STEWARDSHIP REPORT

Q3 2019

CASTLEFIELD

THE THOUGHTFUL INVESTOR

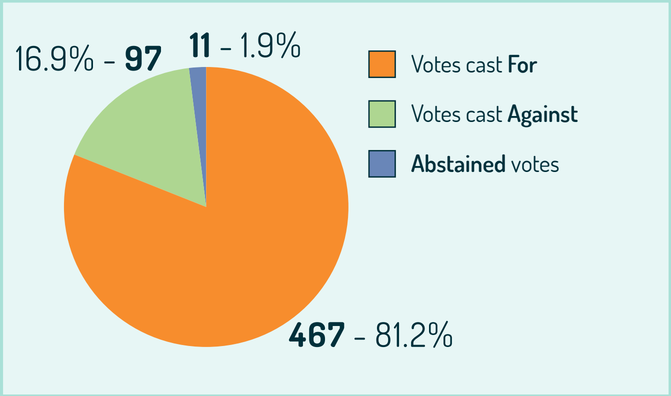
Q3 2019 STEWARDSHIP

VOTING

Throughout the year, Castlefield votes on strategic issues such as executive pay, director nominations and political donations. Each resolution is carefully considered and we aim to vote on all the stocks held in the collective funds we manage. It is our view that voting is an integral part of being a Thoughtful Investor. As such, we have developed a set of guidelines in the form of our voting policy to ensure we take a uniform approach to decision-making.

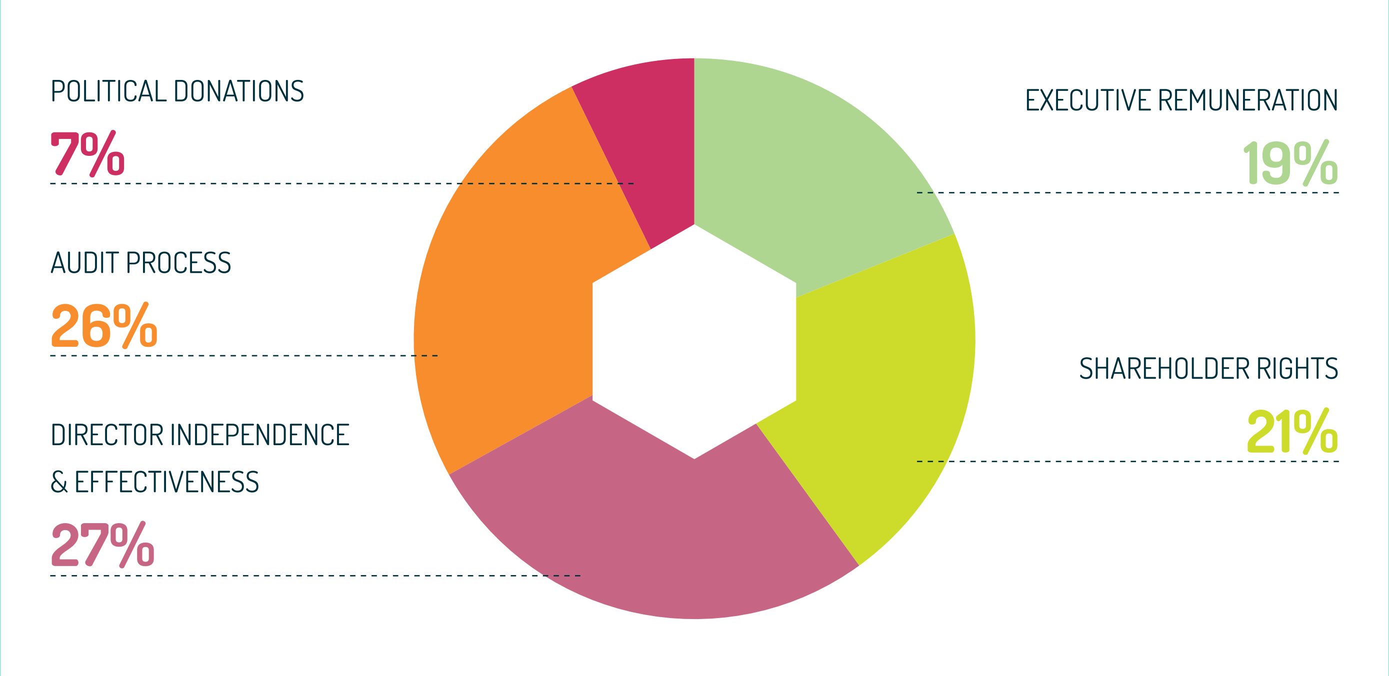
Over the quarter, our investee companies hosted **42** meetings with **575** resolutions to be voted. Of the proposals we voted on, **467** of our votes were cast in support, **97** were against and **11** were abstentions.

