fires — another key business risk. The report noted mitigation strategies being developed by Sappi, such as modelling climate data, replacing certain species over time and implementing rapid detection techniques. We continue to monitor Sappi's progress in these areas.

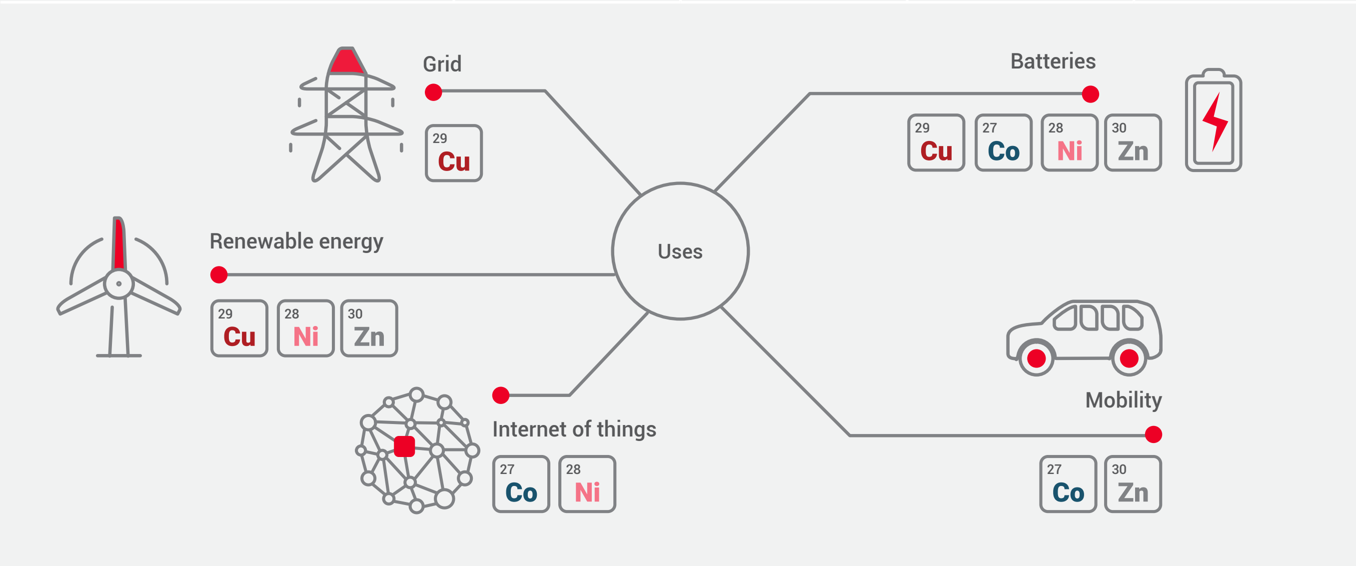
British American Tobacco (BAT): BAT's 2019 ESG Report disclosed that independent climate impact risk assessments were conducted on BAT's tobacco leaf supply chain to consider the risk posed by climate change. During a call scheduled with BAT's head of sustainability, we asked about BAT's supply chain risks, including the outcome of this climate modelling in key growing regions such as Brazil. According to BAT, the climate impact assessments did not identify any major risks; however, they are still working with farmers on climate adaptation techniques to make the supply chain as resilient as possible.

Case study demonstrating how we consider climate-related opportunities

Glencore: The energy transition also presents opportunities for well-positioned companies. We first discussed the opportunity we see in Glencore's commodity basket in our 2019 Stewardship Report. As shown in **Figure 5** on page 18, Glencore is a miner of some of the metals that are critical to a low-carbon, more electrified world. We have scheduled a Q2 2021 internal meeting on these transition metals to further debate their outlook.

