ESG Principles

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SANDS CAPITAL

Purpose

This document sets forth Sands Capital's framework for evaluating material environmental, social, and governance (ESG) factors for portfolio companies. The document is meant to be specific enough to be of value, but flexible enough to reflect the heterogeneity of the businesses we invest in (e.g., to accommodate differences in market capitalization, geography, industry, public/private, applicable regulatory regimes, and cultural and historical context). Importantly, we consider it a living document that will evolve through discussion and challenge, so we encourage feedback on how it can be improved. Finally, we believe strongly in the critical role of judgment in evaluating material risks and opportunities of all kinds for businesses (i.e., "one size does not fit all") as ***"Not everything that can be counted counts, and not everything that counts can be counted."*** — William Bruce Cameron.

Section I: Board and Corporate Governance

Shareholders elect the members of the board of directors, who have a duty to advance the interests of the business (to the exclusion of their own self-interest), treat all shareholders fairly, and act in the best interests of the shareholders as a whole.

The principal responsibilities of the board of directors are to:

1. Appoint an effective and capable CEO and ensure a succession plan is in place;
2. Set CEO and other executive management compensation and align incentives with business objectives;
3. Partner with executive management to develop talent across the organization;
4. Assess and approve strategy and capital allocation;
5. Monitor the health, performance, and risk profile of the business; and
6. Communicate with shareholders.

A significant majority of the board, and all members of the key committees within it (audit, nominating/governance, and compensation committees), should be independent.

An effective board needs a strong leader independent of management. This is often exemplified by a strong independent chairman or lead independent director.

The directors should have the diversity of skills, backgrounds, experiences, and thought required to execute on the board's responsibilities most effectively. Board refreshment should be evaluated to avoid entrenchment, maintain independence, and ensure current skills and perspectives remain sufficiently capable of adapting to changing environments.

The governance structure of businesses with concentrated voting control, including multiple share classes with super-voting shares (common with founder-led businesses), should be scrutinized carefully. It is critical to evaluate the integrity, capabilities, motivations, incentives, and alignment of the controlling shareholder with minority shareholders; what governance protections are in place should incentives become misaligned; and the mechanism by which super-voting shares expire.

In addition to the summary above, there is a more detailed outline for evaluating the duties and responsibilities of board directors as an appendix to this document to be used as a reference for proxy voting and other active ownership efforts.

> **"The role of the board is to ensure the success of a company is longer lasting than any CEO's reign, than any market opportunity, than any product cycle."**
>
> — Andy Grove (Former Chairman/CEO of Intel)

Section II: Human and Social Capital

The disciplined application of our six criteria, coupled with our long-term investment time horizon, seek to find businesses that:

- Create high-quality products and services, which customers inherently need or strongly desire (i.e., "pull" vs. "push");
- Create an environment where top talent aspires to work;
- Invest heavily in innovation and the development of human capital; and
- Contribute positively to the communities in which they operate and to society at large.

Absent those characteristics, a business risks failing our sustainable growth, competitive advantage, and/or clear mission and value-added focus criteria. Furthermore, in a world of accelerating information and communication flow, an organization's relationship with customers, employees, regulators, and society are increasingly interrelated — a material risk in one can quickly jeopardize the others.

HUMAN CAPITAL CONSIDERATIONS

Given that our six criteria tend to lead us to asset-light businesses, we find that human capital is typically a firm's most important asset for enabling the long-term opportunity for value creation.

Areas of focus for human capital include:

- Mission/statement of purpose, culture, and ethics/standards of conduct;
- Ability to attract and retain talent with requisite skill sets at each level of the organization;
- Employee engagement and development;
- Diversity of skills, backgrounds, experiences, and thought;
- Health, safety, and well-being of employees; and
- Labor practices and labor relations.

We believe companies should disclose key performance indicators (KPIs) for human capital management objectives to help long-term investors evaluate this aspect of the business.

SOCIAL CAPITAL CONSIDERATIONS

Sustainable growth over the long term requires a business to adapt as the preferences of customers evolve and the expectations of regulators, governments, and public opinion/society change on material issues related to the business.

In our view, companies that meet our six criteria and anticipate these issues are better able to adapt. However, many otherwise successful businesses are often unprepared for the increased scrutiny and/or increased expectations from external parties as they scale.

We can play a critical role through engagement with portfolio companies on these issues, given our focus on businesses that are growing and scaling fast, are in leadership positions (typically number one in market share), and are investing heavily in innovation (which in some instances may mean they are simultaneously disrupting an existing segment of the economy).

For businesses that operate in less stable political environments with high levels of inequality and social stratification, political and business risks can be mitigated by avoiding policies/practices that could be perceived as discriminatory or exploitative and/or by actively promoting practices that enhance the brand as fair and inclusive.