RESOLUTIONS



1. **EXECUTIVE REMUNERATION**	... is covered by the remuneration report and the remuneration policy. If either of these proposals do not adhere to the guidelines in our voting policy, we vote Against these resolutions.
2. **SHAREHOLDER RIGHTS**	... refers to requests made by a company to engage in practices that we believe may be detrimental to shareholders. For example, we do not believe 14 days' notice is sufficient time for shareholders to prepare to exercise their voting rights and so will vote Against this request.
3. **DIRECTOR INDEPENDENCE & EFFECTIVENESS**	... is an issue often involving Non-Executive Directors (NEDs). NEDs should be independent in order to be effective and if a NED has been in place for longer than the nine-year tenure recommended by the UK Corporate Governance Code we will often vote Against or opt to Abstain. We will also vote Against the reappointment of a director if we feel they have not been particularly effective or if we feel that, due to a large number of external commitments, they may not be able to dedicate sufficient time to their directorship.
4. **POLITICAL DONATIONS**	We do not think it is appropriate for companies to make political donations and consequently will always vote Against a resolution seeking permission to do so.
5. **THE AUDIT PROCESS**	... refers to auditor independence which may be compromised if the auditor has been in place for a long time and no tendering process has been undertaken, or if fees paid are for services other than their primary audit function.

% OF VOTES TO ABSTAIN OR GO AGAINST MANAGEMENT IN Q3



Through July to September 2019, the most likely reason for an abstention or vote against a resolution was on the basis of director appointments. This accounted for **27%** of votes against and abstentions. One key reason that we may choose to abstain or vote against a company director is independence. It is important that the non-executive directors (NEDs) are independent from the executive directors in order to ensure that they are able to hold them accountable and provide effective oversight, challenging management where necessary. A further reason is 'over boarding', which refers to a situation in which a director holds a significant number of external NED roles. We believe that directors should ensure that they have enough time to adequately fulfil all the duties associated with a NED role and will therefore vote against directors where we feel the quantity of their outside commitments is likely to impact on their effectiveness.

Remuneration was another key reason for not voting with management, this accounted for **19%** of votes contrary to management recommendations cast over the period. The reasoning behind these decisions was often excessive base salary or incentive payments. Pay packages are voted against where there is a large disparity between the rewards given to directors and the average pay received by company workers. Remuneration is a topic where Castlefield takes a firm stance. We believe that remuneration arrangements for executive directors should be aligned with the interests of all stakeholders, including employees. A deciding factor is whether the company pays the Real Living Wage, this is an important measure for determining where pay is excessive. In addition, compensation measures that lack stretching performance targets make it too easy for executives to be rewarded generously for mediocre performance, this is another factor that must be analysed carefully before voting.

An additional **21%** of abstentions and votes against fell into the category of shareholder rights. The majority of these votes are the result of our policy to vote against resolutions that propose holding general meetings at **14** days' notice. This is underpinned by the firm belief that this does not allow for investors to prepare adequately for the meeting and therefore is an infringement of shareholder rights. When shareholders have insufficient time to analyse the meeting materials, an unfavourable decision may be forced due to time constraints.

The number of protest votes relating to the audit process accounted for **26%** of the total for this quarter. The number of votes falling into this category is determined by the need for the external auditor to be independent from their client company. We monitor auditor independence by checking the quantum of fees collected for non-audit work and the length of time that particular auditor has been in place. This serves to prevent the formation of a cosy relationship between them and their client company and ensures that accounts are being audited with appropriate scrutiny.