Figure 5: Glencore commodities critical to a low-carbon world

	Copper (29 Cu)	Cobalt (27 Co)	Nickel (28 Ni)	Zinc (30 Zn)
Global supply (million tonnes)	22.60	0.13	2.45	13.80
Glencore production (million tonnes)	1.26	0.03	0.11	1.17
% world supply	6%	21%	4%	8%
Glencore market volumes (million tonnes)	3.40	Undisclosed	0.15	2.80
% world supply	15%	High	6%	20%
Reserve life (years)	21	51	24	17
Resource life (years)	52	143	44	48



Sources: Glencore, Allan Gray research

We believe that the above opportunity is more relevant now that Glencore has committed to align with a science-based 1.5°C global warming trajectory by pledging to reduce its emissions by 40% by 2035 (versus 2019 levels) and to go net zero by 2050. While other major mining companies have made net zero commitments on scope 1 and 2 emissions, with lesser commitments on scope 3, Glencore is the first to include scope 3 emissions in its net zero target. This is important because scope 3 emissions, primarily from the end use of companies' sold products, form the bulk of a company's total carbon footprint. Our analysis of the world's 100 carbon majors (top emitters of industrial GHG emissions from 1988 to 2015) shows that their scope 1 emissions averaged just 10% of their scope 3 emissions.

We questioned Glencore's chairman on the details of this climate commitment during a 2020 call and think that it reduces the risk from its thermal coal exposure. We also agree with Glencore committing to responsibly manage the decline of its coal assets, as opposed to selling the assets to an unlisted or smaller company that is simply subject to less scrutiny. Glencore will use the cash generation from its coal assets, which are still necessary for the world in the medium term, to invest in its energy transition commodities over the longer term.

KEY SOCIAL RESEARCH AND ENGAGEMENT CASE STUDY

British American Tobacco (BAT): BAT is one of our clients' top shareholdings and carries greater ESG risk than the average holding in our clients' portfolios.

The tobacco industry's volumes have been declining for many years now and we expect this to continue as government excise taxes increase to reduce smoking prevalence. Our investment case does not hinge on volume growth; rather, it hinges on BAT's ability to pass on moderate excise price increases to consumers that are greater than the volume declines and therefore offset these declines. This has been the case to date, with a >90% operating profit to cash conversion. BAT is trading on 8x earnings and an 8% dividend yield, making it attractive. The risk to this thesis is that excise duty increases become much more aggressive and higher prices lead to legal volumes declining and being lost to illicit channels. Accelerating volume declines may become more difficult to manage with price increases. Selling pressure due to the growing trend of ESG funds that exclude "sin" stocks may also hamper BAT's ability to re-rate to trade on a multiple that reflects its underlying economics.

Below we disclose how we have monitored, engaged on, and researched some of BAT's ESG risks and public concerns from 2018 to 2020. This includes one engagement held just after the reporting date, on 13 January 2021, as it was an important continuation of a 2020 engagement.

ESG category	ESG risk/ public allegation	Allan Gray actions
GOVERNANCE	Regulation	▪ Potential menthol ban in the US has been discussed internally on multiple occasions and factored into our risk assessment (2018 – 2020). ▪ Frequent internal updates on evolving regulation; for example, ongoing improvements to vaping regulation by the US Food & Drug Administration (FDA). ▪ Ongoing engagements with management include discussion on regulatory changes.
	Litigation & tax compliance	▪ Ongoing review of contingent liabilities and related disclosures in the Annual Report. ▪ Ongoing monitoring of key litigation risks e.g., Canada. We think that Canada (2-3% of BAT's profit) will enter into an agreement with tobacco companies similar to the Master Settlement Agreement in the US. ▪ Questioned the chairman on the UK's Serious Fraud Office (SFO) investigation into BAT, opened in 2017 and based primarily on historical allegations of bribery to undermine anti-smoking laws in East Africa (2018). It is worth noting that this SFO investigation was closed in January 2021, as the evidence did not meet the evidential test for prosecution under their Code. The SFO will however continue to support African authorities' investigations. ▪ Questioned the chairman on how the board gets comfort on tax matters (2018). ▪ Continue to perform our own reasonability calculations on blended excise tax and corporate tax rates, which aligns with what we would expect.
	Engagements with government & other compliance risks	▪ Questioned the chairman on the extent of BAT's engagements with governments to tackle illicit trade and how the board assesses whether appropriate boundaries are maintained during a telecon (2018). ▪ Held a call with BAT's head of investor relations and head of business conduct on compliance procedures and process improvements. This included discussion of controls in place such as legitimate market demand analysis and customer and supplier due diligences (2020). ▪ Further queried how BAT monitors politically connected employees who are higher risk in government engagements (2021).