Areas of focus for social capital include:

- Product quality, safety, access, pricing, and affordability;
- Selling practices (bribery and corruption), product labeling, and media/advertising;
- Customer privacy and data security;
- Ethical supply chain sourcing and human rights (with third-party auditing); and
- Community/government relations and tax policy.

Section III: Environment

We believe businesses that fit our six criteria are well positioned to be effective long-term stewards of resource inputs, with a strong business incentive to effectively manage resource intensity (energy, water, commodities/materials, manufacturing yields, etc.).

Particular consideration should be given to environmental risks that arise from externalities (i.e., costs or side effects of commercial activities not fully reflected in the cost of goods sold or services involved). Classic examples of externalities (depending on the regulatory/enforcement regime) are pollution, carbon emissions, plastics, labor violations, waste management, and ecological impacts.

Businesses that do not proactively and effectively manage externalities can, at a minimum, risk failing to evolve with consumer preferences and failing to capture growth opportunities. In more severe cases, they can suffer meaningful financial and/or reputational damage. In instances in which identified externalities can cause reasonable damage to shareholder interests (i.e., opportunity cost, reputational cost, or direct financial cost or penalties), companies are expected to develop and regularly review policies intended to both ensure regulatory compliance and mitigate risk associated with such externalities.

Areas of focus for environment include:

- Energy, materials sourcing, and efficiency;
- Carbon risk and climate change;
- Water and waste management; and
- Forestry, land use, and ecological impacts.

> **"I call tech progress, capitalism, public awareness, and responsive government the 'four horsemen of the optimist.' When all four are in place, countries can improve both the human condition and the state of nature. When the four horsemen don't all ride together, people and the environment suffer."**
>
> — Andrew McAfee (professor at MIT Sloan School of Management and author of *More From Less*)

Engagement and Escalation

It is our fiduciary duty to actively engage our companies on material issues on behalf of our clients.

We will advocate for our clients and look to have partnership-minded discussions with our companies to explain where we see room for improvement or change.

We expect our companies to openly engage us on these topics.

In the event the company is unwilling to engage in discussions, we will escalate the issues through any one of the following channels:

- Letter writing to the board of directors;
- Voting on the issue;
- Voting against the relevant board members; or
- Potentially selling the business if we feel it has impaired its fit with our investment criterion of a clear mission and value-added focus criterion.

Appendix: Detailed Section on Board and Corporate Governance

BOARD RESPONSIBILITIES

Appoint an effective and capable CEO and ensure a succession plan is in place

- The CEO and management skill sets should match future opportunities and challenges facing the business, as opposed to anchoring to past accomplishments.

- The board should have succession candidates identified (min. of 1-2 internal candidates).

Set CEO and other executive management compensation and align incentives with business objectives

- Proxy disclosures should include benchmark and performance measurements to enable an evaluation of the company's goal-setting process and its relationship to compensation.
  - While companies should not necessarily feel constrained by either compensation structures used by peers or the standards or opinions of proxy advisory services, companies should be prepared to articulate how their approach effectively aligns and incentivizes long-term wealth creation for shareholders.
  - Components of compensation plans should match the time horizon of objectives.
    - Bonuses are best used as a reward for annual objectives, while equity awards (stock, performance stock units, or similar equity-like units) encourage long-term orientation and should be a substantial part of total compensation (50% or more).
    - Equity should vest in five years (or longer). Many leading companies are shifting to performance share units that vest over five years based on a combination of credible KPIs and relative shareholder returns.
    - Grants to management of large special compensation awards for retention purposes (versus normally recurring annual or biannual awards) should be scrutinized carefully and reserved for special circumstances with the rationale clearly explained in the proxy statement.
  - Companies should maintain clawback policies for cash and equity compensation. Boards should consider policies around minimum equity retention for executive management, particularly when long tenured.
  - While the primary focus for investors is on proper incentives/alignment, the absolute dollar amount should be contextualized relative to long-term ROI for shareholders. Therefore, strong alignment does not necessarily allow for egregious pay packages.

Partner with executive management to develop talent across the organization

- A business that appears healthy today can lose competitiveness quickly if talented leaders become demotivated and/or leave, or if the critical employee base has similar skills and mindset and therefore may be unprepared to adapt to the future.

Assess and approve strategy and capital allocation

- Boards assess and approve strategy; however, it is not their job to create it.

- Strategy should be informed by an understanding of the external environment and how it is evolving; an input on the external environment can be among a board's most significant contributions. This is, therefore, an important consideration for board composition.

- The company's focus should be on long-term wealth creation for shareholders, which may often include investments that likely will not pay off in the short term.

Monitor the health, performance, and risk profile of the business

- Financial statements are an expression of how the business performed yesterday.
- To monitor performance, management and the board should identify the critical activities that drive future financial results and track progress toward those goals.

