SKAGEN

ANNUAL SUSTAINABILITY REPORT 2023

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IMPORTANT INFORMATION

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In SKAGEN, our clients are us, our family, our friends, and our neighbours. And when you are that close, you better be sure that what you claim is true and rooted in the facts. Photo: Vidar Nordli-Mathisen, Unsplash.com

A client-centric approach: investing for financial gain and sustainability

While we do not claim to be able to slow climate change, we can say that when we invest and engage with a company, we do so because we see a clear fiduciary benefit to our unit holders, one rooted in financial gain and better sustainability outcomes.

Anyone could be forgiven for struggling to make sense of the many messages and claims that currently abound relating to sustainability. Indeed, it's all gone a bit mad with, in the US, several states now legally challenging the securities regulator for imposing a long-anticipated rule on company climate risks, and several US financial behemoths withdrawing from established climate coalitions.

How did it come to this? I suspect the truth is that this is another casualty of beliefs and feelings trumping facts. I am equally unimpressed by the way in which the finance industry has approached sustainability; too many have cloaked themselves in the garb of ESG as a sales strapline, without really reflecting on what they might credibly claim with the knowledge and capacity at their disposal.

A key advantage of being an investment boutique, is that we are close to our clients. In SKAGEN, our clients are us, our family, our friends, and our neighbours. And when you are that close, you better be sure that what you claim is true and

rooted in the facts. In their 2023 review of ownership actions by the investment team, the SKAGEN Board noted that the firm has been an active and responsible fiduciary agent for the unit holders in the funds. The portfolio managers abide by a sensible and science-based sustainability policy. Sustainability analysis is an integrated part of the investment process for every investment, and this is documented. Our claim to active engagement is evident in the ESG cases that we have pursued and resolved during the year. And we maintain a near one hundred percent voting record for the companies in which we invest. You can read about our engagement and voting activities in 2023 further on in this report.

I cannot reasonably claim that investing in SKAGEN will slow climate change, or halt the destruction of biological diversity, or redress the parlous inequality in the world. What I can say, is that when we invest and engage with a company, we do so because we see a clear fiduciary benefit to our unit holders, one rooted in financial gain and better sustainability outcomes. We know why we are engaging and what we expect to gain from it. This has nothing to do with some abstract third-party rating by a self-proclaimed sustainability expert; it has everything to do with a deep knowledge of the companies in which we invest, and how we think they might improve and thrive.

Where we might arguably improve, is in convincing you, our clients, of the value of this work, and informing you of the benefit it accrues. This report, with its analysis of sustainability opportunity and our approach to integrating this in our investment process, along with examples, makes some effort towards this. I hope you enjoy it.

Sustainability analysis is an integrated part of the investment process for every investment, and this is documented. Photo: Victor, Unsplash.com

Timothy Warrington
Chairman, SKAGEN AS

Last year, SKAGEN Kon-Tiki and ESG Team conducted site visits in Brazil with sustainability as the key agenda point. Photo: Raphael Nogueira, Shutterstock.com

ESG Engagements in 2023

Engaging with companies is a key part of an active manager's responsibility and ESG topics regularly feature on the agenda. We get to know the companies we invest in and offer our advice on improvements. Before deciding to invest in a company, we must have conviction in what that company is doing and trust that it will deliver value.

Our 2023 engagement activity

In 2023, SKAGEN engaged with 24 separate companies on 24 different ESG cases. The engagement level is higher than 2022 when SKAGEN engaged with 8 separate companies on 8 different ESG cases.

Environment-related engagements made up the largest category of ESG dialogues in 2023, with the focus being on transition pathways and decarbonisation. Environment-related engagements made up 38% of all ESG engagements during 2023.

SKAGEN has always maintained the importance of site visits, which gives us a chance to "kick the tyres" and get to know the companies and people that we invest in. Last year, SKAGEN Kon-Tiki and the ESG Team conducted site visits in Brazil, with sustainability as a key agenda point. We wanted to understand the local conditions and efforts being made by our most exposed companies and hear about their plans for managing sustainability concerns going forward. We met with Suzano, a pulp and paper company, and learned about the ESG benefits of their vertically integrated model, their process improvement efforts and net-zero plans. In a similar vein, Raizen, an integrated energy company, is making a move into second-generation ethanol production (E2G), which uses waste from the first-generation production to generate new product and revenue lines. Circularity and stewardship of their local ecosystem is symbiotic with long-term business success and resilience.

Social-related ESG engagements made up 25% of dialogues in 2023, with the focus being on the topics of human rights and occupational, health and safety (OHS). On the social front, SKAGEN voiced our expectation that Dollar General, the US retailer that operates discount stores, should immediately remedy the significant social issues facing many of their shops. These issues relate primarily to safety and the state of the physical working environment. In a meeting we had with management, Dollar General presented a plan which we believe is comprehensive and we will monitor its effectiveness going forward. We also conducted fact-checking exercises regarding potential human rights risk exposures in conflict/sensitive areas and are currently content with the respective disclosures from management.

Governance-related

ESG engagements made up 21% of dialogues in 2023, with the focus being on topics that are generally of importance to minority shareholders. These were board structure related, for example to increase board quality and integrity.

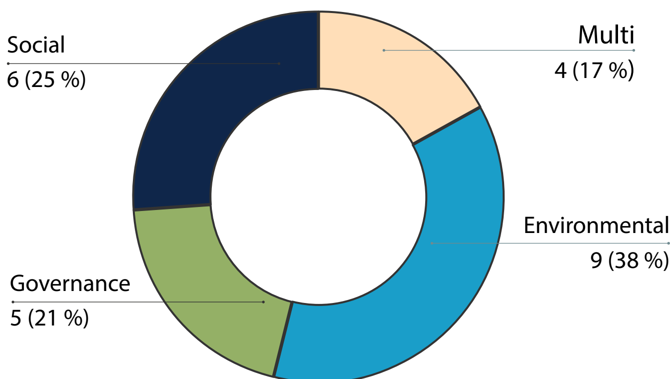
SKAGEN has a long history of long-term investments in the Korean economy. A central component of our longstanding investment record is the heavy discount we believe many of the companies are trading at. We have used our shareholder access to promote corporate governance improvements that will close this discount. Last year, SKAGEN filed formal letters to the Board of Directors of KB Financial Group and DGB Financial Group voicing our support of the proposals laid forth by a local activist investor, Align Partners Capital Management. In particular, we advocate for the Board of Directors to pass a resolution and release fair disclosure in line with the capital allocation framework and shareholder return policy proposed by APCM, or a comparable policy. We note that the absence of such an initiative would translate into our formal support for upcoming shareholder proposals at respective AGMs. This process has been repeated in 2024 and is yielding results with the broader Korean financial sector providing more shareholder friendly disclosures, to the direct benefit of our unit holders.

Lastly, **multi-category dialogues** are becoming a more central feature of SKAGEN's engagement with companies. Multi-category ESG engagements made up 17% of dialogues in 2023. These dialogues are more holistic and span the full range of ESG topics. These dialogues are sometimes also multi-tiered in the sense that SKAGEN will not only engage with the company but also with third parties e.g., ESG data providers. There are occasions when SKAGEN, as a value investor with small and mid-cap exposure, can offer such companies guidance and recommendations on how to improve or clarify ESG disclosure scores towards data providers and to the market more broadly.