ESG category	ESG risk/ public allegation	Allan Gray actions
SOCIAL	Health impact	▪ Ongoing monitoring of health impact studies, particularly emerging studies on next generation products. BAT is targeting 50 million consumers of its next generation products by 2030 (13.5 million in 2020), with the intention that these consumers would switch from combustibles. ▪ Internal report written and meeting held on next generation products, which included substantial discussion of their health impacts versus combustible tobacco products, as well as associated regulation, particularly in BAT's key market, the US (2020). ▪ Recommended that BAT holds ESG investor days on important ESG issues. BAT agreed and were in fact already considering this; for example, a session on the product science behind next generation products versus combustibles (2021).
	Prevention of sales to youth	▪ Noted in several management meetings that we believe in the prevention of sales to youth and encouraged management to keep up their focus on this, particularly considering the teenage vaping problem in the US. We were pleased to see that the US FDA's increasingly stringent regulations to prevent vaping sales to the youth has not affected BAT's e-cigarette volumes, whereas certain competitors have been significantly impacted, suggesting that teenagers were not BAT's target market.
	Public allegations of child labour in the supply chain	▪ Emailed BAT querying these allegations (2019). ▪ Asked BAT's head of sustainability for more details on BAT's recent commitments to eliminate child labour in the supply chain by 2025 and confirmed that this includes its 90 000 directly contracted farmers and >250 000 farmers contracted by its third-party suppliers. We also complimented BAT on its 2 600 child labour training sessions held for >200 000 attendees in 2019 and on its publication of a Human Rights report in 2020, making it the first tobacco company to do this. We found this reporting useful (2020).
ENVIRONMENTAL	Environmental impact of filters	▪ Noted our concern on the environmental impact of filters during a BAT investor ESG survey, managed on behalf of BAT by an independent third party (2020). ▪ Questioned BAT's head of sustainability on BAT's ongoing research and development into biodegradable filters, engagement with start-ups that are launching biodegradable filters, and preparation for the EU's Extended Producer Responsibility (ERP) programme, which will apply to cigarette filters from 2023 (2021).

Source: Allan Gray

KEY GOVERNANCE RESEARCH AND ENGAGEMENT CASE STUDIES

Sasol: As reported in our 2019 Stewardship Report, we view the change in Sasol's executive management as a step in the right direction considering the massive cost overruns and delays of the Lake Charles Chemicals Project (LCCP) under the leadership of previous management. We were however disappointed to learn that the remco thought it appropriate to award the former joint-CEOs separation payments amounting to R36 million, with total pay to the two former CEOs amounting to R94 million for the 2020 financial year. We engaged with Sasol's remco chair, head of reward and head of human resources in September 2020 and relayed our disapproval of the remco's decision.

We were also disappointed to learn that the board-initiated review of the LCCP came at a cost to shareholders of R156 million, and a further R32 million was spent on audit fees for the same report in the 2020 financial year. We communicated our concerns regarding the board's extensive use of consultants and external advisors via a formal letter addressed to the board in September 2020, and subsequently engaged with the board on numerous occasions following our letter.

In our opinion, the separation payments made to the former joint-CEOs were not aligned with the poor outcomes experienced by shareholders during their tenure. Consequently, we recommended that our clients vote against the remco chair and the remuneration implementation report at the 2020 AGM. We also recommended a vote against all long-standing non-executive directors that were up for re-election. We believe that board members have a critical role to play in directing and overseeing the organisations that they serve, and thus were partly responsible for the strategic mistakes made by the leadership team, and the resultant poor outcomes experienced by shareholders. Lastly, we recommended a vote against the proposed non-executive director fees. In our view, the proposed non-executive fees are excessive, especially when considering the board's extensive use of consultants and advisors to assist in their duties as well as the company's significantly reduced market cap.

In summary, we recommended that our clients vote against:

- The remuneration implementation report
- The re-election of the chairman of the remuneration committee
- The re-election of all long-standing non-executive directors
- The approval of non-executive directors' fees

We continue to engage with both management and the board and are hopeful that things will improve going forward.

Woolworths: While we were pleased to learn that the board considered some of our recommendations when structuring the remuneration package of the new Group CEO, a notable improvement being the reduction of the portion related to guaranteed pay, we were disappointed by the excessive restraint payment made to the former Group CEO. In October 2020, we engaged with the board to better understand the rationale behind the restraint of trade payment. According to the board, this was a well-thought-out decision: In determining quantum of the payment, they considered, amongst other things, the fact that no shares were issued to the former Group CEO from 2019 onward despite him being entitled to an annual restricted share allocation of 150% of guaranteed pay.

