

ENGAGEMENT WITH AIM LISTED COMPANIES: DIVERSITY AND REMUNERATION

Thematic Review



THE THOUGHTFUL INVESTOR

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INTRODUCTION

At Castlefield, our investment process is 'responsible' in nature, meaning that, in addition to integrating analysis of environmental and social issues and avoiding investment in certain controversial industries or activities, we also look to encourage adherence to corporate governance best practice in our investee companies.

CORPORATE GOVERNANCE

Corporate governance, as defined by the first UK Corporate Governance Code (the Code) in 1992, is 'the system by which companies are directed and controlled'. This Code, most recently updated in 2018, sets out a number of best practice principles for companies listed on the UK stock market and cover topics such as executive pay, the structure of the Board of Directors, division of responsibilities and risk management. Companies with a 'Premium Listing' of equity shares in the UK (meaning that they are expected to meet the highest standards of regulation and corporate governance) have a requirement under the Listing Rules to report whether they have complied with these principles, and if not, explain why.

Our investment process includes the assessment of ESG and Sustainability factors as well as a bottom-up research process seeking out future earnings power that is not yet fully understood by the wider market. This means that our equity funds typically exhibit a small and mid-cap bias. We also manage our Castlefield B.E.S.T Sustainable UK Smaller Companies Fund, which invests exclusively in small-cap companies.

Smaller companies listed on the main UK equity market or on AIM are generally subject to less strict corporate governance requirements and it is at this lower end of the market capitalisation range that we tend to see greater divergence in standards of reporting and governance structures.

Over the last 18 months, we have initiated engagement with a number of our smaller investee companies on two topics that are important to us at Castlefield: transparency regarding executive pay and diversity.

WHAT DO WE MEAN BY 'SMALL-CAP'?

The definition of Small Cap varies by market, but in the UK, they typically represent the smallest 10% of the market and have a total market value of below £2bn. For reference, at the beginning of the year, the largest UK company on the London Stock Exchange has a market capitalisation of close to £130bn.¹

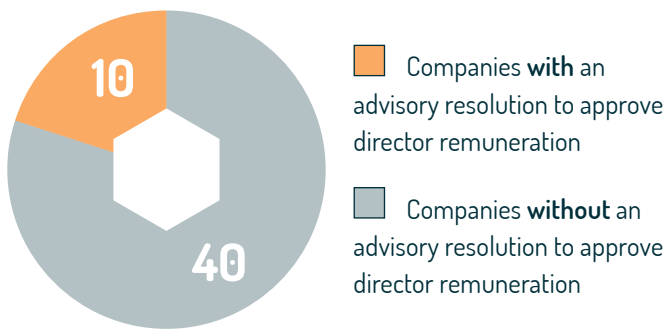
WHAT IS THE AIM MARKET?

AIM, formally the Alternative Investment Market was launched in 1995 and is the London Stock Exchange's sub-market for high-growth, and typically smaller, companies.¹ Disclosure and reporting requirements for companies quoted on the AIM market are far less prescriptive than those for larger peers adhering to the UK Corporate Governance Code.

