MARATHON
ASSET MANAGEMENT

# Sustainability Report

2021

Thoughtful,
patient investing.

# Contents

# Introduction

Welcome to Marathon's first sustainability report.

Marathon is known for not being a trend follower, so you may wonder why we are producing a report on sustainability; after all, "ESG" (Environmental, Social, Governance) and "sustainable" investing is all the rage at present.

Let us reassure you that this is not a case of "us too". ESG issues are, in Marathon's view, investment issues – three factors amongst the many which can make an investment more or less attractive. What are now called ESG factors have always played a part in Marathon's approach to assessing a business and our approach has not changed. What has changed is the debate around the term and clients' understanding of these issues in relation to their investments.

"ESG investing" has become something of a bandwagon. The term is remarkably ill-defined, perhaps deliberately so, and has been used by many investment managers as a marketing tool to signal virtue in the investment approach. Seeking to be "holier than thou" is thus seen as a route to competitive advantage.

As long-term investors, we view analysis of the risks faced by a business, including those relating to its actual or potential environmental or social impacts, as a crucial part of our investment process. These risks can cost a company dearly over the long-term, so assessment of these risks[1], and the governance structure and process which oversee and manage them, is – and always has been – an important part of our approach.

Nothing has changed.

So, if nothing has changed, why the report?

While the approach and process Marathon uses remains the same, the world around us has moved on. Clients are increasingly showing interest in more than just the return performance of their portfolios. This interest often now extends to how portfolio managers assess negative externalities (such as environmental or social outcomes) affecting their investments, how they act to improve the businesses they invest in (via voting and engagement to improve governance for example). It extends to the question of whether the fund management firm itself is a responsible business, seeking to improve its own environmental and social outcomes.

The purpose of this document is to provide information on these subjects in a dispassionate way to enable our clients (and those who are considering joining their ranks) to understand better Marathon's views on, and approach to, sustainability both philosophically and in practice.

[1] *Marathon also sometimes identifies opportunities related to sustainability too; although more recently we find that that these are frequently well known and already discounted in the valuation of the companies.*

# What Marathon means by Sustainability

At Marathon, sustainability covers a variety of topics including:

- the impact of non-financial factors (such as ESG) on our investment philosophy and process;
- stewardship activities such as engagement with companies and active ownership (i.e. voting on company meetings) which seek to improve the businesses in which we invest; and
- what Marathon is doing itself as a company – rather than in the portfolios under our care – in relation to similar factors, such as efforts towards reducing carbon emissions, improving conditions for our staff and considering our societal impact.

In relation to the first point, it may be useful initially to define what Marathon does *not* do.

Marathon does not claim to be an "ESG manager" – whatever that might mean – and we have no intention of using this document to lay dubious claim to our portfolios being somehow more 'virtuous' than others. We do not seek to invest in accordance with any particular ethical view, nor do we screen out companies, countries or industries from our investment universe based on sustainability or other criteria (beyond any legal or regulatory obligations to which we or our clients/funds may be beholden).

Nevertheless, we do consider sustainability risks and opportunities within the process.

What are now described as "ESG risks" are nothing new. They have always presented the possibility of loss over the long-term for the companies in which Marathon invests, and as such they have always been considered in the investment process. The opportunities presented by ESG related issues are also an important source of investment ideas and many holdings have been bought over the years, at least in part, because their sustainability characteristics were not fully appreciated – or valued – by the stock market at the time.

Stewardship is also core to Marathon's process. Voting thoughtfully, engaging actively and, where necessary, escalating forcefully are, we believe, core investment duties. At Marathon, we see ourselves as company owners. We are not price speculators or passive shareholders. Where we see aspects of the business that, in our view, could be improved, we make our views known, and vote for those resolutions that we believe are most likely to improve the business, and thereby enhance asset values, over the long-term. As long-term shareholders, Marathon often has a strong relationship with the boards of companies we invest in. As a result, they also contact us from time to time to solicit our views.

Finally, Marathon itself is committed to being a good corporate citizen. While we believe that this has been the case for many years, there are always emerging areas of concern, innovations in the markets and enhancements which can be made. Marathon conducts regular reviews of its business activities. Recent reviews have focused on environmental impact and inclusion & diversity within the business, but we also regularly consider staff wellbeing and community impact.

