

Our Sustainability Research Process

For many analysts and investors, sustainability *is* ESG – environmental, social, and governance factors. We respectfully disagree; we believe this to be an overly narrow and constrained view of corporate sustainability. For that reason, we have developed and implemented the proprietary 5-factor model shown below. By including “new” factors such as adaptability/responsiveness and innovation capacity, we believe the model to be more robust, and consequently a better predictor of companies’ future competitiveness and financial performance.

The “Iceberg Balance Sheet” and 5-Factor Model: A more comprehensive definition of corporate sustainability

In the 21st century, 75-80% of companies’ *true* risk profile and value potential lies *below* the surface, and *cannot* be captured by traditional financial analysis.

Inflection Point Capital’s proprietary 5-Factor Model has the proven ability to capture these hidden drivers of risk and return:

- Environmental & Social Sustainability
- Human Capital
- Organizational Capital
- Adaptability & Responsiveness
- Innovation Capacity



In developing, refining, and applying the model, we have attempted to be as parsimonious as possible. We have closely observed the “indicators arms race” among research providers, and remain unconvinced that the 900+ indicators which are becoming increasingly prevalent provide either actionable investment insights or a meaningful information advantage.

The trick, of course, is to know *which* performance indicators truly add value, in which sectors, and at which points in the market cycle. *IPCM* uses no more than 8-10 “universal” performance and strategy indicators for each of the 5 factors, plus a roughly equal number of sector-specific ones. The key, of course, is to select the most *relevant* indicators, as well as the most robust and forward-looking data points with which to assess them.

1 The “Iceberg Balance Sheet” concept was first articulated in Dr. Matthew Kiernan (1995) *The 11 Commandments of 21st Century Management*. New York: Prentice Hall.

The *only* way that one can acquire this knowledge is through actual experience, and the analysis of empirical market results, gathered over many years. Inflection Point Capital Management’s principals have over 30 years’ hands-on experience in this regard, and IPCM’s 5-Factor model has been the beneficiary of that practical experience. The single most important part of the entire IPCM value proposition is the selection of both high-impact indicators and the data points with which to assess them.

The table below provides a brief excerpt from our analytical matrix, showing a sampling of the types of performance indicators we use for each of the five factors:

| Sustainability Factor | Performance Indicator |
|---|--|
| Environmental and Social Sustainability | <ul style="list-style-type: none"> ● Energy efficiency and productivity ● “Carbon productivity” ● Water, materials, and resource use efficiency ● Labour and human rights |
| Human Capital | <ul style="list-style-type: none"> ● Recruitment capabilities ● Employee development and motivation ● Retention and high-performance workplace strategies ● Knowledge dissemination mechanisms |
| Organizational Capital | <ul style="list-style-type: none"> ● Board and executive level sustainability governance mechanisms ● Stakeholder relationships/capital with regulators, local communities, etc. ● Customer satisfaction levels ● External partnerships |
| Adaptability/Responsiveness | <ul style="list-style-type: none"> ● “Horizon-scanning” and trend-anticipation capabilities ● Speed of response to emerging demographic and consumer trends ● Speed of response to regulatory and policy change ● Mechanisms to promote rapid decisionmaking and execution |
| Innovation Capacity | <ul style="list-style-type: none"> ● Percentage of revenues from recently-developed products and services ● R&D investment rates relative to peers ● Organizational mechanisms to promote and accelerate innovation ● Rate and quality of patent and IP production |