Communicate with shareholders

- Transparent communication of a board's thinking to shareholders is important. On some issues, such as board governance and CEO compensation, direct communication from the board to shareholders is often warranted.

BOARD COMPOSITION

Independence

- Directors are accountable to shareholders and owe duties of loyalty and care to both the company and its shareholders. A board should not be beholden to the CEO or management.
- A significant majority of the board and all members of the audit, nominating/governance, and compensation committees should be fully independent members.
- At each meeting, the board should meet in executive session without the CEO or other members of management present.
- Independence is not simply a regulatory status. In our view, it refers to directors who 1) are free from external relationships that may influence the director's judgement, 2) are not financially dependent upon compensation from their board seat, and 3) have an ability and willingness to constructively speak their minds.

Leadership

- An effective board needs a strong leader independent of the CEO/management. This is often exemplified by a strong independent chairman or lead independent director.
- This person is responsible for setting the board agenda and facilitating executive sessions of the board (independent director meetings without CEO/management present), keeping board meetings focused, and serving as a liaison between the board and management.

Size

- No one size fits all, as the board should be large enough to have the requisite/varied expertise while small enough to optimize group dynamics. For context, typical board size ranges between 8-12 for public companies, but can vary meaningfully depending on the size, industry, and overall complexity of the business.

Skills and Diversity

- Boards can benefit from one or two directors who are current or recently retired CEOs from other companies. Be mindful of risks with former CEOs remaining on the board of their existing company beyond a specified transition period. For example, if a departing CEO will be staying on as executive chairman, the role should be clearly defined so that the new CEO has enough space to operate and be successful.
- The board benefits from having a critical mass of directors with directly related industry experience, as well as a subset of directors with complementary and diverse skill sets.
- Diversity along multiple dimensions, including diversity of thought, is critical to a high-functioning board. Candidates should be drawn from a rigorously diverse pool.
- Every board should have an accounting expert who is independent.
- Given the demands (meetings and prep time), it is important for the board to consider a director's service on multiple boards and other commitments. While it can vary significantly, boards often meet 8 times annually (typically four to six scheduled one-to-two-day meetings per year, plus board committee meetings and ad hoc special sessions). It is not uncommon for a director's total time commitment to involve 250 hours or more per year.

Director Tenure and Retirement Age

- Businesses should clearly articulate their approach on term limits and retirement age in their proxy statements. When permitting exceptions, the board should justify these in the context of the board's assessment of its performance and composition. For example, we closely scrutinize independent director tenure beyond 10 years.

- Board refreshment should be considered to ensure current skill sets and perspectives remain sufficiently capable of adapting to fast-changing environments. The importance of fresh thinking and perspectives should also be balanced with the recognition that age/experience can bring pattern recognition, judgment, and knowledge.

Nominating Directors

- A board is responsible for nominating qualified directors aligned with articulated criteria.

- Long-term shareholders (such as ourselves) may recommend potential directors for consideration if they have conviction that they would be additive to the board.

Election of Directors

- It is a right and responsibility of shareholders to elect directors they believe are best suited to represent interests of the company and shareholders over the long term.

- Directors should stand for election on an annual basis to promote board accountability to shareholders. However, if a company chooses to hold elections on a staggered basis (or otherwise elect directors less frequently than annually), the board should explain clearly its rationale in the proxy statement for breaking from this best practice.

BOARD COMPENSATION AND SELF-EVALUATION

Director Compensation and Stock Ownership

- Directors should receive a substantial proportion (50% or more) of their compensation in stock or equity-like instruments, of which a significant portion is required to be retained for the duration of their board tenure. Any cash compensation should be reasonable, tied to attendance, and generally aligned with that of the board's peer group, unless articulated otherwise.

Self-Evaluation

- A board should have a robust self-evaluation process on a regular basis (often facilitated by a third party), led by the lead independent director or appropriate committee chair. The board should have the fortitude to replace ineffective (or absentee) directors.

1. Shareholder Proposals

- When a business receives a shareholder proposal, it should consider engagement with the individual shareholder (as well as other long-term shareholders if/when appropriate) early in the process. If the proposal receives majority shareholder support, the business should continue to engage with shareholders and either implement the proposal or clearly explain why doing so would not be in the best long-term interest of the company and its shareholders. Note that, in the U.S., shareholder proposals are typically nonbinding, but in other markets they can be binding (e.g., in the U.K.). This is one of the reasons shareholder proposals are less common outside of the U.S.

2. Company Proposals

- In connection with a management proposal, the business should consider engaging shareholders early in the process. If their proposal is defeated or receives a notable level of shareholder opposition, then the business should consider further engagement with shareholders and formulate an appropriate response.

