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Orca Asia Fund ESG Annual Report 2021

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Introduction

Welcome to the first Orca Asia Fund Environmental, Social and Governance (**ESG**) Annual Report.

Calendar year 2021 has been a transformational year for Orca Funds Management (Orca) with respect to the documentation of our ESG policies, and our aspirations in aligning our processes with the United Nations Principles for Responsible Investment (**UNPRI**) guiding principles.

As signatories to the UNPRI, we are strongly committed to the UNPRI principles of responsible investment, with these principles guiding the formulation of our ESG approach. This includes how we:

- incorporate ESG issues into investment analysis and decision-making
- engage with companies and act as stewards of investor capital
- participate within the investment community on ESG-related issues
- report, disclose and make available information to stakeholders, and
- continuously monitor and improve our practices.

We are proud to report some strong ESG related metrics for our portfolio given our exposure to companies with robust ESG credentials. In addition, we are pleased to detail our activism around company engagement and proxy voting on ESG areas of concern. Whilst we believe that our portfolio companies are excellent businesses with strong product offerings, we note there is often scope for improvement. In these instances, we seek to actively engage and advocate for more sustainable operating practices.

During 2021, we undertook a number of key portfolio actions to align our portfolio with our internal ESG aspirations. This included divesting both an energy company to achieve zero exposure to commodity extractors, and an electronics company that failed our governance review. These portfolio changes are detailed within this report.

ESG overview of the Orca Asia Fund portfolio

Portfolio ESG Rating	Carbon Footprint	Company Engagement	Proxy Voting
A+	16%	81%	98%
Investment Grade Based on Orca's proprietary ESG rating model	of the MSCI World Index (tCO_2e / $m invested)	% of portfolio companies engaged regarding ESG concerns	Active voting record in company motions for shareholders

All ratings are from an internal ESG audit of the holdings in the Orca Asia Fund as at 31 December 2021.

Going forward we will continue to target:

- maintenance of a portfolio ESG rating of A and above (A+ achieved for 2021)[1]
- an increase in the level of our company interaction on ESG issues (81 per cent achieved for 2021)
- maintenance of carbon footprint at sub-30% of the benchmark index MSCI Asia ex-Japan (16 per cent achieved for 2021)
- voting on 100 per cent of proxies (98 per cent achieved for 2021).

We hope this report provides our investors a better understanding of the ESG credentials of our portfolio. We are committed to acting as stewards of investment capital, in a sustainable way, and seek continuous improvement of our processes and those of our portfolio companies.

The Orca Asia Fund Team.

1. An overview of Orca's ESG rating scale is provided on page 6 of this report. Details can also be found in Page 3 of our ESG Advocacy Policy.

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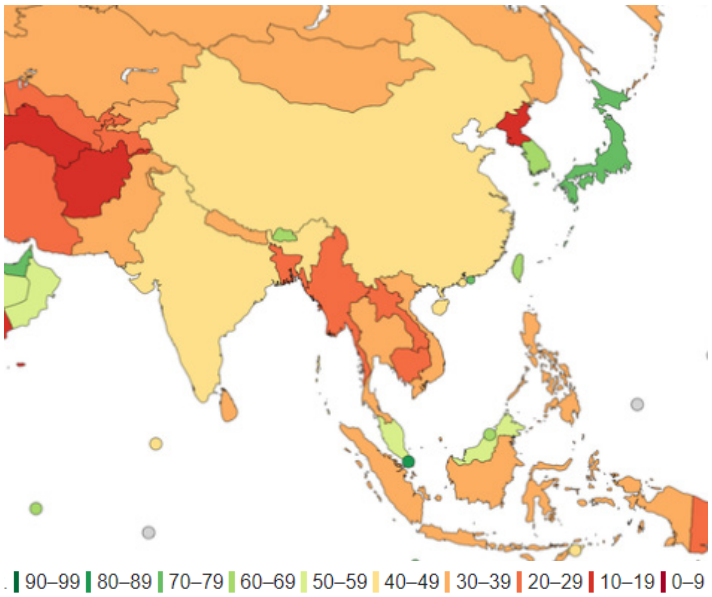
ESG and Asian investments

The Orca Asia Fund covers all the Asian regional markets outside of Japan. We've found that companies' approach to ESG varies greatly, often in-line with distinct regional differences. There are different disclosure requirements, and types of firms. Korea has their Chaebols, India has promoters, China has A shares, H shares, national champions, and ADRs with VIEs! Each type of company brings governance dynamics, which are the biggest differentiator to US and European companies, which are more homogenous.