¹. Alpha Terminal, 31/07/2021

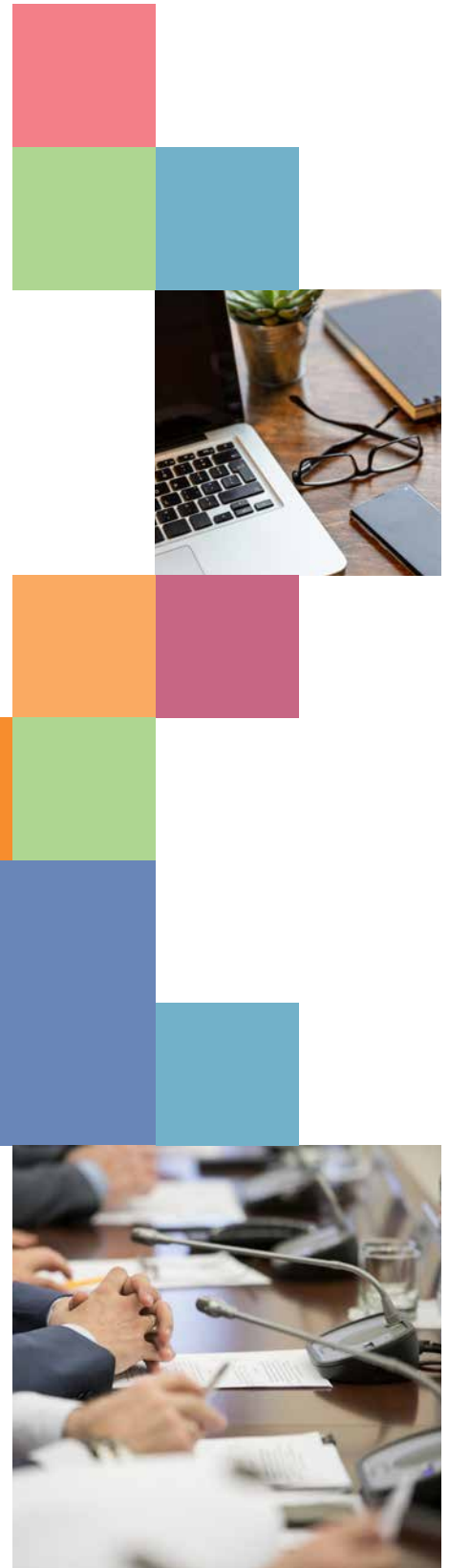
REMUNERATION

As investors, we view increased levels of disclosure favourably and support adherence to best practice as defined by the UK Corporate Governance Code where feasible. For AIM quoted investee companies in particular, this topic is an area where we see a lot of divergence due to the lower reporting requirements of the AIM market. In addition to general levels of disclosure being lower, companies listed on AIM are not required to put a separate advisory resolution to shareholders on remuneration each year at the Annual General Meeting (AGM). A recent survey by KPMG looked at the annual reports for the 50 largest AIM companies based on market capitalisation and found that approximately 20% of these companies included an advisory resolution to approve the remuneration of directors at their AGM.²



Voting at company AGMs is a responsibility we take seriously and having a 'say on pay' resolution allows us to clearly express our views with any pay package we may deem to be too generous or poorly incentivised. We seek to engage with our investee companies regularly and saw this topic as an issue where we needed to set out clearly our rationale to the Boards of Directors at AIM-listed companies held within our B.E.S.T Sustainable fund range.

² <https://home.kpmg/uk/en/home/insights/2021/07/executive-remuneration-in-aim-listed-companies-2021.html>



CASTLEFIELD ENGAGEMENT

At the time of planning for our engagement, of the 36 AIM-listed companies held within our B.E.S.T Sustainable fund range, 19 of those companies did not offer shareholders the opportunity to vote on the pay package awarded during the year at their most recent AGM.³ We had contacted a small number of these companies previously to highlight this specific issue and wrote to the remaining 15 ahead of the upcoming AGM season, which spans from March to August in the UK. We set out our rationale for requesting increased transparency and disclosure, explaining that it is important for us to be able to assess the criteria for remuneration and how pay for performance is determined by the responsible board members.

While we are aware that companies are not required to include a 'say on pay' resolution as a standard part of their Annual General Meeting, we explained that in our experience we are seeing greater focus on corporate governance requirements for smaller companies with the scope of the UK Corporate Governance Code increasing. This has not increased as far as the AIM market, but reporting requirements have already been increased in 2018, when changes to the AIM market rules meant that companies are now required to state which corporate governance code they are applying.⁴ We want to see our investee companies aiming to meet the highest levels of corporate governance wherever possible.

MAKING THE CASE

We were also able to strengthen our case by pointing to the recommendations of proxy advisers. These are companies who specialise in providing corporate governance research and provide recommendations to subscribing investors about how to vote at company meetings. In situations where disclosure is low or proxy advisers feel that remuneration arrangements do not comply with best practice in some way, we have seen examples of recommendations to vote against accepting the report and accounts. This would be a drastic action to take and is usually reserved for circumstances in which investors feel there is something amiss with the financial reports of the business. However, in lieu of an opportunity to vote directly on the subject of remuneration, proxy advisers and some investors have opted to

register their discontent by voting against this resolution, which we see as a significant risk to companies as more and more investors are required to actively vote their shares.