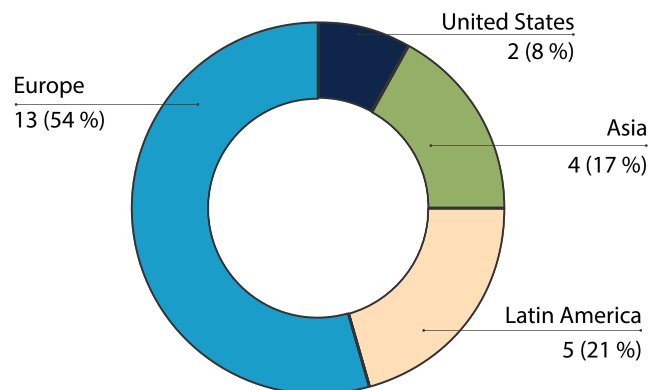
The engagement activity mirrors global investment activity, where engagement dialogue was held with companies in Europe, Asia, North and South America.

Sondre Myge,
Head of ESG

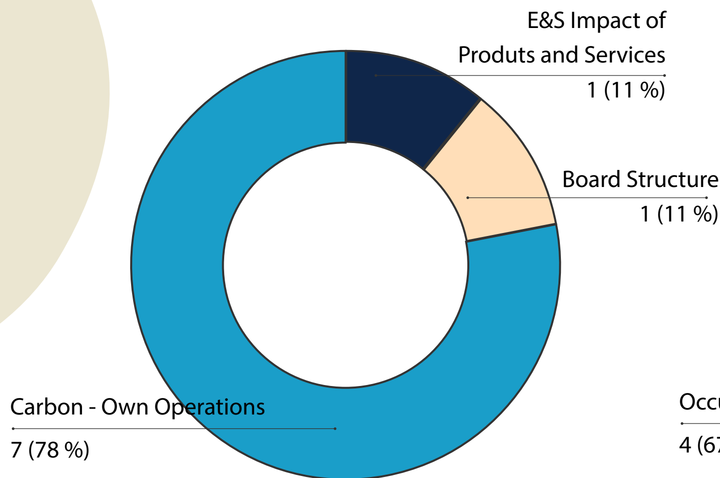
Cases by ESG category 2023



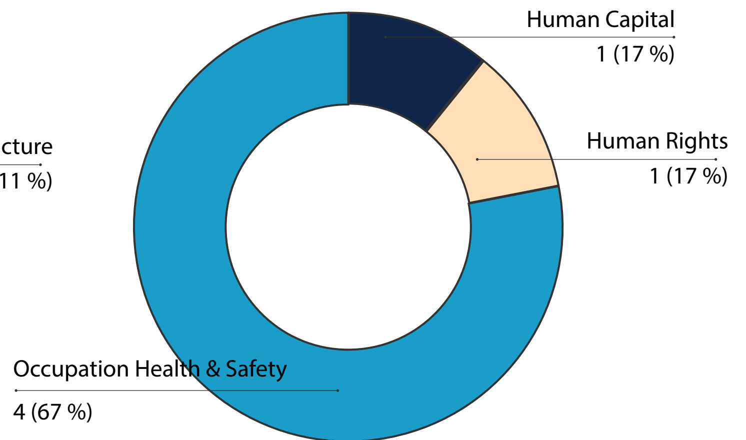
Distribution of Cases by Region



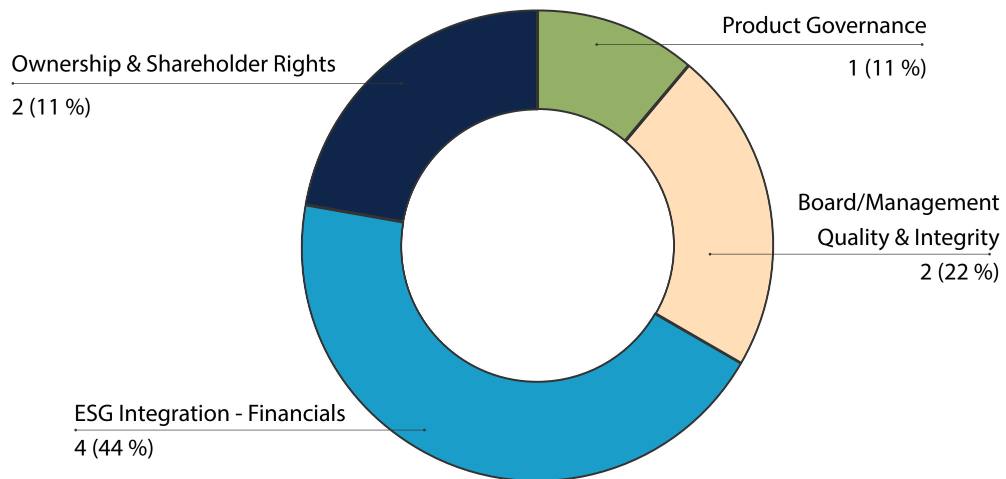
Environmental Engagements



Social Engagements



Social Engagements



After two intense days spent with Suzano, the company's sustainable investment case has become even more clear and promising. Again, we are reminded of the importance of engaging with our long-term holdings in one of the most exciting emerging markets the world has to offer. Fredrik Bjelland and Cathrine Gether, Portfolio Managers from SKAGEN Kon-Tiki, and Sondre Myge, Head of ESG

Postcard From Brazil: Suzano – The Materials Giant

As a nearly 100 year-old forestry giant, one might think that Suzano is on the wrong side of the environmental equation. On the contrary, the materials company has become a global reference in sustainable development.

SKAGEN Kon-Tiki Portfolio Managers, Fredrik Bjelland and Cathrine Gether, along with Head of ESG, Sondre Myge, visited Brazil in 2023. One of the portfolio companies they met with while there was the Brazilian materials company Suzano. Engaging and spending time with the companies in which we invest is key to our long-term success as an active fund manager. This is especially true when it comes to investing in emerging markets, where impressive operations can be found beneath the surface. One such example is Suzano, which is one of the largest vertically integrated producers of pulp and paper products made from planted eucalyptus in Latin America. Its impressive portfolio of sustainable products includes, to mention a few, coated and uncoated printing and writing paper, paperboard, tissue paper, market pulp and fluff pulp. Even more impressive is the company's best practice in sustainable forest management.

Back to Mother Nature

Owned by Suzano and managed by the NGO, Instituto Ecofutoro, the Parque das Neblinas is an environmental reserve spanning seven thousand hectares. In the 1940s, its virgin Atlantic forest was logged for its charcoal to be used by the local steel mills, and when the virgin forest faded, eucalyptus was introduced and grown instead.

Acquired by the company in the the 1960s, the area proved challenging to manage productively, so Suzano set out to manage the area with assisted natural regeneration. In essence, a few seeds were planted and nature did the rest but overseen by active forest management and rangers. Today, the park is an excellent example of how to rewild productive land.

”There are no bad species, only bad management“

You would be mistaken if you assumed that this park is merely a gesture of corporate social responsibility, PR and 'do goodery'. Although the park serves an important part of Suzano's broader social purpose to educate and transform people's relationship with nature, the company is on a broader mission in Brazil, namely to secure lasting biodiversity.

Suzano is building corridors 500 metreas wide in the three biomes it operates in: the Atlantic Forest, the Brazilian Savannah and the Amazon. These corridors will connect used land and are also meant to combat what Suzano sees as the biggest risk to biodiversity - habitat fragmentation with loss of resilience of species.