Map showing Asian countries according to the Transparency Corruption Index, 2020[2]



We've seen improvements in recent years, driven by government policy, stock exchange requirements, and pension and sovereign fund pressure. China, Japan, and South Korea have signed up to carbon neutral plans by 2060, which will in turn pressure companies to comply with incoming regulation. Singapore and Hong Kong stock exchanges have introduced sustainability reporting guidelines. From the demand perspective, a recent MSCI survey found 57% of Asia Pacific investors were found to incorporate ESG issue in decision making[3].

An example of likely future regulatory action is on data security and privacy. In the US and Europe there has been strict regulation over who holds data for what purpose, and how it is protected. Through Asian markets, there are big internet and data companies who hold arguably more consumer data than western peers, with less regulation to protect the consumer.

We expect to see Asian regulations converge to tighter standards seen overseas in coming years.

Broadly speaking, through our ESG analysis we have identified a number of unique attributes of Asian markets which vary from those of US and European developed market peers:

- While environmental policies are supported, and there is frequently a link made between corporate culture and environmental goals, it is rare to see a pathway to net zero or the utilisation of international benchmarking standards. In general, there is less adoption of ambitious goals or targets to dramatically reduce a company's environmental footprint, despite environmental policy support.
- Social policy sees an emphasis on charitable and social activity, with less disclosure relating to working conditions. In general, working conditions compare negatively to Western counterparts, with lower wages, and less protection for workers' rights. This is rarely a focus in ESG reporting.
- Governance standards vary considerably, with generally entrenched boards of vested interests, often due to high family stakes and related party ownership. This comes back to the variation in structure related to Asian public companies and their evolution over the last century (with a generally concentrated shareholder basie).
- Investor activism through shareholder voting is also limited. Western companies generally face regular shareholder votes on ESG issues, offering the opportunity for stakeholders to influence a company via proxy voting. This is less common in Asia, with relatively procedural issues dominating voting opportunities. Although we vote actively at every opportunity, it is less common that resolutions relating to pertinent ESG are presented to shareholders at shareholder meetings. Despite the lower levels of proxy voting, the Orca Asia team does still engage directly with companies related to ESG concerns as and when these are identified through our ESG analysis.

2. Transparency International: https://www.transparency.org/en/cpi/

3. MSCI: www.msci.com/documents/1296102/22910163/MSCI-Investment-Insights-2021-Report.pdf

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Case study: Divesting a Korean electronics company

After an ESG review of one of our holdings, a Korean electronics conglomerate, we divested the holding from the portfolio as the company failed our review on both Social and Governance grounds. As background, the company is a chaebol – a family-owned conglomerate. The head of the family, who is the Vice-Chairman of the company, was imprisoned for five years for bribing a senior politician with $40 million equestrian investment. The bribe was alleged to result in a merger approval to increase his ownership stake in the company. The Vice-Chairman served 11 months in 2017, then was released by the High Court, then sent back again by the Supreme Court in January 2021. He was released in August 2021 on parole, and still faces further charges for a $4 billion accounting fraud case, stock manipulation, and illegal use of propofol.

The Vice-Chairman was released early after a new law was passed by parliament, with the government stating it was in the national interest due to the positive impact on the economy, as strategic plans couldn't be made without his presence. US customers lobbied on his behalf to reduce semiconductor shortages. Days after the release, the company announced a $205 billion investment plan and signed deals with four labour unions to improve worker conditions after his release.

The company failed on our social review due to systematic corruption and poor labour conditions.

- The company has an outsized influence on the country's economy and politics. Due to the company's actions, the previous national President was sent to jail for corporate corruption, and the company has used their political and financial clout to repeatedly get family members pardoned for crimes.
- The company has labour issues, taking an active stance against trade unions, with low wages, limited welfare, long hours and poor conditions. They are alleged to have supported kidnapping and beating of union leaders. 32 of the company's employees were indicted for illegal anti-union activities, including a family member and board member. 26 were found guilty with two senior executives sentenced to jail time. Evidence gathered by China Labor Watch showed the company has utilised children under the age of 16 in its workforce, while working conditions have been dangerous with exposure to hazardous chemicals, and more. The company has formally recognised exposure to toxic chemicals and paid compensation.
- Last year, following the release of the Vice-Chairman from prison, the company signed their first ever collective bargaining agreement with 95 conditions and apologised for their history of anti-union activities.

The Company failed our governance review due to an opaque management structure, and effective control by a convicted felon who is unsuitable to act in the role.