RESULTS

To date, of the 15 companies we contacted regarding remuneration transparency and the inclusion of a shareholder vote, we received a response from 13. We are happy with this high response rate (87%), particularly considering one of the non-respondents is currently involved in a takeover bid situation. The other company we did not receive a response from has undergone some management change during the period and so we intend to raise the topic at our next regular business update meeting.

We did have some very positive responses from companies who took on board our requests, with one company expressing its intention to include an annual shareholder vote on remuneration in future, and a small number of others which have informed us that this is something they are actively considering or have committed to consider at board level.

Interestingly, a few companies noted that this request was the first they had received from shareholders. While not entirely surprising, we believe that this shows that we are in a strong position to be able to encourage companies to be forward thinking about corporate governance. While we might not see immediate results, building a long-term relationship with management teams can enable us to broach these topics in a constructive manner and create food for thought at Board level.

On our more general point about improving transparency for AIM-listed companies, most noted that they were compliant with listing rules and felt that the information they provided was adequate. A number of companies were able to provide examples of how they went above and beyond these requirements.

Encouragingly, several companies also demonstrated their willingness to receive feedback on areas they could improve, and we will continue to follow up with these companies to highlight areas of best practice.

3. Correct as at 28/02/2020

4. <https://home.kpmg/uk/en/home/insights/2021/07/executive-remuneration-in-aim-listed-companies-2021.html>

EXAMPLES

We have received some particularly strong responses to our engagement, including the following:

AB DYNAMICS

AB Dynamics is one of the world's leading suppliers of advanced testing systems to the global motor industry.



We received a positive response from AB Dynamics early on in our engagement and management were keen to outline their approach. We were pleased to note their intention to incorporate aspects of the more stringent UK Corporate Governance Code and to include an advisory resolution on remuneration in future. Please see an extract from their reply to our letter below.

"We publish a Directors' Remuneration Report in which we set out a summary of the activity of the Remuneration Committee, the remuneration of the directors for the year, details of the share option schemes in which the directors participate and details of the directors' contracts."

"We also disclosed a summary of the revised remuneration policy including details of base salary, pensions, bonus and long-term incentive plan and detailing the purpose of each element, how it works in practice, the maximum opportunity and the relevant performance metrics."

"As you note, our current report complies with the requirements of the AIM Rules and the Companies Act and the QCA guidelines. It is our ambition across all areas of governance to adhere to best practice wherever possible. As we review and renew our policies and procedures, we are incorporating additional practices from the UK Corporate Governance Code and other guidance to improve adherence over time..."

"We are in the process of implementing the new policy for the year ending 31 August 2021. As this is further revised in future and the policy matures it is our intention to include a separate advisory resolution on remuneration to be put to shareholders at the AGM and we note that you are in favour of this."

GOOD ENERGY

Good Energy is one of the UK's leading renewable energy suppliers, selling 100% renewable electricity and carbon neutral gas to its customers.



Having received our letter and discussed our points with the management team, Charlie Parry, Company Secretary and Head of Investor Relations, had the following to tell us about Good Energy's plans regarding corporate governance:

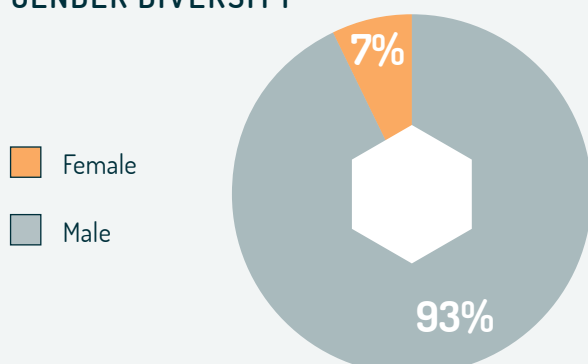
"As part of (our) wider corporate governance review, a separate remuneration report is something we will be actively considering. We are aware of the pension advisory fund position around this topic, as well as an increased focus from a growing range of investors. We are keen to ensure that we are implementing best in class governance and in touch with current investor and market sentiment on key issues. Diversity will also obviously be a key component of this review."