At the same time, the park reflects what Suzano considers to be a critical business rationale for long-term commercial success. Their eucalyptus plants are often grown interchangeably with native forest, where the wellbeing of the native forest is integral to the health of the company's economic assets. It serves an important role in managing physical climate risks.

The impressive Limiera mill

A two hour drive from Parque das Neblinas lies Suzano's Limeira mill. The nearby city is home to 300,000 people and is an important industrial hub in the interior of the São Paulo state. The largest operation in the mills' product portfolio is paper production, with 140 trucks providing 7,300 cubic metres of wood a day. The supply originates from Suzano's own eucalyptus farms with an average of only 200 km radius - demonstrating the cost effective integrated model of the investment case.

Each year, the Lumeira mill produces an impressive 400,000 tonnes of market pulp, 400,000 tonnes of paper and 290,000 tonnes of integrated pulp products. The scale of Suzano's operations becomes even more impressive when taking into account that the Lumeira mill is one of Suzano's smallest mills.

On a guided tour of the premises, we are once again reminded of contrast - the exterior is not representative of the interior of the mill. The efficiency is impressive, so is the humidity and heat as the paper is dried. Approximately 1,200 employees work at the site, in three rotating shifts and a highly automated production process. Watching the paper being produced, we learn that once the pulp sheets have been formed, it takes only 4.5 minutes for the sheets to go from drying process to finished product.

Perhaps even more impressive than the sheer scale of Suzano's operations at Limiera, is the on-site R&D department, consisting of 40 highly skilled research technicians. Their intense focus and purpose is clear: to find the next potentially disruptive usage for Suzano's products, spanning fashion and textiles to makeup and cosmetics.

After two intense days spent with Suzano, the company's sustainable investment case has become even more clear and promising. Again, we are reminded of the importance of engaging with our long-term holdings in one of the most exciting emerging markets the world has to offer.

Photo: Fredrik Bjelland and Cathrine Gether, Portfolio Managers from SKAGEN Kon-Tiki, and Sondre Myge, Head of ESG

On a guided tour of the premises, we are once again reminded of contrast - the exterior is not representative of the interior of the mill. The efficiency is impressive, so is the humidity and heat as the paper is dried.

Photo: Fredrik Bjelland and Cathrine Gether, Portfolio Managers from SKAGEN Kon-Tiki, and Sondre Myge, Head of ESG

Interconnected: As we are guided around the park we hear the life of the jungle all around us. We canoe the river running through the entire reservoir, which provides electricity to the oldest power plant in Brazil, which in turn powers the largest port in Latin America, the port of Santos - a key hub for global trade.

Voting activities

In SKAGEN we believe in exercising our rights as shareholders. Proxy voting gives us the opportunity to vote without being physically present at meetings. As active investors we feel that it is important to vote in order to address concerns and influence companies in a direction that we believe is sustainable.

In 2023, there were 214 voteable meetings and 472 voteable ballots in the portfolio companies with 2,856 voteable items on the agenda. SKAGEN voted on 98.49% of the items. Votes were in line with management recommendations 93.78% of the time and against management for 6.22% of all voted items.

Governance-related matters made up a significant portion of the votes against management in 2023. In our experience, ensuring robust and effective governance is a prerequisite for companies to excel when it comes to more specific environmental or social targets. This is in turn vital in securing the long-term interests of shareholders. SKAGEN will for instance vote against management on items pertaining to the quality of the Board and its members as well as excessive executive compensation. 61% of our votes against management during 2023 related to director election and compensation.

It seems to be an emerging shift that shareholders are more on the offensive in filing shareholder resolutions on specific ESG matters. As an example of a case where we supported an

environment- related shareholder resolution, we voted against the management of Chubb Limited regarding a proposal to increase reporting on GHG emissions reduction targets aligned with the Paris Agreement Goal. SKAGEN voted for this proposal as we believe it would help shareholders assess the company's management of climate-related risks from its underwriting, investment, and insurance activities.

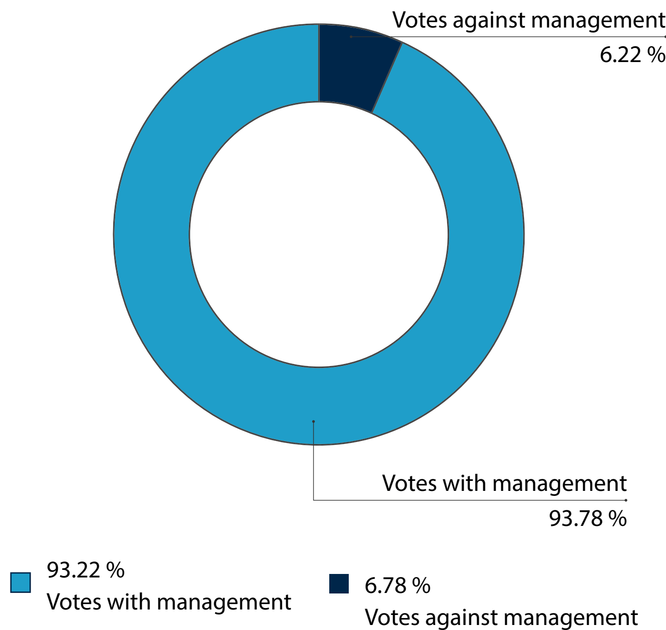
Another example of a case where we supported a social-related shareholder resolution, we voted against the management of Alphabet regarding a proposal to report on the risks of doing business in countries with significant human rights concerns. SKAGEN voted for this proposal as we believe it would help shareholders assess these risk factors and better evaluate the company's management of them.

All voting activities can be found in the proxy voting dashboard on our website. All votes are published the day after the votes have been cast, and in the cases where we have voted against management recommendations, an explanation is provided.

All voting decisions are made by the fund in question, with the objective of securing the best possible risk-adjusted returns for their unit holders.

Our full voting record is available here.

