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Capital

August 2022

DRIEHAUS EMERGING MARKETS SUSTAINABLE EQUITY FUND

Q&A WITH PORTFOLIO MANAGER RICHARD THIES

Richard Thies is the Lead Portfolio Manager of the Driehaus Emerging Markets Sustainable Equity Fund (the "Fund"); an Article 8 fund as classified by SFDR. Rich manages the Fund with Howie Schwab (Portfolio Manager) and Chad Cleaver (Portfolio Manager) along with a team of 5 Analysts.

The investment style is a bottom-up growth equity investment approach. The strategy exploits equity market inefficiencies that materialize following inflection points, combining fundamental, behavioural, and macro analysis as well as integrating environmental, social and governance ("ESG") criteria as part of the investment research process. The approach focuses on companies with strong or improving ESG attributes and growth opportunities tied to social and environmental solutions, and robust governance structures. It also includes evaluating fundamental factors relating to the companies such as the competitiveness of the relevant industry, the company's business model, recent and projected financial metrics and upcoming product releases to be introduced by the company. Macroeconomic or country specific analyses are also utilized to evaluate the sustainability of a company's growth rate.

The Fund excludes investment in companies involved in adult entertainment, coal production, gambling, tobacco and weapons production. In addition, Driehaus has a sustainable-focused proxy voting policy and engages with company management on potential ESG issues.

How does ESG analysis differ with emerging markets vs developed markets?

Conducting ESG analysis in emerging markets can be more challenging than doing so in developed markets, mainly due to differences in the quality of ESG disclosures. In some places, specifically China, the movement towards factoring in ESG, and better disclosures, is quite nascent. A lot of companies, particularly in the A-share market, are very new to the concept of sustainability and sustainable strategies, and as such are less prepared to discuss them.

Beyond that, there are differences between countries in terms of governance and regulation. The standards we might consider to determine whether a company is performing a good social function in China may be different to those we would consider when measuring social functions in the US. Regional differences in governance structures should also be considered; for example, South Korea has a very different approach to other emerging markets. Additionally, some countries' financial disclosures are more reliable than others.

When it comes to determining whether a company is doing well in terms of ESG accountability, there has been increasing standardisation across both emerging and developed markets. On the environmental side, different markets vary. India, for example, is a significantly less developed market, with high levels of poverty and over a billion people, therefore it wouldn't be appropriate to apply the same environmental requirements as you would expect from a US or European firm.

What do you think are the biggest challenges regarding ESG in emerging markets?

We see several nuances to ESG investing in emerging markets. First, less disclosure on sustainability-related topics is more challenging inherently. We think it makes it a bigger opportunity for alpha generation as we do believe that more sustainable businesses will do better over time, but it does create an extra layer of effort. The second is that, broadly, the mindset in emerging markets is not as geared toward these issues so it takes a bit of extra effort to change companies' mindsets. In addition, there are some peculiarities of emerging market corporate structures (higher levels of family-ownership, higher levels of state involvement, cross-shareholding by corporates, etc) that are somewhat unique challenges.

We think the biggest challenge pertains to the relationship corporates sometimes have with their governments. In a country like China, for example, you may find many companies are influenced by the government. Sustainability-minded investors have to consider what the ultimate impact of that alignment really is, because it's not as cut and dry as it seems. The government itself has orchestrated many policies that investors should be rightly concerned about, but they have also focused more recently on rooting out corruption, environmental clean-up and trying to ensure that large companies are having a positive 'social impact.'

How do you approach governance in emerging markets?

Governance standards on the whole are lacking in emerging markets compared to those in developed markets, though they have been improving over the past few years. We have always placed a very high focus on governance in our emerging markets strategies, in part, because it is such a differentiating factor within the asset class and because accurately assessing governance risks has been an essential tool for limiting downside risk in our portfolios. We tend to focus our efforts on companies with less complicated shareholding structures, where founders do not retain excessive influence, and those with disclosures that meet our standards. A more dogmatic approach, excluding companies without a certain percentage of independent board members or where the chief executive and chairperson are the same, for example, would be too limiting in this asset class today. However, we are regularly engaging on those topics with our portfolio companies.

Do you engage with companies to try and improve their ESG behaviour?

We do engage with companies to try and improve their sustainability practices; we have a mandatory engagement policy for companies that have a low rating by external providers. For any company that we would invest in that doesn't have a high enough rating, we have mandatory engagements at the analyst or portfolio management level. Whenever we communicate with a company on a one-on-one basis, we discuss their ESG strategy and practices.