In our opinion, the restraint of trade payment was excessive and not aligned with shareholder interests, especially given the poor performance of the Fashion, Beauty and Home segment and David Jones under his leadership. We therefore recommended our clients vote against the remuneration implementation report at the 2020 AGM. We note that the new Group CEO's remuneration package is structured differently, with a comprehensive restraint of trade agreement baked into his employment contract, and trust that this structure will prevent a similar scenario happening in future.

Old Mutual: As discussed in our previous Stewardship Report, we believe that Old Mutual did not appropriately adjust for hyperinflation distortions caused by Zimbabwe in the 2018 financial year. This resulted in executive bonuses being boosted by figures which, in our view, were not a fair depiction of the underlying economic performance of the business. Following the publication of the 2019 Integrated Report in March 2020, we were pleased to note that the board rectified the hyperinflation distortions caused by the Zimbabwean operating segment. The affected 2018 figures were adjusted, and the portion of bonuses unduly awarded to executives as a result of the hyperinflation were clawed back. The board also developed a governance framework to help it better manage the Zimbabwean business unit given the unique and complex macroeconomic conditions under which this segment operates. As communicated with the board in May 2020, we consider the above to be positive developments.

In June 2020, we wrote to the remco detailing our thoughts on Old Mutual's remuneration policy and the implementation report. In the letter, we highlighted that we believe the downward adjustment of targets and use of remco discretion to boost executive pay in the 2019 financial year goes against the concept of "pay-for-performance". Consequently, we recommended that our clients vote against the remuneration implementation report at the 2020 AGM. We continue to engage regularly with the board.

Naspers (N shares): We engage with Naspers' reward team and the board on a regular basis. In our most recent engagement with the chief people officer (CPO), investor relations officer (IRO) and the global reward leader (GRL), we reiterated our concerns regarding the targets attached to the executive directors' performance share units (PSUs). In our view, the lower end of the vesting scale is not sufficiently stretching. We highlighted that we believe there should be no vesting for total shareholder return (TSR) below the median of the peer group's TSR. In our view, the current vesting has the potential to handsomely reward executives for "average" performance. As communicated with the CPO, IRO and GRL in February 2021, we will assess the reasonability of the PSU outcomes when the first tranche vests in 2022 to determine whether the PSU vesting scale achieves adequate alignment with shareholders.

Overall, we are pleased with the direction that the remuneration policy is taking and understand that making policy changes seldom happens overnight. We view the introduction of PSUs and subsequent increase of their weighting to 60% of the annual LTI award for executive directors as positive steps. This results in executive incentives being largely based on the performance of Naspers Ecommerce (i.e., Naspers excluding Tencent), something we have been asking the remco to do for several years. Other recommended improvements, as shared with Naspers, include enhancing the disclosure performance targets attached to the STI and lengthening the performance period attached to LTIs. We believe improved disclosure of STI targets will enable shareholders to better assess whether targets are sufficiently stretching and that an extended LTI performance period will achieve better alignment with shareholders who are invested for the long term.

Business Sustainability Report

Rob Formby , chief operating officer

The first section of this report outlines our role in stewarding our clients' investments and contributing to improvements in governance standards and social and environmental responsibility in the companies in which we invest. This business sustainability section, which we added last year, aims to report on our ongoing endeavours, as a business, to make a meaningful difference to society. With 2020 overrun by COVID-19, we highlight some of our pandemic support efforts and the impact made by our various entities during what was a most unusual year.

BUSINESS FOCUS

Clients

Our core focus as a business is to deliver long-term returns for our clients. Since 1973 we have adhered to the same set of values. These have provided us with a consistent framework to help us make the best decisions for our investors in a changing environment and over time.

We always put our clients' interests first and avoid (not manage) conflicts of interest. We build our clients' trust and confidence through investment returns, offering excellent client service and designing our products and fees so that they tie our success to that of our clients. Our performance-based fees make our income more sensitive to long-term investment performance than the size of assets under management. Our senior executives are shareholders in the business, aligning their long-term interests with our clients.