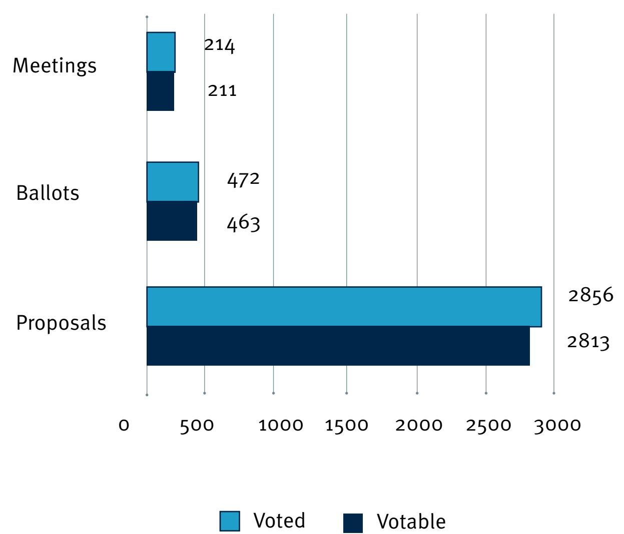
Votes cast statistics



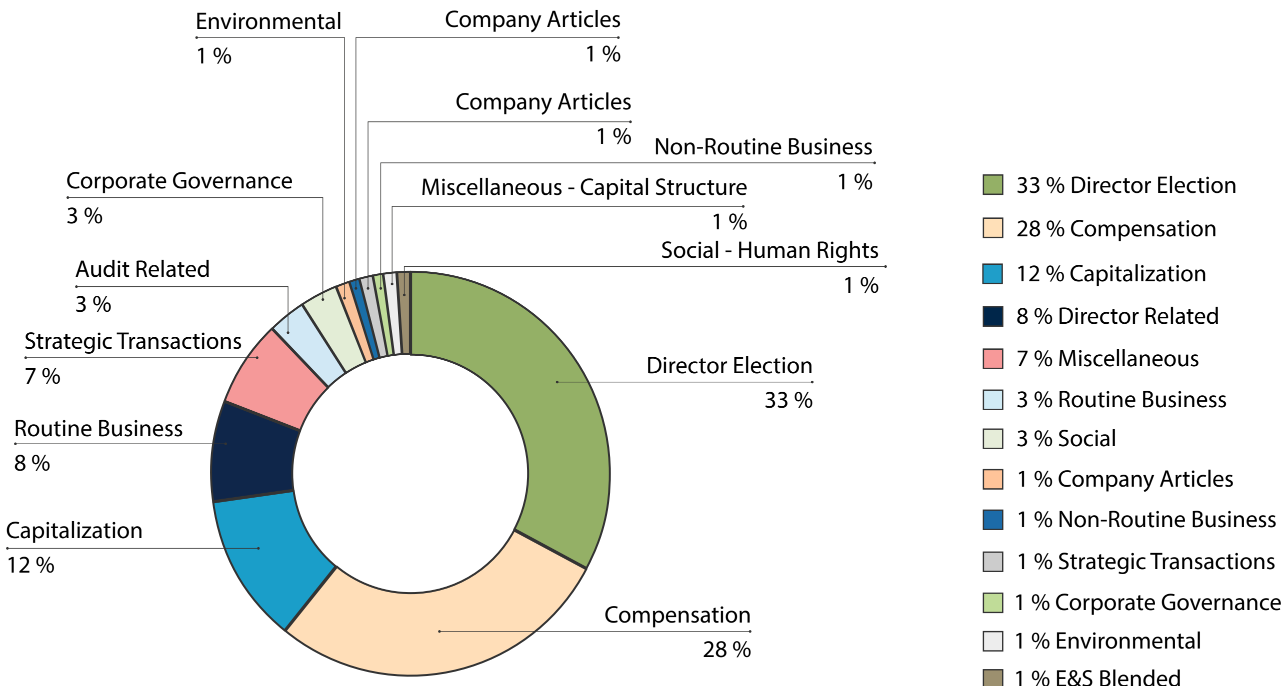
93.22 % Votes with management

6.78 % Votes against management

Meeting activity in 2023



Votes against management - categorized



By finding the right companies at the right prices with a good ESG story and then engaging with them to help spread the word, smaller companies and their investors can become the big winners of the green transition. Photo: Cheng Feng, Unsplash.com

SKAGEN Focus:

Looking below the radar to find ESG's future leaders

Why neglected small-caps driving real-world changes can be the big winners of the green transition.

The list of companies topping the ESG ratings of providers like MSCI or Sustainalytics contains few surprises. Most are household names and all are among the largest listed business on the planet. Does this mean that they became the biggest through being the greenest or is it just coincidence that the most valuable companies also rank as the most responsible?

Neither is true, of course. A recent study found that ESG ratings are uncorrelated with a company's environmental performance and CO2 emissions, energy use, water and waste production unsurprisingly scale with company size[1].

Many of the supposed ESG leaders are technology companies which are asset-light but where less visible emissions from things like data centres, servers and electronic waste put the sector's overall environmental impact on a par with the aviation industry. As these companies have grown increasingly weighty in global stock markets (the tech sector now represents a quarter of the MSCI ACWI Index), so carbon intensity measures have fallen while real-world emissions – which unfortunately can't be outsourced or passed along the supply chain – have remained flat.

[1] Assessments of the environmental performance of global companies need to account for company size, Mastrandrea et al, January 2024.

Self-fulfilling bias

There are other reasons why ESG ratings are biased towards larger companies. Scores are determined largely by disclosure and policies which bigger firms are better resourced and staffed to provide. A report last year found that listed companies spend on average between $220,000 and $480,000 on ESG ratings-related expenses annually – a significant cost for smaller companies which are also disproportionately burdened by growing sustainability regulations. For their part, ESG rating agencies rely on investors for revenues and since there is typically higher demand for large-cap companies to be assessed, this skews their coverage decisions. As well as perpetuating an upward bias, it can mean that smaller companies, particularly those with a market capitalisation below $500 million, aren't on the radar of rating providers.

For those with sustainable business models, this can be frustrating but can also spell opportunity. Scores are typically based on perceived ESG risks or characteristics and a positive re-rating can drive an equity repricing in the same way that corporate governance improvements historically triggered a favourable share price reaction. The recent growth of sustainable investing where thematic funds allocate capital largely on the basis of company ESG ratings can drive further positive momentum.

This opportunity extends to investors prepared to do their own analysis into a company's ESG risk profile and trajectory in the same way that a lack of sell-side research can be exploited. Rating anomalies are common at the smaller end of the market where providers are also slow to recognise ESG initiatives and changing company dynamics.

Changing perceptions

The first dimension of this opportunity is to identify stocks where a better appreciation of their strong underlying ESG characteristics could also unlock a valuation re-rating. Many companies providing innovative solutions to help tackle the biggest sustainability issues such as climate change are small and mid-caps. Also, many large-cap companies are reliant on these smaller businesses to reduce supply chain or scope three emissions to achieve their own net zero targets.

A good example from our own fund is Cascades, a $0.8bn circular packaging company that represents 3.3% of the portfolio.

The Canadian company, which ranks in the top 20 of the world's most sustainable companies according to Corporate Knights, uses about 80% recycled material in the containers and tissues that it produces for corporate and residential customers internationally.

Photo: White cement plant Anqing, China, Cementir Holding

Another source of ESG-related alpha can come from small-cap companies in traditional industries where innovation can bring about meaningful reductions in real-world emissions. Cementir, a 2.1% holding in SKAGEN Focus, illustrates this potential. The $1.6bn Italian cement producer inevitably has a large carbon footprint but has committed to reducing CO2 emissions by 30% per ton of cement by 2030 thanks to its innovative limestone and calcined clay technology which removes energy-intensive clinker in the production process. Cementir expects the low carbon cement, which has already been used to build two bridges in Denmark, to reach 50% of sales by 2030, meaning the company could have a very different ESG and equity rating in future.

We have been in dialogue with DGB Financial Group as part of our longstanding governance engagement in Korea to improve company board composition and the protection of minority shareholders. Photo: jet dela cruz, Unsplash.com

Engagement

The second dimension is the opportunity to engage with small-cap companies on sustainability to help them drive and better communicate their ESG plans and progress. Last year we visited Fortuna Silver Mines, a 2.0% position in the fund, to discuss the company's climate-related targets and see the positive impact of its Séguéla operations on the local community in the Ivory Coast.

We have also recently been in dialogue with DGB Financial Group as part of SKAGEN's longstanding governance engagement in Korea to improve company board composition and the protection of minority shareholders. In January we wrote to the company, a 2.1% portfolio position, in support of Align Partners an activist investor which has called on seven of the country's financial firms to improve their shareholder return policies.

