

Incorporating Environmental, Social, and Governance (ESG) into the Investment Process

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The UN Principles of Responsible Investing

Aspirational goals to incorporate ESG (Environmental, Social and Governance) issues in investment process. While the PRI is global, a significant percentage of signatories are based in Western Europe and the US.

The Principles

- Incorporate ESG issues into the investment analysis and decision making process
- Serve as an active owner and incorporate ESG issues into ownership policies and practices
- Seek appropriate disclosure on ESG issues by the companies in which we invest
- Promote acceptance and implementation of the Principles within the investment industry
- Work together with other industry participants to enhance effectiveness in implementing Principles
- Report on activities and progress toward implementing principles

Key Points About the UN PRI

- Guidance on integrating ESG issues into investment decision making
- Grounded in fiduciary duty
- Voluntary and aspirational
- Global collaborative investor network
- Forum for discussion and concrete action
- Global organization providing implementation and support

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Why is it Important?

- Increasingly investors and consumers are demanding companies focus on ESG issues.
- Investors representing approximately 20% of the world's capital (\$30T USD) have signed the UN PRI and subscribed to its goals.
- Non-financial factors may have a significant impact on the valuation, growth trajectory, and corporate returns.
 - Resource constraints
 - Competition for capital
 - Subpar decision making / governance leading to opportunity cost

William Blair and the UN PRI

- William Blair became a signatory of the UN PRI in May 2011
- We have historically evaluated corporate governance and transparency as part of our quality assessment of companies, but have not systematically evaluated environmental or social issues.
- Our goal is to incorporate these issues systematically into the evaluation of company quality.

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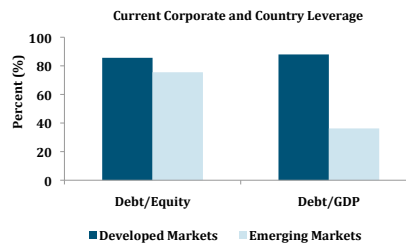
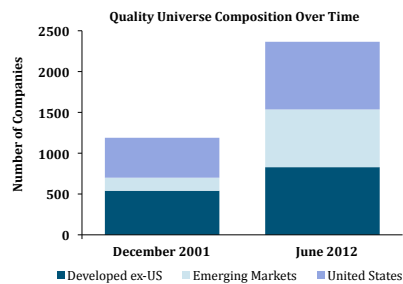
Emerging Markets: Catching Up to Developed Markets

Emerging Markets Have Established:

- Strong GDP Growth
- Better Long Term Market Performance
- Superior Corporate Growth
- Positive Long Term Demographics

But Improved Quality Is The Real Story:

- Better Corporate Returns
- Lower Leverage
- Improved Productivity
- Now approximately 30% of a Global High Quality Universe



Source: William Blair, IMF World Economic Outlook Database, Factset, MSCI. Quality is defined as those companies with good balance sheet metrics, efficiency, and higher returns.

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Is Quality Enough?

Companies with high quality and sustainable growth characteristics tend to:

- Perform well in up markets
- Protect in down markets
- Produce attractive, risk-adjusted returns

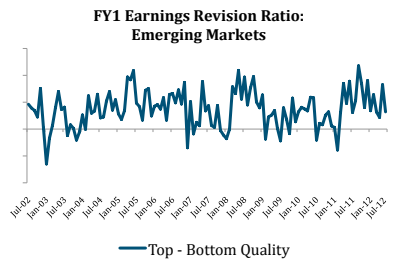
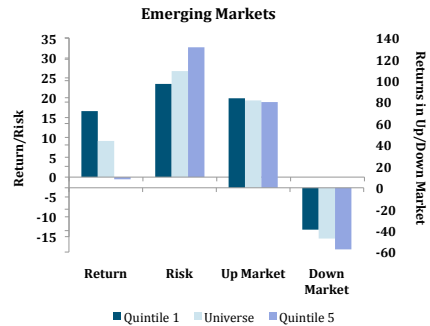
These companies generally lead in:

- Organic value creation
- Peer group leadership
- Consistent earnings growth
- High return on capital and assets
- Positive earnings trends over time
- Low leverage

*Where does ESG Analysis
Come into Play?*

*Is Evaluating Financial
Quality Factors Enough?*

July 31, 1997 - June 30, 2012. Data source: William Blair Emerging Markets Universe. Quality is defined as those companies with good balance sheet metrics, efficiency, and higher returns. Up/down market returns based on MSCI Emerging Markets IMI Index, monthly annualized returns. FY1 Earnings Revision Ratio reflects % of companies reporting positive earnings revisions minus those reporting negative earnings revisions. Line represents differential between top and bottom quality quintiles.