DIVERSITY

As part of the engagement, a second issue which we wanted to draw attention to was diversity, including gender and ethnicity, at board level. So far, the wider market has been focusing on increasing levels of diversity at Board level within the FTSE-350 and we have seen success in encouraging business leaders to increase levels of diversity within their organisations. It is a particularly pertinent area for Castlefield as we are members of the 30% Club and signatories to HM Treasury's Women in Finance Charter and our work linked to this initiative has helped to inform our approach elsewhere.

Within the AIM market gender diversity levels remain low: the executive director population surveyed in a recent KPMG report has female executive directors accounting for 7%.⁵ Levels for other forms of diversity can be much more difficult to track, but from our experience, and the findings of The Parker Review which surveyed larger businesses, these have been slow to change.

AIM COMPANY EXECUTIVE DIRECTOR GENDER DIVERSITY¹



We believe boards that genuinely embrace cognitive diversity, as manifested through appropriate gender and ethnic representation and a broad spectrum of skills and experience, are more likely to achieve better outcomes for investors by avoiding 'group think'. There is a growing volume of research to support this hypothesis. Fostering inclusive workplaces can also play an important role in increasing innovation, attracting and retaining talent, and enhancing reputation and brand.

CASTLEFIELD ENGAGEMENT

We encouraged the companies to:

- Publicly disclose a policy regarding diversity and where possible publish aspirational targets.
- Outline what internal policies are in place to develop a pipeline of talent to promote women and minority ethnic employees at all levels of the organisation.

We also discouraged boilerplate text and explained that we would instead welcome tangible evidence of what actions the board are taking in order to encourage and improve diversity.

5. <https://home.kpmg/uk/en/home/insights/2021/07/executive-remuneration-in-aim-listed-companies-2021.html>

RESULTS

Pleasingly, our engagement on diversity was met with enthusiasm by the majority of our investee companies and we had responses from all those we contacted. In our view, this topic felt like an area that was a 'hot topic' on the agenda for Boards of Directors and we had some very interesting conversations with management teams about the plans they were implementing to improve their reporting in this area and support a more diverse workforce.

Some key highlights

- Many companies were able to provide detailed examples of diversity and inclusion policies and actions
- A few we spoke to seemed to be open to setting aspirational targets
- Increased levels of reporting were being planned for the majority of companies

What did become clear through our engagement was that companies often felt more confident talking about gender diversity as there are clearer guidelines in place for target levels of representation and this data appears to be more systematically recorded. In certain regions, such as France, it is not permitted to collect data on race,⁶ creating challenges for firms wanting to get a broader look at their workforce. We must also be aware that for companies with overseas operations, what is considered a diverse workforce in terms of ethnicity can be vastly different from our interpretation here in the UK and may skew overall statistics where provided.

However, we do not believe that these challenges should present a barrier to companies having frank discussions about how they can improve in this area and laying the groundwork to ensure that a truly inclusive culture is in place within their organisations. We do not expect perfection from our investee companies, but do expect them to be looking for, and acting on, opportunities to progress.

EXAMPLES

The following excerpts have been taken from some of the responses we received to our engagement.

MATTIOLI WOODS

Mattioli Woods is a leading UK provider of wealth management and employee benefits.



We have always thought highly of the company culture at Mattioli Woods and were pleased to see the level of detail that we received from Group Financial Director, Ravi Tara.

"Diversity has been embedded in our culture and ethos throughout our 30 years of trading. As a business with founding roots in Leicester, one of the most diverse cities in the UK where no one ethnic group is the majority, and the home of our largest office, we are surrounded by different races, genders and mental and physical ability levels daily, which is something we positively embrace. The population of Leicester comprises a diverse mix of ethnic groups, with over 40 religions and faiths represented by them. It is this diversity that we encourage within our business throughout the country."

Such words were also supported by hard numbers too and we were provided with a detailed breakdown of workforce by gender, age, part-term vs full-time and ethnicity split across all levels of the business. This detail painted a truly diverse picture from Board and Senior Director level to Support and Operations functions.