Investors who are willing to go the extra mile will often find small and mid-cap companies that have a low or non-existent ESG rating but are doing much more to manage ESG risks and take opportunities than their larger peers. This is especially true of family-run businesses which usually take a longer-term view of sustainability.

This creates huge possibilities as changes in ESG factors can be powerful equity triggers, particularly as sustainable investing becomes more popular. By finding the right companies at the right prices with a good ESG story and then engaging with them to help spread the word, smaller companies and their investors can become the big winners of the green transition.

Jonas Edholm,
Portfolio Manager,
SKAGEN Focus

David Harris,
Portfolio Manager,
SKAGEN Focus

Western investors, civil society and governments shame companies for their supply but silently ask for their products. Photo: Quinten de Graaf, Unsplash.com

Thematic Study:

The ESG Merit of Energy Companies

When it comes to addressing climate change and decarbonisation, asset owners need to face the conundrum posed by the fossil fuel industry. In SKAGEN's case specifically, we need to reconcile owning fossil fuel related companies as an ESG-focused investor.

This topic is important to us and here we lay out why we view owning fossil fuels – albeit not indiscriminately and at all costs – as both good for clients and a necessary contribution to ESG principles and real-world dynamics.

The (disconnected) investor rationale: morality

Two overarching arguments are made as to why ESG investors should not own fossil fuel companies – and they are often used in tandem. The first is a quasi-morality-activist stance arguing that it is not the right thing to do and/or that selling these companies will have a punitive effect on their cost of capital, inducing them to change in the desired direction. The latter argument has largely been rebutted. The former provides one perspective on what the appropriate moral stance ought to be. It also implies accepting a discount on financial return (but not necessarily lower financial risk), which is hard to justify over the longer term for actors whose role it is to maximise returns. The second argument relates to financial risks; that these stocks represent dangerous stranded asset risks, soon to be triggered by changes in demand and government crackdown. Yet, as active managers will tell you, this is not new and is in fact considered comprehensively in the investment process by any manager who cares about their reputation and fiduciary duty.

On a general basis, we find neither argument convincing. First, the brown/green or ESG/non-ESG dichotomy is false and does not consider either the key drivers of financial risk and return or real-economy intricacies. Very few investors can do without owning these companies either directly or indirectly without this having a clear impact on their business model. Moreover, it is a disfavour to morality to assert that shunning is the right thing to do. The moral utility function of not owning oil and gas companies is different to not owning tobacco and gambling. For one, the act of emitting is a byproduct of producing and using energy, which in turn is a basic necessity for economic growth and social stability – which is the premise under which investors operate. Society

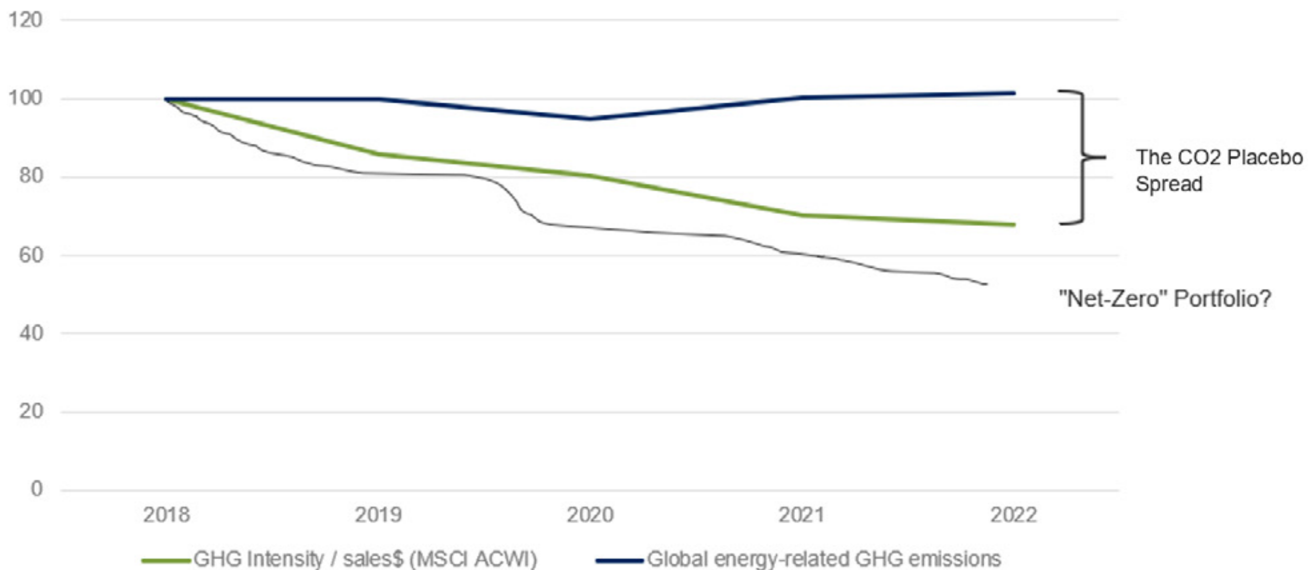
does not function without energy, but it functions perfectly well without tobacco and gambling. The latest energy crisis and implications of Russia's aggression in Ukraine is a belated reminder of the inherent social function of energy – and the importance of energy security and dependability.

When arguing that owning or not owning fossil fuel companies is a morality issue, the actor making the morality claim must define their terms and vantage point. If the claim is made to respect their individual values, the act of shunning is justifiable. This is also the case in SKAGEN. We exclude a range of companies whose behaviour and activity we do not support from a principled position (such as coal and oil sands producers, companies that lobby against the Paris agreement, etc.). That does not mean the entire industry should be shunned. Nor do we believe that not owning these companies will have an effect on their financial outlook.

If actors wish to remove and reduce CO2 emissions and address their financial risks by using open ended funds in secondary equity markets as a vehicle to do so, the required strategy looks vastly different. In this instance, owning fossil fuel companies and engaging with them to change and improve over time is by far the best tool these types of investors have at their disposal. If you are an active manager, you have an additional tool up your sleeve; you can consider the ESG factors of companies in this industry for stock selection. Yet, the current setup in the equity investment chain – at least in certain markets – demands that asset owners demonstrate alignment with an indicator that is at best a placebo, and most likely has a negative impact on real world outcomes and financial risks.

The (disconnected) investor rationale: ESG

To demonstrate the dislocation, let us look at the figures directly. With the tendency to (mis)use carbon footprint figures at fund level, it seems as though climate and carbon exposure as a headline portfolio risk (exogenous) matters more than as a risk at holding level (endogenous). We have highlighted the significant financial and social risks of misusing carbon footprints as a gauge to indicate "managed climate risk" in financial portfolios. If ESG really is about using financial portfolios to impact real-world outcomes, the industry is doing a botched job of it so far. As the chart below shows, we demonstrate the failure of going short brown/long green and demonstrate this through the now notorious fund level carbon footprint KPI (key performance indicator). We rebase from 2018, which is when flows into ESG products saw a massive increase. Five years later, we can deduce the following: the development



of real-world emissions is flat, but financial portfolios have decarbonised by 25%. The consequence is that this strategy has a negative real-economy impact. Second, the strategy drives investment risks of holdings in the fund facing real world risks of a physical and transitional nature. On the flipside, it is an easy and generalisable factor to use in the asset owner/asset manager link, and so we attach face value and believe in the ideal of the action. However, humanity lives on the blue line, not the green. Investors seeking to contribute to real world outcomes must recognise this – by owning fossil fuel companies in public markets. Selling brown assets to private markets only results in the same assets producing more CO_2 emissions than would have been the case if retained . Evidently, physical, and transitional climate risks do not confine themselves to private markets - they remain just as global and indiscriminate.