- The management structure was opaque from 2018-2021, with three co-CEOs. In December 2021 it was restructured to a single CEO. Despite this, control clearly lies with family head and Vice-Chairman, as evidenced as the requirement for his release for a strategic plan to be approved. The Chairman position has effectively been vacant since the passing of the Vice-Chairman's father, although eventually the current Vice-Chairman is likely to assume the position.
- The board does not provide independent oversight and there is no effective shareholder representation to reduce the influence of the controlling family.

We completed the review on 17 December 2021 and sold out on 20 December 2021.

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Portfolio carbon emissions

The following tables summarise the Orca Asia Fund's listed equities carbon emissions, in contrast to that of the benchmark MSCI Asia ex-Japan index. The **Carbon Footprint** is a *normalised* measure that expresses the carbon contribution of portfolio companies based on a one-million-dollar USD investment in the Orca Asia Fund. The **Weighted Average Carbon Intensity** is a measure of exposure to carbon intensive companies and is useful as a proxy for carbon risk within the portfolio.

The Orca Asia Fund ended the year at just 16% of the carbon footprint of the benchmark index – a meaningful reduction versus that of the benchmark index.

Carbon Footprint (metric tonnes CO_2 emissions/US$million invested)

	Dec-2021
Orca Asia Fund	17.7
MSCI Asia ex-Japan	108.7
vs Index	*-84%*

Weighted average carbon intensity (metric tonnes CO_2 emissions/US$milion sales)

	Dec-2021
Orca Asia Fund	65.3
MSCI Asia ex-Japan	330.9
vs Index	*-80%*

Source: MSCI ESG Research, Orca Funds Management. Includes Scope 1 (Direct) and Scope 2 (Indirect emissions)

Orca proprietary ESG rating system

Overall portfolio ESG rating

Portfolio ESG Rating

A+

Investment Grade
Based on Orca's proprietary ESG rating model

The Orca Asia Fund achieved a portfolio rating of A+[4] for ESG based on our proprietary ESG rating model. This implies that, overall, the portfolio companies are generally highly investable from an ESG perspective with skew to a lower (mild) level of controversies.

As detailed in our ESG Policy, Orca have developed and implemented a proprietary process for scoring businesses on ESG risks and opportunities. Prior to investment, each prospective investment will have a full ESG analysis completed by the team, with an overall ESG score assigned. This score is based on the team's opinion of the company's performance against each of the three pillars of the ESG framework – Environmental, Social and Governance – and in aggregate (typically an average of each pillar).

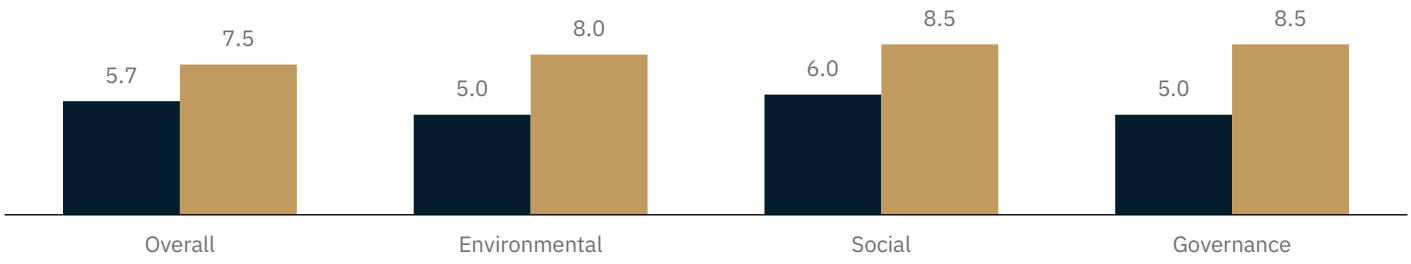
To derive an overall portfolio score, individual company scores are collated and averaged based on portfolio weightings. This score is then translated into a rating per the conversion table below. We use ratings (similar to those used by debt rating agencies) as we believe they provide better indicators of the investability of a stock.

Orca ESG rating system

	Orca score	Orca rating	
Investment Grade	10	AAA	**Leader** **Proactive** in managing ESG risks and **opportunities**
	9	AAA	
	8	AA	
	7	A+	**Investable – some areas of concern** Mild to moderate controversies, varied quality/ambition in ESG policy
	6	A	
	5	BBB	
Non-Investable	4	BB	**Non-investable** Mixed track record with some exposure to significant controversies ↓ High exposure and failure to manage ESG risks
	3	B	
	2	CCC	
	1	CC	
	0	C	

The above table illustrates how an ESG score assigned to an individual company translates into an investment rating. Orca will not invest in any company that is rated a BB or lower (sub-investment grade) for any of the three E, S or G pillars – as it is deemed non-investable.