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What is ESG Analysis?

ESG Analysis integrates Governance, Environmental Sustainability and Social Responsibility into the evaluation of corporate performance and prospective sustained return potential.

Governance

- Compensation
- Board structure
- Shareholder rights
- Vision/strategy

**Impact on Corporate
Value Creation**

Social Responsibility

- Employee comp, training
- Diversity
- Supply chain management
- Product safety

Environmental Sustainability

- Resource management
- Environmental reporting/disclosure
- Emission reduction
- Waste disposal policies

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Global ESG Practices

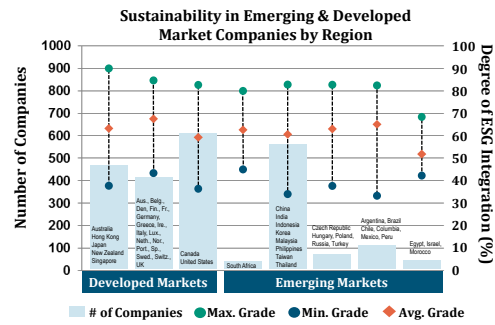
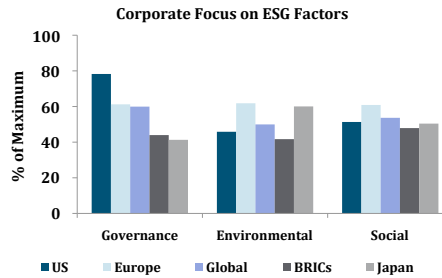
Developed Markets

- Companies incorporate across sectors and size
- The US leads on governance, while W. Europe leads on social and environmental.
- Stakeholders increasingly demand ESG considerations

Emerging Markets

- Multinationals knowledgeable about ESG considerations
- Ownership structure may slow down integration / governance
- Competition and awareness increasing
- Individual countries address through listing requirements

Sources: Goldman Sachs. Universe is Goldman's Research Universe - 1000 companies. Why ESG Matters II, December 14, 2011, Inrate Research



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Case Study: Company Comparisons

	Truworths International	CIMB Group Holdings	Chaoda Modern Agriculture
Description	South African Retailer	Malaysian Bank	Chinese Farming
Global ESG Rating	A	B	F
Governance	A	B	C
Environmental	C	C	F
Social	C	C	F
Key Issues	<ul style="list-style-type: none"> • Independent board and committee structure • Commitment to corporate governance • Sustainability program • Diversity initiatives 	<ul style="list-style-type: none"> • Staggered board structure • Audit committee independence 	<ul style="list-style-type: none"> • Bribery and inside information charges and convictions • Resignation of Auditor • Related party transactions • Potential environmental cost risk

Source: GMI. Ratings represent a normal distribution. A (Superior) represents top 5%; B (Above Average) represents next 20%; C (average) represents middle 50%; D (Below Average) next 20%; and F (Failing) represents bottom 5% of universe.

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Current and Future Emerging Markets ESG Integration Drivers

What Drives Integration?

- Higher returns and valuation
- Stronger corporate performance
- Competition for foreign capital
- Customers require it
- Increased resource scarcity
- Consumer demands: social issues

What are Key Market Prerequisites?

- Size/depth of stock market
- Size/competitiveness of local investment industry
- Sovereign credit rating

Outstanding Issues:

- Emerging Markets companies are still catching up
- Do cheap products mean poor ESG management?
- Limited coverage and disclosure: although coverage is expanding
- Policy v. practice
- What is the quantitative result?
- The regulatory role: country examples

Source: The State of Sustainable Investment in Key Emerging Markets May 2011, IFC

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