The following pages provide examples on all of these issues.

# Examples of Sustainability: Investment Decisions

Marathon's primary objective – the fiduciary duty to add value within clients' agreed risk parameters – is enhanced by considering material sustainability issues and opportunities. Although sustainability will rarely be the main reason for an investment, or for the avoidance of one, it can have a material impact on decisions.

As previously mentioned, sustainability risks are, ultimately, financial risks to a company. However; many are "long tail risks", meaning they could occur at any time, but have a low probability of occurring at any *particular* time. For example, poor environmental practices may not have an impact today, or in the next year, but could lead to fines, litigation and clean-up costs eventually.

Even though the long-term risks are clear, management teams often suffer from short-termism. This results from a temporal form of "moral hazard"; poor practices may benefit a company's finances in the short-term as long as the worst does not happen, because it is often cheaper to behave badly than to behave well. Combine this with short-term incentives for management and short director tenures and the hazard is magnified.

To compound the issue, this moral hazard is shared by those investment managers who look at short performance time horizons. We would argue that the use of "ESG screens" and distinct sustainability research and/or engagement teams which separate stewardship functions from investment management, is an attempt to mitigate this inbuilt conflict.

At Marathon, our investment horizon is five years plus (currently the business has a weighted average holding period of around eight years across all portfolios). As a result, our portfolio managers are not so subject to this conflict and have an incentive to seek improvements in the companies they invest in, even at the expense of short-term performance. This forms the foundation for our stewardship efforts with the companies in which we invest.

## Examples of holdings where sustainability factors are material:

### Taiheiyo Cement, Japan

Taiheiyo Cement, a holding since 2019, is Japan's largest cement producer with a high market share on the US West Coast too. Cement is a dirty product which generates substantial carbon emissions but it is also fundamental to human society and is the second most consumed material on earth, after fresh water.

One of the attractive features of Taiheiyo Cement is that it has developed processes which allow it to incorporate substantial quantities of recycled material into its cement, making it a (relatively) low emission producer. This proprietary process – which creates cement suitable to meet the requirements of notoriously earthquake-prone Japan – is an attraction for Marathon. As governments globally legislate ever further to reduce carbon emissions there is scope for the business to monetise this proprietary knowledge – potentially through acquisitions or licensing, but also perhaps as a target for acquisition by another major cement producer.

### KAR Auction Services, USA

KAR Auction Services is a wholesale seller within the used car market in North America which is a recent addition to Marathon's portfolio. KAR is a major player in what remains a highly fragmented market, and one of the attractions of the business to Marathon is that it has a good management team, with a clear vision and ideas about how best to deploy capital. Management are undertaking a strategy of cautious acquisition where it makes financial sense and have used this strategy to grow the business for many years.

The business is attractively valued and is in a market segment which is consolidating, which makes it attractive from a capital cycle angle. However, the fact that the governance structure is strong and effective and that management have displayed a strong discipline over many years in allocating capital according to a clearly defined plan formed a significant part of the investment case for this business.

### Swedish Match, Sweden

Swedish Match, a tobacco company held in some portfolios by Marathon since 2010, may be an unusual example to highlight in this section; however, this business has been pivoting from traditional tobacco products to alternative nicotine delivery methods for many years (having sold its cigarette business in 1999). In particular, the business has been successful in introducing its nicotine pouch products to the US market, where they have become popular replacements among both chewing tobacco enthusiasts and cigarette smokers. These products appear to have significantly fewer negative health effects than tobacco itself, and substitution of traditional products like cigarettes with these oral pouches is therefore likely to have societal health benefits over time. As a result, we view the business as – relatively speaking – a socially responsible choice in its sector.

## Example of a transaction undertaken in part due to sustainability concerns

Sustainability concerns can, occasionally, lead Marathon's portfolio managers to seek to sell out of an investment, or provide enough uncertainty to dissuade a purchase.