Minimum and maximum assigned company scores by pillar



Source: Investment Manager

4. This rating excludes cash and non-liquid legacy investments to which we do not assign an ESG rating.

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Company scoring examples

While our portfolios overall average ESG rating is highly investable (A+), the underlying environmental, social and governance pillar contributions that underlies it reflects a broad range of scoring (as per the minimum and maximum scores above). To help provide insight into the Orca ESG rating process, the following tables go through specific company examples (names redacted) to illustrate their rationale.

Petrochemical and EV battery producer

One of the best ranked companies in our portfolio from an environmental perspective, this company is an industry leader in EV battery manufacturing.

What we like

This company is a market leader in the industry, producing up to a quarter of the world's EV batteries. While the legacy petrochemical business is carbon intensive and generate large amounts of toxic emissions, the company is shifting its strategy towards clean technology and renewable energy such as EV batteries, organic light emitting diode (OLED) materials, and water treatment. The company has set a target for carbon neutral by 2050 and committed to sourcing 100% of its electricity from renewable sources by 2030.

Areas for engagement

While electric vehicles are beneficial in addressing climate change, the technology is still in relatively early stages and thus carry risks around safety for consumers. We also raise concerns on governance where the company is largely controlled by the family and has a complex ownership structure. We also flag the lack of gender diversity on the board with the entire board consisting of males.

How we differ from the external view

The company is rated highly on carbon emissions by an external rating agency on its exposure to clean tech. While we agree on the company's positive transition and superior position relative to peers, we note that more than half of its revenue is still derived from carbon intensive sources.

Convenience store and big box retailer

One of the worst-ranked companies in our portfolio from an environmental perspective, this company is the largest convenience store and big box retailer in Southeast Asia.

What we like

The company plays a key role in modern retail and provides the Thai population with access to FMCG and other services such as banking and payments in a country with relatively low modern retail penetration. As a relatively large employer of 64,000 people, we view its labour management efforts positively with its employee benefit program, education centres and welfare programs offered to employees. Lastly, we rank the company highly around its compliance system and information security processes.

Areas for improvement

We highlight concerns on the company's environmental aspect. As an FMCG retailer, a large part of the products that it sells are highly carbon intensive and heavily rely on raw materials with high environmental impact. There are some initiatives to lower its carbon intensity such as reducing the use of plastic, but the company lacks a specific timeline to reach carbon neutral. In addition, from a social aspect we would like to see the company focus more on product safety and reduce the instances of product recalls.

How we differ from the external view

There has been concerns around the products that the retailer provides and the lack of nutritional offerings. While we would like to see changes in this area, we see the social benefits that the company provides to the region outweighs the concerns.

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Consumer internet company in Southeast Asia

One of the best-ranked companies in our portfolio from a social aspect, this company is the largest e-commerce player in Southeast Asia, a digital game producer, and a provider of financial technology.

What we like

Substantial social benefits to the developing countries across ASEAN in which it operates by promoting digitalisation, empowering SME's, and lowering barriers to entrepreneurship. Through its marketplace platform and financial services segments, the company plays a role in improving product availability for consumers and promotes financial inclusion to a region where a large part of the population are categorised as underbanked or unbanked. The company is also one of the leaders in the industry in providing training for merchants.

Areas for engagement

While the nature of the business is low carbon intensive and has a positive impact to the environment, there is limited disclosure to its carbon emissions figures and the company does not set specific environmental targets. We also highlight concerns on governance as a majority of the board is not independent and the stock has a dual voting structure resulting in substantial control to the founders.

How we differ from the external view

The company is currently not on the radar of the major ESG rating providers we subscribe to.

E-commerce platform and cloud service provider

One of the worst-ranking companies in the portfolio from a social perspective, the company has been criticised for advocating long hours and overtime by social media and generally lack of disclosure on controversial issues.

What we like

The company is becoming highly engaged in social issues including employee welfare and benefits as well as the highest standards for data security and privacy. As a leader in internet-based e-commerce provider and enterprise service provider, they possess enormous amount of data and information with higher social responsibility. The company in its latest investor day, has proactively promoting the best practice in engaging employees as well as all stakeholders. In addition, they committed to set the highest standards in data security and information privacy.

Areas for improvement

There have been concerns about the business practices including antitrust practice which have been fined by regulators in 2021. The company has worked closely with the regulatory agencies to rectify issues and adjust business structures not only in line with requirements but also to be more towards to leading peers. As a high-profile company in almost everyday lives for most, the company is expected to have more social positive energy generated via their leading practice other than simply zero controversy.