As well as this, and the types of more standard policies we would expect, the company has various initiatives in place to foster a diverse workforce, from allowing flexible working to suit the needs

6. <https://www.businessinsider.com/france-weighs-legalizing-race-statistics-to-picture-discrimination-2020-6?r=US&IR=T>

of its employees (a feature that was part of our team pre-COVID) to offices which provide designated private and quiet spaces for employees to use for time away from the computer including for prayer and reflection.

Inclusivity and diversity do appear to be considered of paramount importance to the company and “it continually evolves presenting opportunities for growth and improvement.”

KEYWORDS STUDIOS

Keywords is an outsourced technical services provider to the global video games industry.



As one of the larger AIM-listed businesses we hold, we had higher expectations. As a global, people-focused business, we were pleased to have the opportunity to speak to the company's Chief Financial Officer about the topic and on Keywords' aims for the future.

During the call, we discussed its recently established Global Diversity Council which is sponsored by the company's head of HR but run by individuals from across the wide geographic range in which Keywords operates. The company has plans to establish further committees across the business to contribute to the wider company's diversity and inclusion strategy.

The company currently monitors diversity at a group level but is in the process of widening that to a country and individual studio level.

Overall, we were very impressed by the level of attention that was being paid to diversity at a senior level and found management to be very open to increasing their levels of reporting in this area.

APPRECIATE GROUP

Appreciate is the UK's leading multi-retailer redemption product provider to corporate and consumer markets.

The logo for Appreciate Group plc features the word "appreciate" in a large, bold, blue, lowercase sans-serif font. Below it, the words "group plc" are written in a smaller, blue, lowercase sans-serif font.

The company provided an extensive response to our letter and was able to demonstrate high levels of female representation at board level and in senior management role. We were particularly impressed by the steps taken in their recruitment practices.

Tim Clancy, Appreciate Group's Chief Financial Officer, said:

“Diversity in recruitment - Diversity, equality & inclusion is embedded throughout our recruitment lifecycle. We work proactively with recruitment partners to ensure that shortlists for all roles across the business are well balanced. Resourcing principles are underpinned by diversity and help us to build diverse candidate pipelines.”

“In 2020, we introduced a gender bias decoder into all of our job role advertisements; and we have developed interview guides and competency frameworks to eliminate unconscious bias. We have also invested in talent acquisition capabilities, to ensure that we reach broader and more diverse talent pools. We recognise that women are often less likely to move roles during these uncertain times, and with this in mind we are working hard to extend hiring timelines and to engage more specialist support to provide shortlisted candidates for varied backgrounds.”

We also had a high number of follow up calls with companies in response to our letter and had some in depth discussions with management teams.

CONCLUSION

As ever, it was invaluable to be able to engage and discuss such topics with management teams, something we are afforded to a greater extent with smaller companies. Such engagements are a key part of our investment process, whilst continuing to build long-term and constructive relationships with companies on behalf of our investors we believe can help aid the outcome of our engagements.

Our requests around remuneration look likely to be supported by changes to the QCA Code in due course and we will continue to encourage further transparency, particularly around AGMs when company reports provide the basis for our voting decisions. Where we do not feel that a company has provided enough information to make a decision, we will continue to speak to management to seek further detail. However, if this is not provided, this lack of transparency, particularly if combined with non-standard remuneration practices, may result in us using our votes to express our dissatisfaction.

We will continue to engage on the topic of diversity with our investee companies and are interested to see how companies progress following on from the point of our engagement with them detailed in this report. This is an area of great interest for many stakeholders, and we believe it is our responsibility to ensure that, as investors, we make our support for a diverse workforce and supportive employment practices clear to those with the power to influence them.

As a member of the 30% Club, we are working with other investors to widen the scope of the group, originally set up to increase female representation at board level, to incorporate other forms of diversity. We hope that by working collaboratively with other investors, we can send out a consistent message and develop achievable expectations for the businesses we invest in.



IT IS OUR RESPONSIBILITY TO ENSURE THAT, AS INVESTORS, WE MAKE OUR SUPPORT FOR A DIVERSE WORKFORCE AND SUPPORTIVE EMPLOYMENT PRACTICES CLEAR TO THOSE WITH THE POWER TO INFLUENCE THEM.



MEET THE TEAM



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