The ESG investor rationale and moral case for carbon intense companies

How then, should holistic investors looking to use funds as a vehicle to enable real economy change position themselves vis-à-vis carbon intense companies? In a similar vein as the first iteration of ESG focused on headline ESG data and extrapolated questionable implications from it, so too has the dynamic been for carbon intense companies. Fossil fuels are not all created equal – there are significant differences in emission intensity amongst them. The combination of pricing negative externalities (CO_2 levies) and technological innovation enables substitution effects for investors to take advantage of and position themselves over a longer investment horizon. These substitution effects come with environmental benefits. Removing a unit of electricity produced using coal and instead replacing that unit of electricity with gas reduces CO_2 emissions by 40-60%, without sacrificing the energy required to grow and modernise emerging markets.

Seen from a broader socio-economic perspective, Asia will be the main driver of economic activity – and therefore also emissions – over the coming decades. Growth and modernisation aspirations will not be stalled by virtue of environmental considerations, and whilst renewable energy will play a systemic role in the energy grids of emerging markets, it is nevertheless the case that no man is an island. The scaling of renewable energy requires a broader ecosystem of technology, policy frameworks and more. Therefore, spotting investment cases that enable positive environmental substitution effects will both enable a real economy reduction and recognise real economy conditions. As always, Rome will not be built in a day; slow and steady will win the race.

Photo: Andreas Gücklhorn, Unsplash.com

Conclusion

Western investors, civil society and governments shame fossil fuel companies for their supply but silently ask for their products. However, decarbonisation cannot be solved by the supply side alone. Fossil fuel companies have become convenient scapegoats for our collective choices. If society really cared about reducing carbon emissions, we would demand more of the fossil fuels with the lowest lifecycle carbon – which will come at a premium price – and use the powers afforded to investors to work with the companies to reduce these emissions further and enable realistic and comparable products at scale. Yet, as with any sustainability-adjusted consumption, it is constrained by the purse and inertia to change. So instead, we wait for technology to solve our consumption trade-off. Investors would do well to play it as it lies rather than play it as it should.

[i] Transferred-Emissions-How-Oil-Gas-MA-Hamper-Energy-Transition.pdf (edf.org)

Sondre Myge,
Head of ESG

SFDR milestones: increased transparency around sustainability

The new EU sustainability regulation, Sustainable Finance Disclosure Regulation (SFDR), has resulted in more transparency around sustainability in the financial market. All financial market participants, including SKAGEN, must provide additional sustainability disclosures and reporting.

We view the additional disclosures as an opportunity to provide clients with deeper insights into our comprehensive work on sustainability. This article will provide some guidance on what SKAGEN has reported according to SFDR, and how you as a client can make use of this information.

All reported SFDR disclosures for SKAGEN's equity funds are based on our **ESG Integration Strategy,** which consists of four pillars that we apply throughout the investment cycle:

1. Exclusions and negative screening
2. Enhanced Due Diligence (for companies in high-emitting industries)
3. Factsheets
4. Active ownership

Precontractual disclosure

Precontractual disclosure is one of the SFDR requirements and it is the one which best describes the products' sustainability strategy. The precontractual disclosure follows a set template provided by the regulation, which requires financial market participants to describe the sustainability strategy of a product. You can find the precontractual disclosure in each of SKAGEN funds' prospectuses, in the appendix.

All SKAGEN's equity funds are classified Article 8 under the SFDR, meaning that they promote environmental and social characteristics, but they do not have a sustainable investment objective. The precontractual disclosure contains detailed information about how the ESG Integration Strategy is implemented and integrated, and how the product as such

promotes environmental and social characteristics. This disclosure aims to ensure that clients are informed about the sustainability risks and impacts of their investments. The information provided in the precontractual disclosures will enable you as a client to make more informed decisions aligned with your sustainability preferences.

Periodic report

The periodic report provides a detailed description of how the product has performed over the previous financial year relative to the stated sustainability strategy in the precontractual disclosure. Since SKAGEN's equity funds follow the above-mentioned ESG Integration Strategy, we report process-based KPIs in the periodic report. All four pillars of the ESG Integration Strategy are measured and reported on.

One example of the type of information you can find in the periodic reports is: Pillar 3, Factsheets, which contain company-specific ESG analysis for all the investments within each portfolio. The analysis culminates in a traffic light to indicate the relative level of ESG risk and ESG opportunity for each holding. The traffic light distribution of the portfolio as of year-end is disclosed in the periodic report. Another example, Pillar 4, Active Ownership, sets out the fund's voting and engagement activities, and the periodic report provides information on how active the fund has been when it comes to engaging and voting on ESG matters over the past year. The periodic report is part of the funds' annual report, and it is available on each fund page on our website.

Web disclosure

SKAGEN has published extensive ESG information on our website. Nevertheless, the SFDR website disclosure is a mandatory separate piece, required to follow a set format and template. The SFDR web disclosure can be found here, and contains information about the investment strategy, methodologies, data sources and relevant policies. The SFDR disclosure is useful for clients seeking an overall description of SKAGEN's approach to integrating sustainability into the investment process.

PAI entity level statement

PAIs (Principal Adverse Indicators) measure negative sustainability effects. The PAI entity level statement describes our work to reduce and manage the principal adverse impacts of the investment activity. Financially material principal adverse impacts are considered, measured, and documented at various stages of the investment decision-making process as part of our ESG Integration Process. This disclosure also contains PAI specific data on entity level for all indicators where data is available. This statement helps clients understand how SKAGEN works to mitigate the potential negative effects on environmental, social, and governance issues. SKAGEN's PAI entity statement is available here and is updated yearly in June.

To summarise, all the additional SFDR reporting requirements are beneficial to all clients seeking to better understand the sustainability ambition of a financial product. Increased transparency throughout the financial market will ease decision-making based on sustainability preferences and make it possible to compare the sustainability strategies of financial products.

Karoline Hatlestad
ESG Data Analyst

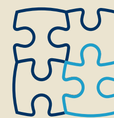
Photo: Alexander Abero, Unsplash.com

A Deep Dive into Pillar 3 of SKAGEN's ESG Integration Strategy

As a long-term active value investor, we perform bottom-up ESG analysis of each of the companies we are invested in.

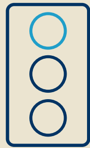
ESG analysis is performed in Pillar 3 of our ESG Integration Strategy, whereby the ESG Team draws up a dedicated ESG factsheet for each investment. The ESG factsheet serves an essential role in linking the ESG parameters of an investment, from idea generation to execution. It informs the execution of ESG aspects and assessment of the ESG components of the investment thesis. The relevance, or lack thereof, will vary depending on sector, geography, and company specifics.

The ESG factsheet is intended to inform and describe SKAGEN's overall ESG view of an investment. The framework has been developed to evaluate the ESG aspects of the investments based on a consistent method. The ESG factsheet of a potential investment will identify material ESG and PAI information and present potential ways to manage ESG and PAI associated risks – or undervalued opportunities – through active ownership or other investment-related actions.