How we differ from the external view

Externally, the company is rated slightly above average on social perspective. We see the company becoming more engaging on ESG issues and have integrated ESG as foundation to their business practice. We view this as very positive but wait to see their implementation and execution in the future.

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Media and technology company in South Korea

One of the best-ranked companies in our portfolio from a governance aspect, this company operates the country's main search engine, a mobile messenger and a digital content platform.

What we like

Contrary to governance practices in the region, this company is a leader versus its regional peers. The company has been proactive in improving its governance in the past couple of years by bringing in an external director to replace the CEO and chairman, increasing the percentage of outside directors. In addition, the company does not have a controlling shareholder or a special capital structure. The company has also revised its shareholder return policy to incorporate share buybacks with cancellation and has a specific percentage to be returned to shareholders. From an environmental aspect, the company is an industry leader in energy and water efficiency and has set a target of carbon negative by 2040 by transitioning its energy consumption to renewable energy.

Areas for engagement

There are concerns on the company's human resource management and evidence of a lack of work-life balance, office bullying and recent controversies around the suicide of an employee. There has also been risks with the regulators for its market power in the online search engine space and questions around anticompetitive practices. Lastly, we highlight the need to improve gender diversity to include more females in the board of directors.

How we differ from the external view

The company is given the highest ESG rating from an external agency that we subscribe to. However, we highlight several areas of concern around its human capital policies that still require improvement.

Tool manufacturer

This company rates poorly on Governance, despite strong ratings on other areas. This Hong Kong based industrial manufacturer exports predominantly to the US.

What we like

The company has stated good intentions on ESG, with a plan due out in mid-2022. They produce environmentally friendly products, displacing polluting legacy technology. They appointed their first female director in 2021. They haven't had issues around corruption, cyber breaches, anti-trust, and their reporting on issue sis strong. They pay an appropriate tax return. The company has established an ESG working committee.

Areas for engagement

We have some concerns about the structure of the board. Half of the board has served over 15 years, and are not independent. Their ESG push has been assigned to the founder's son, so is unlikely to consider vested interests. They had no female representation on the board until 2021. Shareholders are not well represented.

How we differ from the external view

Governance is flagged by others. We are keen shareholders, and very positive on all other aspects of the company. We understand that founders were responsible for much of the innovation and sound business decisions in the past. However, we worry that the company will be handicapped in decision making in the future. We have engaged with the company.

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The Orca Asia Fund team

Ted Alexander

Portfolio Manager & Head of Investments

Ted is Head of Investments at Orca Funds Management and Portfolio Manager for the Orca Asia Fund and the Orca Global Fund.

Prior to this Ted worked at Magellan Financial Group where he was Portfolio Manager and Head of Healthcare, as well as being a voting member of the Investment Committee and the Macro Committee.

Ted also previously worked as a Portfolio Manager at Neptune Investment Management, where he was Head of Alternative Investments, Head of Technology and Telecoms and ran several strategies including European Long/Short Equities, Global Long/Short Equities, UK Equities, International Bonds, and UK Corporate Bonds. He initially commenced his career at the Reserve Bank of Australia.

Ted holds a Master of Philosophy in Economics from Oxford University, where he was a Rhodes Scholar, and has a Bachelor of Economics with First Class Honours from the University of Tasmania.

Ying Luo

Assistant Portfolio Manager

Ying is Assistant Portfolio Manager of the Orca Asia Fund.

She brings more than 12 years of dedicated equity research experience to her specialist role, where she researches and recommends high-quality companies with attractive risk-adjusted returns over the long-term period in the Asia Pacific region.

Prior to joining the Orca Funds team, Ying worked at Principal Global Investors in the Global REITs team, where she was responsible for the research of Australian and New Zealand listed real estate companies. She also worked for AMP Capital Investors as a senior investment analyst on two of their key Asia funds.

Ying has a Master of Commerce from the University of New South Wales and a Bachelor of Commerce from the University of Melbourne. She is also a CFA Charterholder and full member of CPA Australia.

Irene Liando

Senior Analyst

Irene is Senior Investment Analyst for the Orca Asia Fund.

Prior to joining the team, Irene worked at Schroders in Indonesia where she was an equity analyst and a portfolio manager. As an analyst, Irene was responsible for the telecoms, media, retail, mining and healthcare sectors. Prior to this, she was based in California where she initially started her career at Dimensional Fund Advisors as an associate in the International Equities team.

Irene holds a Bachelor of Science in Business Administration with a concentration in Financial Analysis and Valuation with First Class Honours from the University of Southern California. She is also a CFA Charterholder.

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Signatory of:

PRI Principles for Responsible Investment

Important information

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