Government, regulator, industry

We are committed to the growth and development of the financial services industry in South Africa. We are actively involved with the Association for Savings & Investment South Africa (ASISA) and engage with the government and the regulator through ASISA. We have representation on ASISA's board, we are involved in various board committees and support their growth and development programmes.

We have contributed to ASISA Enterprise Supplier and Development Proprietary Limited's IFA Programme since its inception in 2016. This programme aims to provide business development support to select independent financial advisers (IFAs) and equip them with practical management toolkits, skills and knowledge to grow their businesses, and therefore bolster the industry's distribution capability. Furthermore, the programme provides high-potential, early career individuals with the opportunity to participate in an internship with a selected top-performing IFA in a structured programme.

Our environmental footprint

As a business we are committed to doing what we can to reduce our own impact on the environment. The Allan Gray building in Cape Town was designed to be as environmentally friendly as possible. Over the past few years, we have taken steps to identify areas of our operations where we can reduce our consumption and incorporate alternatives. With most of our staff working offsite during 2020 and travel vastly reduced, our ways of working and communicating have changed. This has been incidental and there are no new proactive initiatives to report on.

Transformation

Transformation is a business and ethical priority and therefore remains a key focus of our sustainability efforts. We value, seek and foster diversity. Allan Gray is a level 1 B-BBEE contributor, having improved its contributor status during the most recent review. For more information on our transformation efforts, please contact us for the latest copy of our "Transforming our business" report.

The Allan Gray Staff Scheme was established in 2005. This is a key lever to encourage employees to contribute to and share in the growth and profitability of the business. Equally, it is a lever which aims to help Black employees build wealth to reduce historic wealth imbalances within South Africa. A 14% equity stake was reserved for current and future employees, of which 70% is earmarked for Black employees.

PHILANTHROPIC OWNERSHIP

We are a privately-owned company, with a controlling interest held in perpetuity by Allan & Gill Gray Foundation. Other shareholders include past and present employees and E Squared (which is described below). Allan & Gill Gray Foundation has no owners in the traditional sense and is instead designed to exist in perpetuity and to serve two equally important purposes: (1) to promote the commercial success, continuity and independence of the Allan Gray and Orbis asset management businesses, and (2) to ensure that the distributable profits Allan & Gill Gray Foundation receives from these firms are ultimately devoted exclusively to philanthropy.

Importantly, Allan & Gill Gray Foundation does not directly manage Allan Gray, but rather vests control of the firm to Orbis Allan Gray Limited, a holding company whose board consists of a majority of present and past executives of the underlying asset management companies.

With perpetual ownership in strong hands, the management of Allan Gray can focus entirely on adding value for clients for generations to come, and the investment professionals can continue to focus on achieving long-term results.

While our ownership allows focus, equally it places us within a philanthropic ecosystem that includes the Allan Gray Orbis Foundation, the Allan Gray Orbis Foundation Endowment, E Squared and the Allan & Gill Gray Philanthropies.

Allan Gray Orbis Foundation

The Allan Gray Orbis Foundation was established in 2005 as part of the Gray family's vision of making a sustainable, long-term contribution to Southern Africa by nurturing the emerging entrepreneurial potential within the region. The Allan Gray Orbis Foundation now runs in South Africa, Namibia, Botswana and Eswatini and is funded by a donation of 5% of the pre-tax profits from Allan Gray.

The Allan Gray Orbis Foundation provides successful candidates with extensive support aimed at enabling them to pursue entrepreneurship as a viable career option. This includes tuition and residence fees for programme participants to pursue their high school or university studies. Once graduated from university, the programme participants are recognised as Allan Gray Fellows and encouraged and supported to pursue entrepreneurship. In addition, some are also offered the opportunity to pursue a postgraduate degree at a local university or top-rated international institution after acquiring relevant working experience. **Figure 6** summarises the Allan Gray Orbis Foundation's reach and impact.