Pollution seems to continue to be a problem in emerging markets, how do you approach the environmental aspect in your analysis?

Environmental issues are more significant in emerging markets in terms of the overall level of pollution, waste and in many cases, access to clean water. As a result, the environmental factors within ESG are of more importance to us. They tend to be easier to measure than social factors and for the most part require less interpretation in terms of what is important and what's not.

When considering social aspects, your lens of looking at a country and a company might be a bit more subjective, whereas environmental issues are cleaner cut in terms of the companies that are doing better and worse. The balance you must play within emerging markets and focusing on environmental issues is being cognizant of where the country is in their level of development and what is appropriate for them. Expecting countries like India or Indonesia, which are less developed on aggregate, to have the same level of carbon output as more developed areas is not realistic since they are much earlier in their economic development trajectories.

There are more opportunities as sustainability-minded investors, since these are bigger problems in these markets. Specifically, we have seen this in China over the last decade - there are a lot more companies and a lot more investments being made to try and address some of these issues. In China, for example, the government's focus on renewables has provided us a wealth of opportunities over the last few years and we do not see that impulse changing. It is different for many governments; however, it is an even bigger focus than in a place like the US for a government such as China's, where they know that people care about clean air and the average person still sees pollution. Things like climate change and reducing carbon output are a little easier to explain and focus on from a political perspective, which is a good thing for an ESG investor.

Could you tell us a bit about your background and what made you interested in sustainable finance?

This is something I have been interested in my entire career and even earlier, dating back to my time in university. My educational focus was in development economics and my first jobs were all in that capacity, working primarily in microfinance in sub-Saharan Africa. That work gave me some real-world introduction to both the positive and negative impacts such businesses can have, particularly in the lesser developed economies of the emerging and frontier markets. Ultimately, I moved into the field of investments because I saw the transformative power that larger businesses can have on societies and economies at large and I wanted to be a part of that in some capacity.

From a personal level, that more altruistic interest gave way to several more practical ones. First, it's quite clear that the days of capitalism as the end-all be-all of government policy are over and governments and voters are beginning to think more about externalities. That isn't necessarily positive or negative, but it is real. We have seen this in China for quite some time where you invest in companies who aren't aligned with the government's desires at your own peril. At Driehaus, we are big believers that being successful in investing requires getting the big things right and spotting the major inflection points. A final note, as someone with a young daughter, I would like to, at least in a small way, be part of the solution to some of our great challenges rather than potentially contributing to making them worse.

About the Author: Richard Thies – Portfolio Manager

Richard is a portfolio manager of the Driehaus Emerging Markets Sustainable Equity Strategy and leads the Driehaus Emerging Markets Team's ESG efforts in addition to the Team's coverage of the financials sector and has primary responsibility for macroeconomic analysis. He is also the lead portfolio manager of the Driehaus Emerging Markets Opportunities strategy and a portfolio manager for the Driehaus Emerging Markets Growth and Driehaus Emerging Markets Small Cap Equity strategies. Mr. Thies' macroeconomic analysis, idea generation, security analysis, ESG work, portfolio construction, and risk management responsibilities are leveraged across the four strategies managed by the Driehaus Emerging Markets Team. He joined Driehaus Capital Management in 2011. Mr. Thies received his B.A. in international studied from Emory University and his M.A. in international political economy from the University of Chicago.

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The Fund is subject to special risk considerations including geographic concentration risk, portfolio concentration risk and operational risk. The investment return and principal value of an investment will fluctuate so that the investor's shares, when redeemed, may be worth more or less than their original cost. Any investor should consider the investment objectives, risks and charges and expenses of the fund carefully before investing. Where an investment is denominated in a currency other than the investor's currency, changes in rates of exchange may have an adverse effect on the value, price of, or income derived from the investment.

SFDR

This Fund has been classified as an Article 8 for the purposes of the EU's Sustainable Finance Disclosure Regulation ('SFDR'). The Fund promotes environmental and/or social characteristics but does not have sustainable investment as its primary objective. It might invest partially in assets that have a sustainable objective, for instance assets that are qualified as sustainable according to EU classifications but does not place significantly higher importance on the environmental objective of each underlying investment. Please see prospectus for further information on the Funds environmental and/or social characteristics and relevant sustainability risks and principal adverse impacts which may impact the Fund's performance.

For all definitions of the financial terms used within this document, please refer to the glossary on our website: https://www.heptagon-capital.com/glossary

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