Finally, we do not view political donations as an appropriate use of capital and, as such, we always vote against resolutions requesting shareholder permission for this activity, for the third quarter of 2019 this was **7%** of total dissenting votes.

GENDER DIVERSITY

THE 30% CLUB

Castlefield has become a signatory to the 30% Club. The 30% Club was established in 2010 and is a collaborative engagement effort comprised of Asset Managers, Owners and Charities with the aim of engaging with the largest 350 companies on the topic of gender diversity. This is done by encouraging CEOs and Chairpersons to publicly commit to gender balance by 2020, aligning itself with the Hampton-Alexander review. Another key part of the 30% Club is trying to influence public policy, engaging on regulation and on the Stewardship Code through communication with the Financial Reporting Council. Importantly, the key to this collaboration is engagement, not quotas, despite the name "30% Club".

> "Now there remain just 3 all-male boards in the largest 350 companies[1] compared to 151 in 2010.[2]"

In the past engagement has been targeted at all male boards and now there remain just 3 all-male boards in the largest 350 companies[1] compared to 151 in 2010.[2] Encouragingly, the largest 350 companies have now reached 30% of women on Boards compared to 9.5% in 2010[3] when the 30% Club was founded and in comparison, to 7.6% in Japan's TOPIXX 100[4] and the 23.6% for the US' S&P 100[5] today. However, the UK figure is significantly different when removing female Non-Executive Director roles and thus, there is still further to go at the Executive level (i.e. the role of Chief Executive Officer and Chief Financial Officer). Going forwards, this will be a key topic of engagement.

The initiative has also progressed beyond its initial gender focus, further looking at diversity more generally including ethnic, cognitive and socioeconomic. This is also a step Castlefield has taken by removing the word 'gender' from the voting policy, so as to capture diversity in all its forms. In joining, Castlefield has agreed to its Statement of Intent,[6] committing to actively engage with Board Chairpersons and Nominations Committees, as well as exercising our voting rights when a lack of diversity at Board level warrants. Whilst this is nothing new for Castlefield and has been a part of our voting policy for several years, the power of a collective investor voice cannot be underestimated.

We are firmly of the belief that a balanced workforce is good for business and society and there is an overwhelming amount of literature, backed by empirical evidence, to support this. We have had two meetings with the 30% Club since becoming members in April and we are looking forward to the pipeline of work outlined.

30% Club
GROWTH THROUGH DIVERSITY

1 BoardEx, 30 September 2019
2 https://30percentclub.org/about/chapters/united-kingdom
3 Hampton-Alexander Review, FTSE Women Leaders, November 2016, BoardEx October 2016
4 https://30percentclub.org/
5 Ibid
6 https://30percentclub.org/assets/uploads/UK/Investor_Group/30__Club_Investor_Group_Statement_of_Intent_2016_FINAL.pdf

THE JOURNEY TO SUSTAINABILITY

THE JOURNEY TO SUSTAINABILITY FOR THE CASTLEFIELD B.E.S.T SUSTAINABLE SMALLER COMPANIES FUND

It's now close to eighteen months since our own UK Smaller Companies Fund completed its transition to a sustainability mandate in February last year. There had been a long process leading up to this development for the Fund and hopefully what follows provides an overview of the journey we have been on to prepare the Fund for this next step.

Prior to the Fund's change in mandate, it was managed for several years without sustainability factors being explicitly considered. However, between this and the transition to a sustainable mandate, a focus on engagement and employee-ownership was integrated into the investment process. This came about in part due to Castlefield's own ethos as an employee-owned company and focus on social responsibility. The financial benefits of investing in companies which incorporate employee ownership was also well understood by co-manager, Alistair Currie, given his involvement in a company which provides finance to growing companies which are either already employee-owned or looking to become so. This added factor to the investment process naturally then led to the consideration of other so-called 'non-financial' risks being considered.

In early 2017, the investment team therefore discussed the potential for the Fund to build on this and become the first in its sector to move to a sustainability mandate. As the 'Thoughtful Investor', the team at Castlefield was already experienced in incorporating social responsibility, ESG risks, and sustainability considerations into investment decision making, and so began the process of transition.