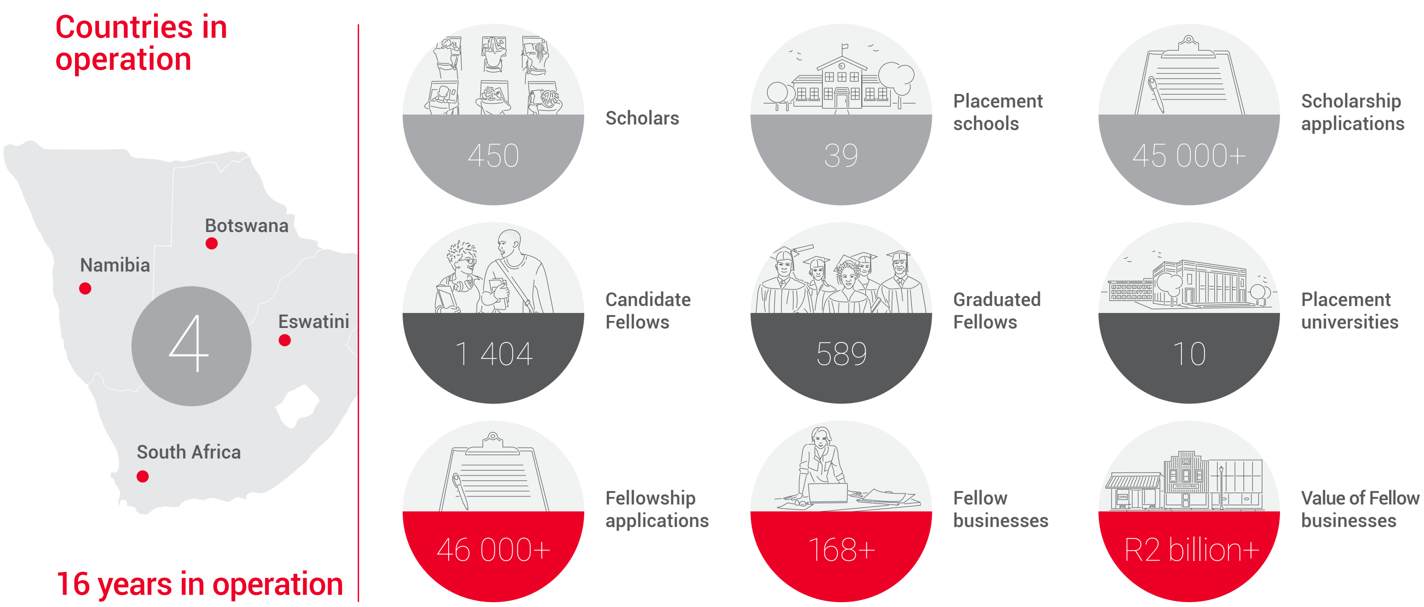
Allan Gray Orbis Foundation Endowment

The Allan Gray Orbis Foundation Endowment came about as a result of a donation from the Gray family. The Endowment's original purpose was to provide financial support to the Allan Gray Orbis Foundation if required. However, as the Foundation's financial position became more secure, the Endowment fund has evolved its reach into three key areas of early childhood development and education, entrepreneurship and employment. Some of the key programmes within these focus areas are:

Early childhood development and education

- **Jakes Gerwel Fellowship:** An independent and aspirational initiative committed to creating a pipeline of future, high-impact teachers.
- **Funda Wande:** A world-class multimedia course to train Foundation Phase (Gr R-3) teachers on how to teach reading.
- **Grow Great:** A partnership which seeks to mobilise South Africa towards a national commitment to zero stunting by 2030.

Figure 6: Allan Gray Orbis Foundation reach and impact (since inception to date)



Employment

- **10KJ:** A partnership with 10 public benefit organisations that have created more than 10 000 meaningful income-earning opportunities.

Entrepreneurship

- **Allan Gray Makers:** An initiative committed to providing transferable entrepreneurial skills and support to youth who are technically or vocationally talented. This aims to accelerate the creation of meaningful employment opportunities in South Africa.

E Squared

E Squared (together with the Allan Gray Orbis Foundation and Allan Gray Orbis Foundation Endowment) aims to foster "entrepreneurship for the common good", with a focus on creating successful entrepreneurs who in turn create employment opportunities. E Squared was established in 2007, when it purchased shares in Allan Gray from the Gray family through a loan guaranteed by the Allan Gray business. E Squared owns 17.8% of Allan Gray. The long-term objective of E Squared is to extend subsidised financing to predominantly Black entrepreneurs. These entrepreneurs are either graduates of the Allan Gray Fellowship Programme or social entrepreneurs who are sought out by E Squared for their leadership and creative initiative.