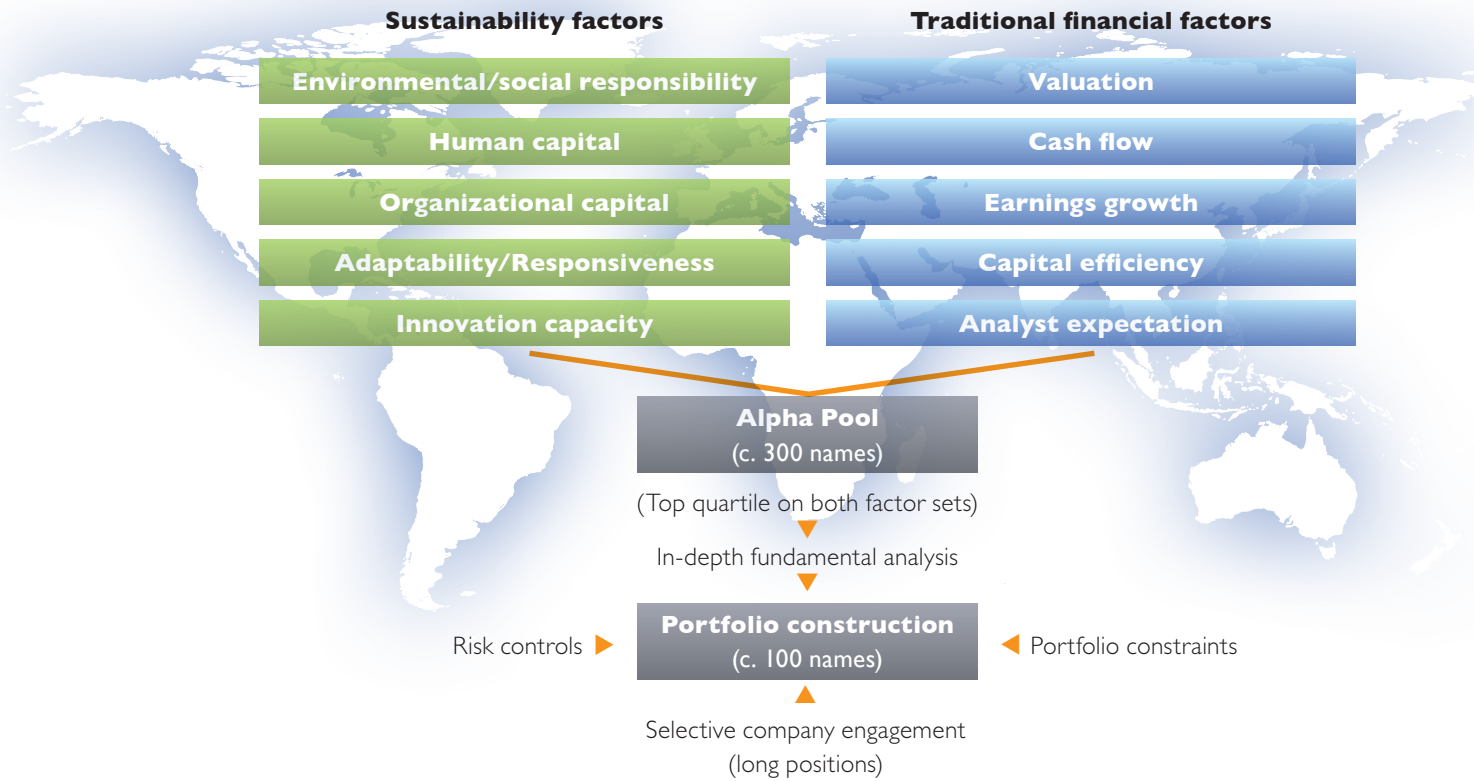
The IPCM sustainability research process has two discrete steps:

1. First, we utilize a *combination* of ESG research providers to help narrow down an investable universe of over 2,500 to a more manageable “alpha pool” of roughly 300 securities. (Of course, traditional *financial* analysis is also critical to this winnowing process, and receives equal weight to the sustainability analysis.) The research providers include both specialist boutiques and leading sell-side firms such as Goldman Sachs, SocGen, and Deutsche Bank.

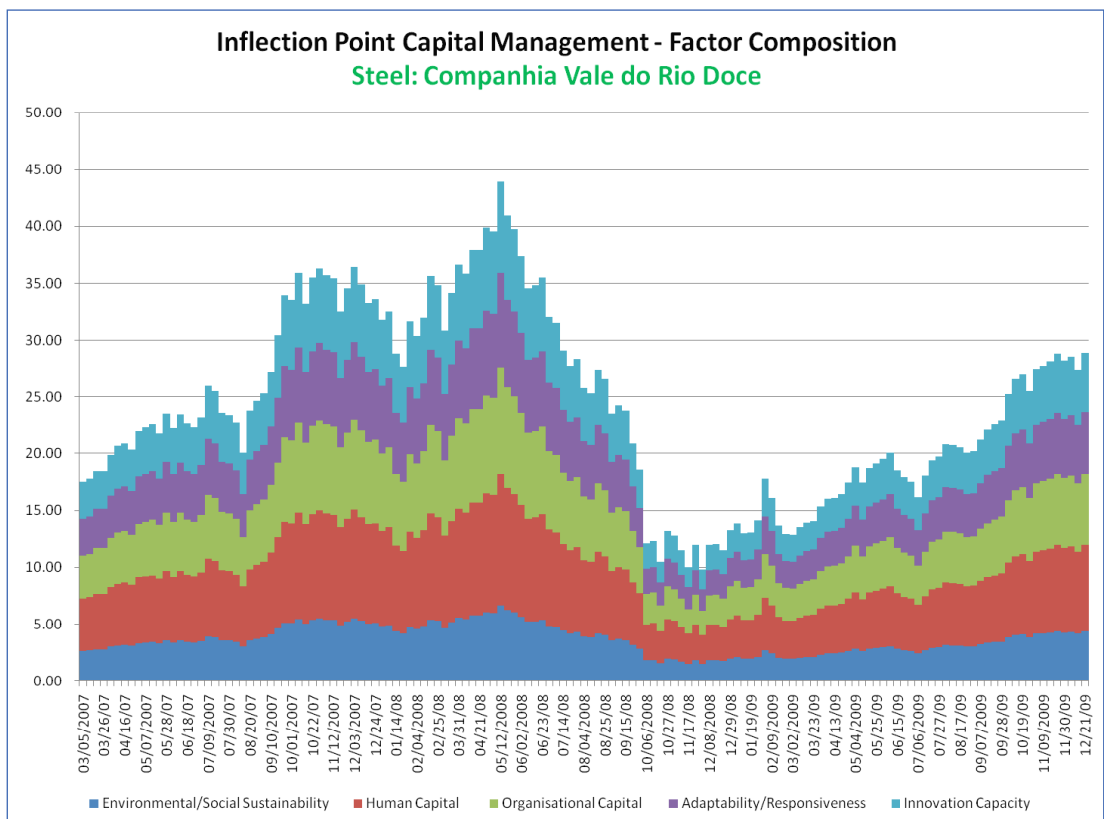
Recognizing that not all research providers are equally well-resourced or of equal quality, we have developed a proprietary algorithm to weight the different contributions differentially. We believe that this process combines the benefits of multiple perspectives with a knowledgeable judgment about the relative value of the differing contributions.