3. Say on Pay

- Where not already required by law, we believe businesses should periodically (at least once every three years) provide shareholders with a nonbinding advisory vote on the compensation of the most highly compensated executives. Furthermore, businesses should disclose (usually in their proxy statements) how their compensation policies and decisions take account of the results of their most recent say-on-pay votes. We believe it is helpful for boards to engage with significant longstanding shareholders ahead of advisory votes on compensation and receive feedback on compensation structure.

4. Proxy Access

- Businesses should consider allowing proxy access. For context, among companies that adopt proxy access provisions in the U.S., a typical requirement is that a shareholder (or group of up to 20 shareholders) that has continuously held a minimum of 3% of the company's outstanding shares for three years is eligible to include on the company's proxy statement nominees for a minimum of 20% of the company's board seats. However, note that proxy access provisions vary considerably country to country.

5. Multiple Share Classes with Super-Voting Shareholding Structures

- Founder-led businesses often have several advantages (e.g., long-term orientation, strong entrepreneurial culture, capacity/willingness to invest heavily today for potentially large payoffs out into the future, etc.) that have the potential to create superior long-term business and stock outcomes.

- It is increasingly common (particularly in the U.S.) for founder-led businesses to utilize multiple share classes with super-voting shares (i.e., dual-class shareholding structures) in order to retain control and protect the company from short-term behavior, typically in market segments that are rapidly evolving (e.g., in parts of the technology or media sectors). We are not specifically opposed to such structures, as they often help create long-term value when used appropriately. However, they also have the potential to introduce certain risks and can create misalignment if used inappropriately. For that reason, it is important to evaluate multiple company-specific dimensions when considering whether to support dual-class shareholding structures:
  - In the event that a company has a dual-class shareholding structure, we believe there should be a thoughtful mechanism for the expiration of the super-voting rights at a specified point in the future (e.g., seven years after IPO) or upon a triggering event (e.g., founder no longer involved in the day-to-day of the business or their economic stake falls below a certain threshold, etc.) that makes the most sense for the long-term longevity of the business. As an example, we do not believe it is best practice for public companies with super-voting shares to pass from a founder to another family member.

- We evaluate the gap between the economic interest of the controlling shareholder and the voting control of that shareholder. The wider the gap between economic and voting control, the higher the risk of misalignment. We believe it is important for the controlling shareholder to own a material economic share if they wish to also retain voting control.
- We believe many of the negative side effects of a super-voting share class can be effectively managed through a strongly independent board structure that can ensure minority shareholders' interests are protected and that all shareholders are treated equally in any corporate transaction.

6. Anti-Takeover Measures

- Poison pills and other anti-takeover measures diminish management accountability. If a company looks to adopt a poison pill or other anti-takeover measure, the board should put the item to a vote of the shareholders and clearly articulate why its adoption is in the best interests of all shareholders. On a periodic basis, the board should review such measures to ensure they remain appropriate.

RESOURCES AND REFERENCES (FOCUSED LIST)

Websites:

- International Corporate Governance Network (ICGN) Global Governance Principles
  http://icgn.flpbks.com/icgn_global_governance_principles/ICGN_Global_Governance_Principles.pdf
- Commonsense Principles 2.0
  https://www.governanceprinciples.org/wp-content/uploads/2018/10/CommonsensePrinciples2.0.pdf
- SASB Materiality Map
  https://materiality.sasb.org/

Books:

- *The Director's Manual: A Framework for Board Governance* by Peter Browning & William Sparks
- *Boards That Deliver* by Ram Charan
- *Dear Chairman* by Jeff Gramm
- *Corporate Director's Guidebook* by the Corporate Laws Committee, American Bar Association
- *More from Less: The Surprising Story of How We Learned to Prosper Using Fewer Resources—and What Happens Next* by Andrew McAfee

SANDS CAPITAL

At Sands Capital, we are active, long-term investors in innovative growth businesses, globally. Our approach combines rigorous fundamental analysis with inspired thinking to seek innovative, high-quality businesses that are creating the future. By enabling our clients to participate in the growth of these businesses, our mission is to add value and enhance their wealth with prudence over time.

ALL-IN CULTURE

We are one team dedicated to one mission and one philosophy. As a fully independent and staff-owned firm, we attract and retain strong talent, focus on long-term outcomes, and are highly aligned with our clients' interests.

INSIGHT-DRIVEN

Businesses that can build a sustainable advantage are few and far between. To seek them, we apply six criteria to separate signal from noise, identify what matters most, and construct differentiated views on tomorrow's businesses, today.

GLOBAL PERSPECTIVE WITH LOCAL UNDERSTANDING

Innovation-driven growth knows no geographic boundaries. Neither does our research team. We are hands on, on-the-ground, and deeply immersed in the ecosystems in which our businesses operate.

HIGH CONVICTION FOR HIGH IMPACT

All our strategies concentrate investments in only our best ideas and avoid mediocrity. With the intent to own businesses for five years or longer, we seek to create value for clients through the compounding of business growth over time.

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