Allan & Gill Gray Philanthropies: Philanthropy Initiative with Employees of Allan Gray

Allan & Gill Gray Foundation's philanthropy is pursued by the Allan & Gill Gray Philanthropies, which pursue projects aimed at promoting public benefit or social improvement. One of these initiatives is the Philanthropy Initiative with Employees of Allan Gray, where employees vote for a funding theme and beneficiaries, and grants are channelled towards these beneficiaries following an evaluation process.

The 2020 funding theme remained "Ensure inclusive and quality education for all and promote lifelong learning" for the third year.

COVID-19 SUPPORT EFFORTS

Although we were classified as an essential service provider at the start of the pandemic and could therefore keep our offices open, we encouraged our employees to work remotely for as long as practically possible. Our IT and Facilities teams rallied before the lockdown, and 97% of staff were set up and able to function remotely. The number of employees accessing the offices varied over the year, as was appropriate. This allowed us to continue servicing our clients by making sure they had uninterrupted service and access to their investments.

While prioritising the health and safety of our employees, we also did what we could to support our long-standing suppliers. In terms of the broader community, we identified worthy initiatives to support, including feeding schemes, the supply of COVID-19 testing kits, the provision of medical supplies and care packages to health workers, and assistance to small to medium enterprises in distress. Staff members donated to these very worthy causes, and the company matched these donations. We also made a donation to the South African National Editors' Forum Media Relief Fund. Meanwhile, members of the leadership donated to the Solidarity Fund in their personal capacities.

The Allan & Gill Gray Philanthropies, E Squared and the Allan Gray Orbis Foundation Endowment and the Allan Gray Orbis Foundation all made significant donations in their own right, amounting to R180 million across the Allan & Gill Gray Philanthropy ecosystem. The response sought to address both the immediate welfare and economic impact, as well as keeping a smaller resource available for future responses, with each entity's efforts aligned to their own area of responsibility.

Figure 7 on page 26 shows the funding made available through various entities, including the Allan & Gill Gray Philanthropies, Allan Gray Orbis Foundation Endowment, E Squared and Allan Gray Orbis Foundation in the first phase, with 20% of the funding (R40 million) held back for a strategic response beyond the immediate need.

Figure 7: COVID-19 funding from entities in the Allan & Gill Gray Philanthropy ecosystem

R10 million
to fund a Coronavirus Rapid Mobile Survey (CRAM) – a survey of a nationally representative sample of 10 000 South Africans every month over a six-month period, helping to create a six-wave panel survey to track changes in social and economic outcomes over the period.

R10 million
towards additional support in Namibia (R5m), Botswana (R3.5m) and Eswatini (R1.5m) in accordance with the Allan & Gill Gray philanthropic footprint in the Southern African Development Community (SADC).

R10 million
of relief support to children and early childhood development sites to assist with nutrition and enable the centres to meet the new COVID-19 compliance requirements.

R50 million
to the Solidarity Fund.

R50 million
to support small businesses dealing with the fallout from COVID-19; the donation was made to the South African Future Trust.

R20 million
to COVID-19 Innovation and Response Fund – an initiative that the Allan & Gill Gray Philanthropy ecosystem established to fund businesses and start-ups who are providing products and services that are either highly innovative or essential in the fight against the COVID-19 pandemic.

Additional grants have been awarded to support opportunities to increase livelihoods and research new treatments for patients with COVID-19.

APPENDIX

ASSESSING CARBON RISK IN CLIENTS' PORTFOLIOS

Table 3 reflects the weighted average carbon intensity (WACI) of the top 30 local equity holdings of the Allan Gray Balanced Fund (AGBF), as at 31 December 2020. The top 30 equity holdings listed accounted for 85% of the AGBF's local equity market value and 45% of the Fund overall as at 31 December 2020.

We began reporting on the emissions and WACI of our clients' top 30 equity holdings in 2019, using the AGBF as our most representative fund.

WACI is a metric recommended by the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD). Please refer to pages 7 to 9 of our 2019 Stewardship Report for more detail on the WACI methodology, as well as its benefits and shortcomings, and please see the WACI formula on page 28. We use this metric in conjunction with other metrics and qualitative research to assess the portfolio's carbon risk.