### Sale of Canadian Natural Resources and purchase of NOV and Prairie Sky Royalty, Canada

Canadian Natural Resources, an oil and gas company, was held in Global portfolios until early in 2021. Marathon's portfolio managers re-assessed the holding over the winter and one issue, amongst several concerns, was the company's relatively poor environmental practices. Oil is not a clean industry; however, a number of other options to provide exposure to the Canadian oil sector were considered, and several had a stronger reputation on sustainability as well as good valuations and other attractive features. As a result, Canadian Natural Resources was sold from Global portfolios and replaced by **NOV Inc** and **Prairie Sky Royalty Ltd**. Both companies have better ESG credentials and, in Marathon's view, prospects than the former holding. In addition, NOV, which is a technology/services supplier to the traditional energy sector, is now developing strategies to use its technology for areas such as offshore wind installation. While currently a small part of the business, this has the potential to grow over time.

It should be noted that this sale does not imply that Canadian Natural Resources is a "bad company", and Marathon may take a position in the business again in the future. What it does mean is that, at the valuation at the time, it was felt that the potential rewards from continuing to hold were outweighed by the risks, including the environmental risks, identified.

# Examples of Sustainability: Stewardship

## Engagement with management

We provide several examples of recent engagements between Marathon's portfolio managers and investee companies below. Due to the sensitive nature of engagement activity, where it is currently ongoing or particularly sensitive, we have chosen to leave the company involved anonymous.

### East Asian conglomerate

Marathon has invested in a large East Asian conglomerate for over five years and during that time has repeatedly expressed concerns about the business's sprawling, complex corporate structure and lack of focus. Despite this, limited progress has been made, and some actions in the past year have actually made the structure more complex rather than improving the situation. As a result, Marathon recently wrote a letter to the company's board informing it of our intention to support a shareholder proposal to replace the existing board.

### Entain Plc, UK

Entain (formerly GVC Holdings), a UK-listed international gaming company and long-term Marathon holding, reached out to Marathon for advice on an alteration of its executive remuneration scheme. Following the departure of their CEO, the business wanted to restructure its executive pay policy to reflect better the international nature of the company and business it now competes in. Marathon provided advice on our general preferences for executive remuneration (that the structure should create significant share ownership over time and the kinds of performance measures we prefer to see to determine scale) based on what we see other businesses doing to align better remuneration and retention.

### Greek Banks

In late 2020 Marathon received a request from the board of a Greek bank that we invest in to approach the Greek government in relation to the legal restrictions on remuneration that are in place in the industry. Following the Global Financial Crisis, and Greece's well-known problems thereafter, legal restrictions were imposed on banking remuneration. This was understandable given the state of the economy and the banking industry at the time; however, an unintended consequence has been the drain of talent from Greece to other jurisdictions with fewer restrictions. Upon consideration, Marathon made representations to the Greek Ministry of Finance to request some relaxing of the restrictions in order to permit Greek banks to begin to repair their competitive position.

## Voting

As well as engaging with management, Marathon is an active owner of the companies selected for our client portfolios. Information on proxy voting firmwide can be found on the Marathon website ([www.marathon.co.uk](http://www.marathon.co.uk)) and, for clients, details of all votes which impact their portfolio can be found in the client area of the website.

Marathon's portfolio managers are ultimately responsible for each vote cast. Our default position is to vote in-line with the recommendations of our proxy voting advisor, Institutional Shareholder Services (ISS). ISS provides recommendations for all votes based on a number of criteria, often based on quantitative data. While this is a useful starting point, it can ignore local norms and business specific nuance. Portfolio managers will dissent from ISS views where they believe it is in the best interests of clients to do so.

Overall, in 2020, Marathon's voting was aligned with ISS 98% of the time on management proposals (8,390 such proposals were voted upon) and 92% of the time on shareholder proposals (218 such proposals). Further data on Marathon's voting track record can be found on the website at: [https://www.marathon.co.uk/sustainability/proxy-voting-dashboard/](https://www.marathon.co.uk/sustainability/proxy-voting-dashboard/)

We provide below information on some instances where Marathon has dissented from ISS (and sometimes management) views:

### Facebook Inc., USA – May 2020

Marathon supported three shareholder proposals in relation to improving corporate behaviour (to require the company to report on median gender/racial pay gap, undertake a civil and human rights risk assessment and to require and independent director nominee with human and/or civil rights experience). The proposals were rejected by management and ISS, who opposed these three despite supporting most shareholder proposals, as it believed adequate measures were already in place. Marathon believes that the added disclosures and pressure applied from a specialist independent director would further focus the company's thoughts and effort on the role it plays in society, which have been subject to substantial criticism and scrutiny in recent years. All shareholder proposals failed, as Facebook's share structure makes any proposal opposed by its CEO, Mark Zuckerberg, impossible as he holds over 60% of the voting power of the company, but much less of the economic ownership. Nevertheless, Marathon will continue to advocate for companies to behave positively towards the societies they serve.