2. Once the alpha pool has been narrowed to approximately 300 names, IPCM’s internal research team conducts more in-depth research on the remaining companies, to narrow the field to approximately 100. IPCM’s research team includes the former global head of research of Innovest Strategic Value Advisors, formerly the #1 ranked firm in this field, as well as the former Chief Executive and several former senior analysts.

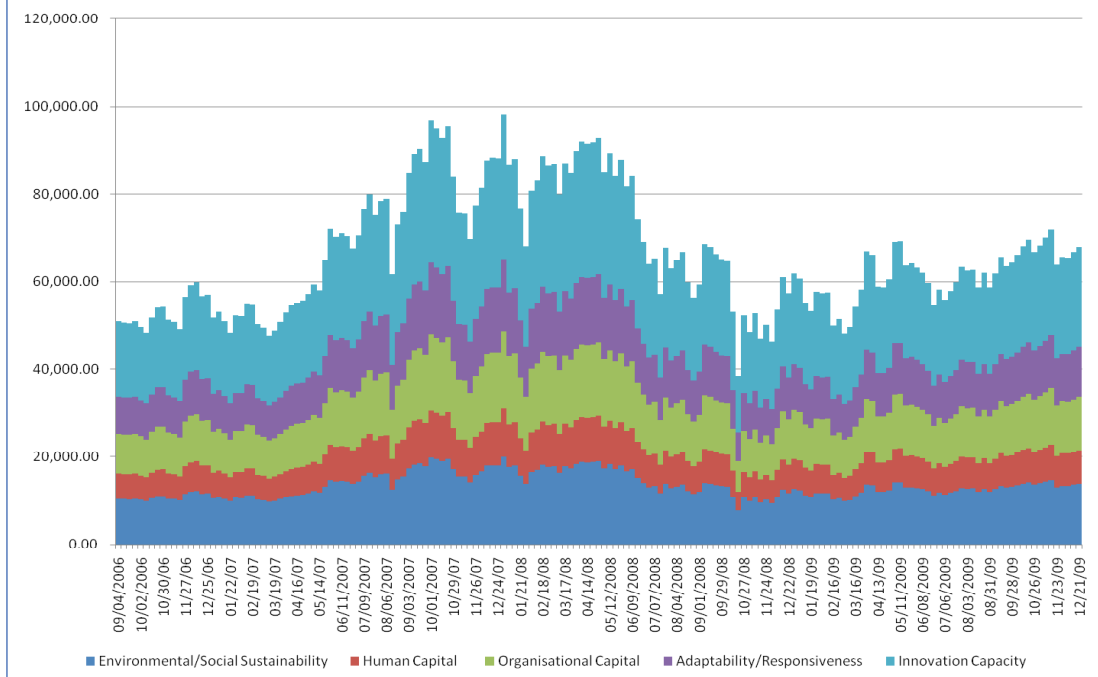
The following diagram outlines this research process schematically:



Fundamental to our analysis is the recognition that the 5 factors do not affect all companies uniformly. Their alpha contribution varies from one to the other, and differs dramatically not only from sector to sector but over time, as the following two factor attribution charts demonstrates. The coloured bands represent the return impact of each of the IPCM sustainability factors over time:



Inflection Point Capital Management - Factor Composition Construction and Engineering: Hyundai Construction and Engineering



In addition, we believe that a robust analysis of companies' sustainability performance must also include:

- A sophisticated, in-depth analysis of the different competitive dynamics in each *industry sector*. Strong (or weak) performance on a given sustainability indicator is of little practical value to investors if that particular factor is relatively unimportant in that sector, eg. environmental performance in the software sector.
- A clear recognition of the profound difference between policies and strategies on the one hand, and actual *performance* or execution on the other. For example, while a company's signing of the UN Global Compact does provide a certain level of useful information, we believe that it is the companies' actual performance in *implementing* them which gives us even more valuable insights.
- An understanding that, while a "snapshot" of a company's *current* risk, management, and opportunity profile relative to its same-sector competitors is useful, it is even more important to understand its "performance improvement vector" – positive or negative. This dynamic approach, applied over a multi-year research horizon, gives investors a much better ability to predict and anticipate its *future* performance.

Our 5-factor model makes one additional critical distinction: between the sustainability of the *business activity* itself on the one hand and the individual companies' management quality and execution capabilities on the other. The most brilliantly managed and led company in the world will not reward its investors in the long run if its very business or industry is itself intrinsically unsustainable on IPCM's 5 factors.