Table 3: Weighted average carbon intensity of the AGBF top 30 local equity holdings as at 31 December 2020

(Listed in order of their size in the portfolio. Pink is the most carbon intensive, followed by orange, then yellow, then grey is least intensive.)

AGBF top 30 equities at 31 December 2020	Scope 1 + 2 emissions (tonnes)	Revenue ZARm	Financial year end	% of AGBF equity	Carbon intensity i.e. emissions ÷ by revenue	WACI using total equities only
Naspers	32 189	65 877	31-Mar-20	15.9%	0.5	0.1
British American Tobacco	782 000	477 441	31-Dec-19	10.2%	1.6	0.2
Glencore[i]	29 240 000	617 918	31-Dec-19	7.2%	47.3	3.4
Standard Bank	206 995	110 461	31-Dec-19	4.3%	1.9	0.1
Woolworths	721 565	72 208	30-Jun-20	4.0%	10.0	0.4
FirstRand	179 362	105 098	30-Jun-20	3.7%	1.7	0.1
Remgro	834 627	54 732	30-Jun-20	3.2%	15.2	0.5
Old Mutual	85 730	175 078	31-Dec-19	2.9%	0.5	0.0
Multichoice Group	76 721	51 387	31-Mar-20	2.8%	1.5	0.0
Sibanye Stillwater	6 725 000	72 925	31-Dec-19	2.7%	92.2	2.5
Sasol	66 015 000	190 367	30-Jun-20	2.6%	346.8	9.2
Nedbank	72 761	56 164	31-Dec-19	2.5%	1.3	0.0
Reinet	No data	Not applicable	31-Mar-20	2.4%	No data	No data
Life Healthcare	154 469	25 386	30-Sep-20	2.1%	6.1	0.1
Capitec	31 765	21 131	29-Feb-20	2.0%	1.5	0.0
Rand Merchant Investment	No data	Not applicable	30-Jun-20	1.6%	No data	No data
Impala Platinum	3 644 000	69 851	30-Jun-20	1.4%	52.2	0.7
AB Inbev	5 362 154	771 900	31-Dec-20	1.4%	6.9	0.1
Northam Platinum	1 077 362	17 812	30-Jun-20	1.3%	60.5	0.8
Investec	30 144	15 939	31-Mar-20	1.3%	1.9	0.0
Sappi[ii]	5 279 312	74 821	30-Sep-20	1.3%	70.6	0.9
Tiger Brands	No data	29 796	30-Sep-20	1.2%	No data	No data
BHP	15 800 000	675 352	30-Jun-20	1.1%	23.4	0.3
Anglo American	16 080 000	508 508	31-Dec-20	1.0%	31.6	0.3
KAP Industrial	924 198	22 166	30-Jun-20	1.0%	41.7	0.4
Pan African Resources	436 982	4 306	30-Jun-20	0.9%	101.5	0.9
The Foschini Group	171 870	35 323	31-Mar-20	0.8%	4.9	0.0
Super Group	349 107	34 578	30-Jun-20	0.8%	10.1	0.1
Absa Group	176 544	81 593	31-Dec-20	0.7%	2.2	0.0
Momentum Metropolitan	52 936	51 430	30-Jun-20	0.7%	1.0	0.0
Total top 30				**85.1%**		**21.8**

Notes:

i. Use industrial revenue only (pre-intergroup eliminations) as it is responsible for the bulk of emissions. Including the marketing division revenue would substantially inflate group revenue, thereby understating Glencore's carbon intensity.

ii: Reported emissions do not take Sappi's plantations into account, which act as a carbon sink.

Sources: Allan Gray research, company annual reports, CDP platform, Bloomberg, Refinitiv.

Weighted average carbon intensity (WACI)

$$\text{WACI} = \left(\frac{\text{issuer's scope 1 + 2 GHGs (tonnes)}}{\text{issuer's revenue (ZARm)}}\right) \times \left(\frac{\text{current value of investment}}{\text{current portfolio local equity value}}\right)$$

SOURCES REFERRED TO IN TEXT

(Note: Charts, graphs and figures sourced separately under each relevant image).

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9. Allan Gray calculations based on CDP dataset. Note: This is based on cumulative scope 1 and scope 3 emissions from 1988 – 2015.
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