### Svenska Handelsbanken AB, Sweden – March 2021

ISS objected to the re-election or election of a number of directors either because they viewed them not to be independent or to have spent too long as board members. After speaking to management, we agreed with them that long experience is important in a bank board, and that the proposed directors provided a good combination of experienced and new members. The issue of independence arises from a difference between ISS standards and the requirements of the Swedish Corporate Governance Code, and all the board members described as independent met the definition in the code. As long-term shareholders, voting against the reappointment of directors we know well and admire simply due to their long tenure would send a contradictory message, although we understand the rationale behind ISS's policy. All directors were elected despite ISS's objection.

### Mahindra and Mahindra, India – August 2020

Mahindra and Mahindra, one of India's many largely family-owned businesses, was undergoing a CEO transition; seeking to move the management of the business from the family to non-family. Marathon was keen to support this move, given the nominee's views on capital allocation and exiting loss-making subsidiaries. ISS took issue with the proposed remuneration structure as it was largely at the discretion of the board. However, the corporate decisions that needed to be made were long dated and the company made the argument that it was difficult to develop a set remuneration framework for such complex actions. They also pointed out that when benchmarked to other industrial groups in India the remuneration structure proposed was appropriate. In our view, the long-term benefits from the transition of management at the firm outweighed potential concerns about remuneration structure, and we voted against ISS's advice. The vote passed with 82% shareholder support.

# Sustainability within Marathon

Marathon seeks to be a socially responsible business. Although we believe that we perform relatively well in this regard, there is always more that can be done. The world is not static and new concerns and opportunities arise all the time. As a result, we consider the business's environmental and social impacts, including staff wellbeing, on an ongoing basis and actively seek out potential improvements.

Initiatives include:

**Environmental impact**

- Recycling review – seeking to increase amount of waste recycled
- Installation of energy saving hardware (e.g. lightbulbs, sensor switches)
- "Cycle to work" scheme providing staff access to bicycles and e-bikes paid for via salary sacrifice pre-tax income (and currently consulting on the introduction of an equivalent "Electric vehicle" scheme)
- Installation of water filtering taps (faucets), which provide chilled and boiling water, reducing use of bottled water
- Electricity purchased from a "100% renewable sourced" supplier
- An initiative to look into the use of a carbon offset scheme to achieve carbon neutrality is underway

**Community**

- A "payroll giving" scheme is also available, allowing staff to pay regular charitable donations from pre-tax income
- Marathon will take part in the #10,000 BlackInterns initiative to provide paid professional experience to young people from minority backgrounds
- The company runs a volunteering scheme whereby staff may periodically volunteer to work at a partner charity

**Inclusion and Diversity**

- Engage recruitment agencies with clear I&D Policy, mandate a diverse candidate slate for all positions and ensure interview panels are diverse
- Review job descriptions to ensure gender-neutral language is used
- Line Manager training (e.g. on Inclusive Leadership) and add an inclusion-focused performance objective
- Initiatives (including mentoring and internal recruitment) to improve the career options for diverse staff members
- Project underway to measure and provide meaningful information on diversity across the business within the constraints imposed by UK law

**Staff wellbeing**

- Marathon provides a competitive package of pay and benefits for staff in order to attract and retain talented employees, and to support them in achieving a happy and healthy lifestyle
- At the onset of the covid-19 pandemic, the business provided hardware to facilitate and make home working safe, including desks, chairs and IT equipment, an access to "wellbeing" resources including Headspace
- Access to an Employee Assistance Programme providing access to a counselling and advisory services both in person and remotely
- Introduction of a virtual social committee was created to provide staff with access to remote social events to help foster team spirit and reduce the possibility of isolation during the covid-19 crisis

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