The ESG Integration Strategy consists of four pillars that we follow throughout the investment cycle:

1. Exclusion and negative screening
2. Enhanced Due Diligence (high-emitting industries)
3. ESG Factsheets
4. Active ownership



Traffic Light Indicators

ESG risk and opportunity indicators:

Black: Breach of ESG plan, risk-based divestment recommendation from ESG Team

Red: Significant ESG risk that is a present risk – reputationally and possibly financially

Amber: Structural and long-term ESG risks identified – possible reputational risk

Grey: Neutral ESG and reputational risks and opportunities; unlikely to swing in either direction beyond a minimum level of responsible products and behaviour

Light green: Investment exposure with undervalued ESG opportunities (segment, product, long-term strategy)

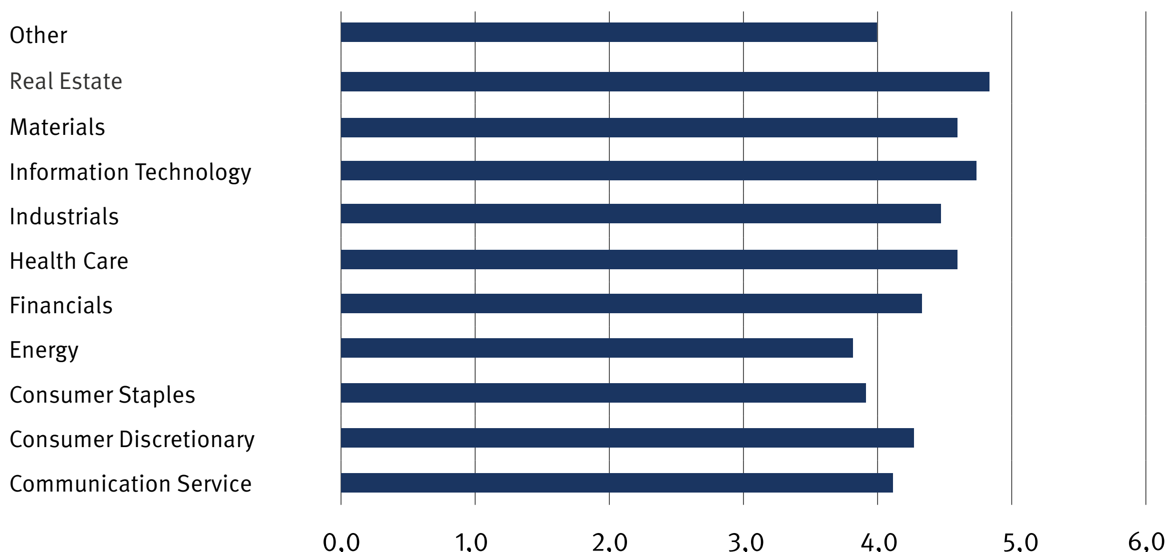
Dark green: Nature of business model make direct contributions to broader public

The ESG analysis culminates in a traffic light indicator for each investment. The traffic light indicator that is assigned to each investment case is meant to indicate the overall ESG risk or opportunity of an investment in terms of double materiality (harm to people/planet and financial impact). A sum-of-parts assessment will be made, where we consider amongst other things the quality and maturity of ESG disclosures, ESG governance, year-on-year trends and developments of material areas, adherence to global standards and norms, involvement in controversies, transition pathways communicated (including articulated action plans to achieve set targets), etc.

The traffic light distribution as of 31 December 2023 is visualised below by converting the traffic lights into numerical values represented by the numbers 1 (dark green) through 6 (black). The average score for SKAGEN funds' total holdings is 4.5 as of 31 December 2023, representing a total score in the light green range.

Fund		Avg.	Min.	Med.	Max.
SKAGEN Complete Holdings	●	4.5	2	5	6
Vekst	●	4.2	3	5	6
Kon-Tiki	●	4.2	3	5	6
Global	●	4.5	3	5	6
M2	●	4.8	3	5	6
Focus	●	4.5	2	5	6

SKAGEN Traffic Light GICS Sector Average



Whilst the ESG risk of a company provides an assessment of current ESG risk, it does not necessarily capture future momentum and positive potential. Photo: Jeremy Allouche, Unsplash.com

ESG Risk Rating: Assessing the full picture

To understand companies' exposure to material ESG issues and how they may impact shareholder value, SKAGEN uses the ESG risk ratings compiled by the research and rating firm Sustainalytics. These ratings are expressed as absolute scores between 0 and 100, with 100 indicating the highest level of ESG-driven financial risk. These scores fall into five levels of risk: negligible (0-10), low (10-20), medium (20-30), high (30-40) and severe (40-100). The ESG risk rating is made up of two components: the general ESG risk exposure that a company has (ESG exposure), and how well that risk exposure is managed (ESG management).

A company may have high exposure to ESG risk by virtue of the industry it operates in (e.g. oil & gas) but also have good practices to manage those risks, thereby bringing down the overall ESG risk.

SKAGEN's ESG integration framework is built on four pillars:

1. **Exclusion:** All investments are screened and approved against our Sustainable Investment Policy.
2. **Enhanced due diligence for companies in high emitting industries:** In order to identify and assess potential climate risk.
3. **ESG factsheet identifying ESG factors:** Produced for each investment case and includes a dedicated ESG overview.
4. **Active Ownership:** Engage and collaborate with companies by voicing our views on how to achieve ESG improvements over time.

Large caps provide more disclosure

The ESG management score tends to favour larger and/or older companies, as smaller and/or newer ones rarely have the resources or capability to provide solid management programs and policies. Younger companies also tend to have less experience in conducting materiality consultations and integrating ESG factors into their corporate strategy. We therefore often see that these companies receive a low ESG management score, despite being involved in few controversies. As some of our funds tend to invest a significant proportion of their portfolios in small cap companies, this should be kept in mind when considering the score.

Future potential

Whilst the ESG risk of a company provides an assessment of current ESG risk, it does not necessarily capture future momentum and potential. Returning to the oil & gas industry as an example, a snapshot assessment of the exposure companies in the industry face might not capture the renewable energy efforts that are being developed and the gradual pace of sustainable transitioning. Active ownership and our engagement with companies can help us identify such dimensions.

Importantly, there are no objectives or expectations for the funds to have a specific ESG risk at portfolio level or to be better than the benchmark. ESG integration in the investment processes is used to prioritise and execute active ownership as a tool to influence the risk and reward profile of an investment. ESG data provides crucial input in our investment processes and serves as guiderails for investment decisions. It thus informs our sole purpose: to provide the best possible risk-adjusted return to our clients.

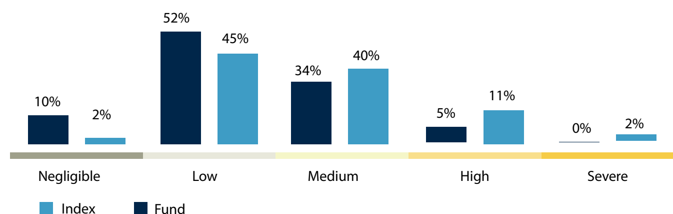
ESG RISK RATING

All risk ratings on this page are powered by Sustainalytics.