> "In early 2017, the investment team therefore discussed the potential for the Fund to build on this and become the first in its sector to move to a sustainability mandate."

Aware that a number of holdings would also have to be exited in light of this decision, the team conducted a thorough review of the Fund's existing holdings to assess and quantify the extent of any direct, or indeed indirect, exposure to activities or industries that were considered inappropriate for a sustainability objective. In total, 11 holdings were exited for this reason. Several were straightforward in that their sale was based purely on clear exclusionary criteria. However, there were a few companies where our review process did not produce a binary outcome. In these instances, a more detailed assessment was undertaken with the findings discussed and debated by the wider investment team.

The exit of holdings also logically saw the introduction of several new names to the portfolio which were felt to have more sustainable characteristics. These were gradually introduced as opportunities for investment arose. Through the transition process, the Fund saw the addition of 16 new companies. A prime example of one of these new holdings meeting key sustainability themes is low-cost fitness chain, The Gym Group (TGG).

As well as the attractive commercial aspects of TGG, growing the wider market and taking share from the more traditional operators, it also has a clear positive social impact. The provision of access to low cost gyms across the UK promotes health and wellbeing which is an increasingly important issue in today's society. Its low average monthly membership fee compared to most of its competitors means that access to TGG's high-quality facilities are affordable. This is compounded by the ease with which customers can join, leave and freeze their memberships meaning people are not trapped by fixed-term obligations if they find the service is not suitable. With the gyms being open all day, every day, it also makes it easier to use the gyms when employed on shift work – as is common among NHS workers, for example. In fact, over a third of TGG members are shift workers and 10% of members use the gyms at times when other facilities are closed.[1] Interestingly, around 30% of The Gym Group's new joiners have previously never been a gym member.[2] This serves to emphasise the importance of the service that TGG offers to those who would usually not be able to fit exercise in the gym around their work commitments and/or afford a membership. We therefore feel there is a strong case for the positive impact that TGG is having through its provision of high quality and low-cost gyms.

Since the change, the fund has grown to c.£9m in size,[3] as compared to c.£5m at the start of 2017, when the process started. This reflects support following the new mandate and resulting enhancements made to the investment process. Performance has been solid both through, and post, the transition process, returning +23.1% since the start of 2017 vs. +23.9% from the wider sector.[4]

> "Since the change, the fund has grown to c.£9m in size,[3] as compared to c.£5m at the start of 2017, when the process started. "

This focus on companies exhibiting sustainable business practices, we believe, will support the delivery of positive long-term returns in the future. We believe the fund to be the only UK Smaller Companies fund with an explicit mandate of this type, presenting an excellent opportunity not only for Castlefield, but also for investors who want to ensure that their investments are more closely aligned to their own values.

Past performance is not necessarily a guide to future returns and may not be repeated. The value of investments may go down as well as up, and you may not recover the amount of your original investment.

1 Numis, 2016
2 The Gym Group, 2016
3 NAV at 30/09/2019
4 FE Analytics. Performance period 31/12/2016 – 30/09/2019

ENGAGEMENT CASE STUDY

SCOUT 24

Scout24 is a company held in our B.E.S.T Sustainable European Fund and is one of the companies with whom we have had most engagement since the Fund's launch in November 2017. Over time, we have developed a strong rapport with the Group and whilst it remains one of the Fund's top performers, it is important that we are aware of complacency risk.

SCOUT 24

"Scout24 is a leading player in the field of online classified platforms. They have three divisions operating across a real estate portal (IS24), automotive portal (AS24) and a Consumer Services (CS) division."

Scout24 is a leading player in the field of online classified platforms. They have three divisions operating across a real estate portal (IS24), automotive portal (AS24) and a Consumer Services (CS) division. This year's Annual General Meeting raised some interesting topics for further engagement, in particular around Board nominations, remuneration and the strategic direction of the Group. We scheduled a call in advance of its August 30th AGM.