SKAGEN Global

	SKAGEN Global	MSCI ACWI
Coverage rate:	100%	100%
ESG Risk Rating:	18.4 (Low)	21.6 (Medium)
ESG Exposure:	36.6 (Medium)	42.3 (Medium)
ESG Management:	54.0 (Strong)	52.6 (Strong)

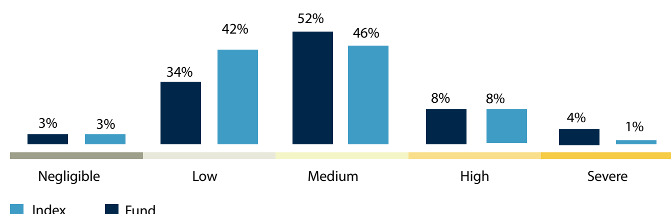
ESG Risk Category by aggregate portolio weight %



SKAGEN Vekst

	SKAGEN Vekst	MSCI Nordic/ ACWI ex Nordic
Coverage rate:	98%	100%
ESG Risk Rating:	23.1 (Medium)	21.1 (Medium)
ESG Exposure:	45.1 (Medium)	42.3 (Medium)
ESG Management:	52.7 (Strong)	53.6 (Strong)

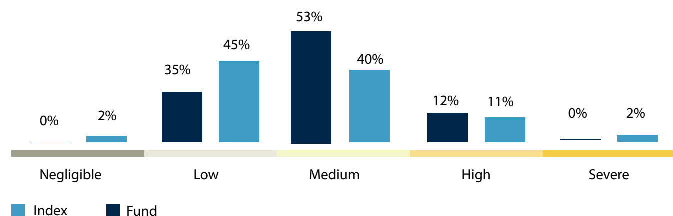
ESG Risk Category by aggregate portolio weight %



SKAGEN Focus

	SKAGEN Focus	MSCI ACWI
Coverage rate:	97%	100%
ESG Risk Rating:	22.9 (Medium)	21.6 (Medium)
ESG Exposure:	43.3 (Medium)	42.3 (Medium)
ESG Management:	50.0 (Strong)	52.6 (Strong)

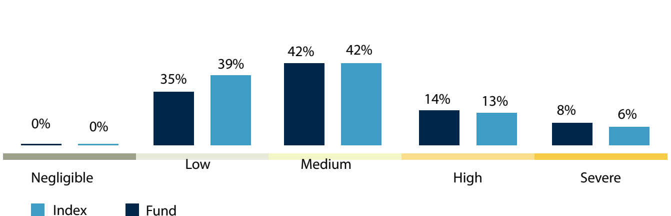
ESG Risk Category by aggregate portolio weight %



SKAGEN Kon-Tiki

	SKAGEN Kon-Tiki	MSCI EMI
Coverage rate:	91%	99%
ESG Risk Rating:	25.3 (Medium)	24.2 (Medium)
ESG Exposure:	47.4 (Medium)	43.7 (Medium)
ESG Management:	50.2 (Strong)	47.5 (Average)

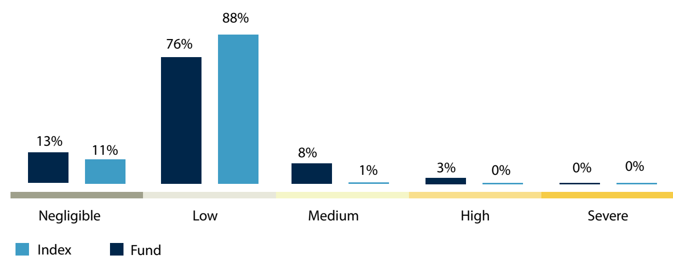
ESG Risk Category by aggregate portolio weight %



SKAGEN m2

	SKAGEN m2	MSCI Real Estate
Coverage rate:	100%	99%
ESG Risk Rating:	16.2 (Low)	14.0 (Low)
ESG Exposure:	27.9 (Low)	26.8 (Low)
ESG Management:	43.8 (Average)	48.9 (Average)

ESG Risk Category by aggregate portolio weight %



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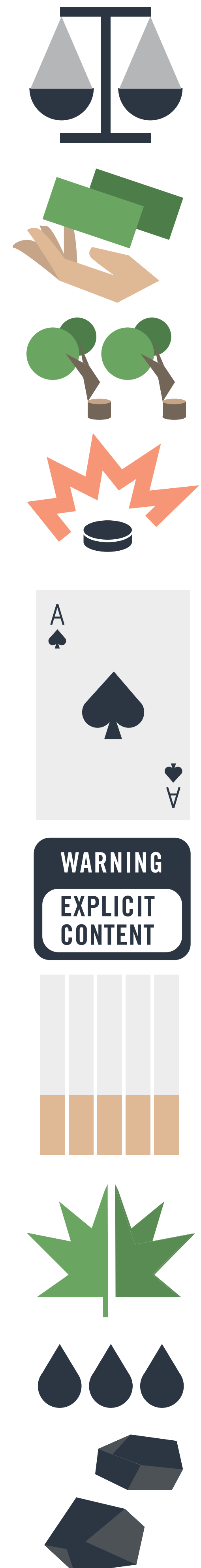
Exclusion as a last resort

Exclusion is to be used as a last resort and should only be applied where companies clearly fail to demonstrate change or improvements. If an excluded company demonstrates positive change that reduces the risk of recurrence, the company may be re-included in the list of companies we invest in.



SKAGEN excludes the following activities from our funds:

Norm-based exclusions:

Conduct-based norm-breaches:

- Companies that contribute to serious and systematic breaches of international law and human rights
- Companies involved in serious environmental degradation, including the climate
- Companies involved in systematic corruption and financial crime

Non-conduct-based-norm-breaches

- Companies that produce or sell controversial weapons, including nuclear, land mines, cluster munitions, biological and chemical weapons
- Companies will be excluded if the breaches are considered serious and the risk of recurrence is assessed as high.
- We also exclude investments in companies within certain single product categories or industries that are unsustainable. These products or industries are associated with significant risks and liabilities from a societal, environmental or health-related perspective. In these product categories there is also limited scope to influence companies to operate in a more sustainable way.

These product-based exclusions include:

- Companies with more than 5% of revenue from tobacco
- Companies with more than 5% of revenue from recreational cannabis
- Companies with more than 5% of revenue from gambling
- Companies with more than 5% of revenue from adult entertainment
- Companies with more than 5% of revenue from coal related activities as well as companies mining more than 20 million tonnes of coal annually or that have over 10,000MW coal power capacity
- Companies with more than 5% of their revenue from production and/or distribution of oil sands
- Owners of palm oil plantations with unsustainable business practices
- Companies that actively lobby against the goals of the Paris Agreement and/or international agreements which promote sustainable use of biodiversity, such as the Convention on Biological Diversity.

Exclusion list as of 31.12.2023 Exlusion category	No. of companies
Conduct-based exclusion	77
Tobacco	28
Controversial weapons	40
Climate - Coal	117
Climate - Lobbying	4
Climate - Oil sands	5
Deforestation	14
Cannabis	0
State-controlled companies	15
Deep sea mining	1
Tailings disposal	4
Gambling	38
Total number of companies	337*

* Some companies are excluded on the basis of several criteria. We do not invest in companies that have been excluded by Norges Bank from the Government Pension Fund – Global.

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Front page:

Anna Ancher, Young fisherman's wife at her spinning wheel, looking out of a window, ca. 1880. This painting is manipulated and belongs to The Art Museums of Skagen.

The art of common sense

Part of Storebrand