During the call we voiced our disappointment with the lack of opportunity for investors to have a 'say on pay'. Unlike one-tier Board structures in UK Companies, German companies often operate a two-tier structure comprised of the Management Board and the Supervisory Board. It is best practice to have a separate resolution for investors to vote on remuneration at both levels. Whilst we were encouraged that the Group's remuneration was linked to non-financial metrics in addition to the usual financial metrics, the specifics were not disclosed, and we advocated for further transparency. It is important that investors are able to vote on Board compensation to avoid excessive payments and serve as an accountability mechanism. It is equally important to scrutinise how pay is awarded to ensure remuneration is aligned with shareholder interests. Interestingly Scout24 noted that this was the first time an investor had raised such issue, which we view as positive testimony of our commitment to engage with companies on important topics. Scout24 confirmed that they would take our proposals into consideration for next year's AGM.

A further topic of engagement concerned board nominations. We raised this after we saw that activist investor Pelham Capital had submitted a counterproposal for nomination in favour of their own candidate. They were trying to garner support for an outsider from Switzerland to be appointed to the Supervisory Board, instead of one of the three candidates recommended by the Scout management team. Their premise was based on his experience in online classifieds. During the call, management explained that the Supervisory Board had come up with a detailed competency set for prospective candidates, which included challenge on product innovation, driving growth within the group and real financial expertise. We were comforted by the Group's in-depth response to the questions we posed, and we remain impressed with Scout24's willingness to engage. We enjoy the constructive dialogue and feel that management stand out in their attitude of openness to us as one of their smaller institutional shareholders.

CASTLEFIELD EXTERNAL ADVISORY COMMITTEE MEETING

Early in September saw the third meeting of Castlefield's External Advisory Committee in Manchester. Following on from the structure of previous meetings, the Committee discussed a number of topics, some of their own choosing and the remainder put forward by Castlefield's investment team. The meetings are a valuable opportunity for the team to gain an external viewpoint on emerging sustainability issues and the Committee's insight has influenced some of our engagement work with companies held in the B.E.S.T Sustainable fund range.

Topics covered during this meeting included data security, the use of the UN's Sustainable Development Goals by companies and investment teams, as well as the ethical and sustainability issues surrounding the healthcare and pharmaceuticals industries. We also took the opportunity to present on one of our funds, in order to give the Committee the opportunity to ask questions directly to the fund manager and see how our investment principles are put into action.

A summary of the minutes from the meeting can be found on the Castlefield website.

DATA SECURITY

Over the past few years, a number of data breaches and scandals have brought the use and protection of customer data into the spotlight. Consumers are becoming increasingly aware of the risks of sharing personal data, while regulators are placing increased scrutiny on companies, with the European Union leading the way with the implementation of General Data Protection Regulation (GDPR) in 2018.

Some of the key issues surrounding customer data include:

- How is the customer data being acquired? Is consent freely given or buried in the terms and conditions?
- For what purposes is it used? Is customer data being exploited inappropriately?
- How is the data protected? Are appropriate security measures in place?
- Who is the data shared with? Is customer data being shared with third parties and if so, for what purpose?

Incidents involving data breaches or the misappropriation of customer data can have serious reputational ramifications for companies and the introduction of GDPR means that there are severe fines for any company that do not comply with the legislation. For example, British Airways has recently suffered the largest fine levied under GDPR so far at £183m (1.5% of BA's worldwide turnover in 2017).[1] This fine came after BA admitted that more than half a million customers' data had been stolen by hackers last August from its website and mobile app.

Following the discussion of this topic with our External Advisory Committee, we intend to conduct a more detailed series of engagements with the companies we invest in regarding this risk.

We believe that it is the responsibility of engaged investors to ask questions of investee companies who are exposed to the risks surrounding customer data.

1 https://www.theguardian.com/business/2019/jul/08/ba-fine-customer-data-breach-british-airways

MEET THE TEAM

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Chartered MCSI

Associate, Investment Management & Director, Piccadilly Trustee Limited

Alistair Currie
BCom (Hons), CA

Partner, Investment Management

Amelia Overd
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Executive, Investment Management

Chloe Smith
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Senior Executive, Investment Management

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