Castlebay Investment Partners LLP Stewardship

2023 REPORT

Castlebay Investment Partners LLP
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Contents

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Introduction

Castlebay's 2023 Stewardship Report provides details of our approach to stewardship and our compliance with the Stewardship Code 2020 (the code) for the twelve month period to the end of April 2023.

The code is a set of 12 principles, published by the Financial Reporting Council (FRC) with the aim of enhancing the quality of engagement between investors and investee companies to help improve long-term returns to shareholders and promote the efficient exercise of governance responsibilities.

The FRC defines Stewardship for the updated code as:
"The responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society".

For more information please visit the FRC web-site (www.frc.org.uk/investors/uk-stewardship-code)

Castlebay Investment Partners LLP (CIP) agrees with and supports the 12 principles outlined in the code and through our policy set out in this report. We aim to provide a clear framework for how we exercise our responsibilities as long-term business owners; how we monitor our invested businesses and how we engage with management when we identify issues, which we believe could be to the detriment of long-term shareholder returns.

Castlebay is regulated and authorised by the Financial Conduct Authority (624445). If you would like further information on our Stewardship of capital please contact David MacNeil on 0141 2127930 or davidmacneil@castlebayinvestments.com

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Principle 1.

Signatories' purpose, investment beliefs, strategy and culture enable stewardship that creates long-term value for clients and beneficiaries leading to sustainable benefits for the economy, environment and society.

Our purpose & culture

Castlebay Investment Partners LLP was established in 2013 by the partners David MacNeil, David Ridland, John Poulter and Alistair Mackintosh to manage their fellow investors' capital alongside their own, whilst being aligned to their long-term best interests. We focus our time and efforts on the long-term investment of high Quality, listed businesses when they are attractively valued.

Castlebay is independently owned by the four Partners. Our independence allows us to invest away from the market noise and investing herd and focus on only those businesses which pass our quality test. As business owners we understand the challenges faced by our investee companies, particularly when it comes to the long-term allocation of capital. Our partnership structure also allows us time to implement and develop our Quality value investment style as well as developing enduring relationships with like-minded investors.

Our purpose is to provide **Security through Compounding - Knowledge, Returns and Trust**. Compounding is an activity that is often misunderstood and underappreciated by investors, often to their detriment. To benefit from the power of compounding we need time and patience. Compounding the knowledge on each of the companies in our investment universe and their sectors, enables us to get to know the businesses, what challenges they face and how they are meting them. Investment returns are clearly an important aspect of investing and we want, over time, our businesses to continue to generate high returns on their capital and equity, without an over-reliance on debt or capital. The Retained Return on Equity is the compounding measure we focus on most and believe that over time, the share price of a business follows these returns that are retained in the company. Finally, to be able to effect a long-term approach to investment, we require investors who understand how we invest and will patiently wait for the compounding to create greater value over time. Developing enduring relationships with like-minded investors is a critical aspect to our overall approach.

Developing a strong culture at Castlebay is a key focus. The team operates in an environment where we are all encouraged to make suggestions to improve what we do and how we do it. Discussing our mistakes and what we could do in future to prevent them being repeated is a strength of our culture. The team are engaged in how we can keep developing and improving what we do and how. In addition to our purpose of 'security through compounding', we have adopted three non-negotiable behaviours.

- Honesty & integrity;
- World class basics;
- Growth mindset

Achieving and developing a strong culture and environment are critical to the enduring success of Castlebay and our fellow investors. The Partners have "skin in the game" by investing alongside our fellow fund investors, ensuring a strong alignment of interests.

Our vision & strategy

Our Quality-value investment philosophy aims to preserve capital and generate returns in excess of Consumer Prices (CPI) +4% per annum on a rolling three-year basis by investing in high-returning quality businesses at attractive valuations.

Our independent ownership allows us to focus on what we do best and avoid market noise and short termism. Being the managers and owners of the business allows us to make long term business and investment decisions and develop meaningful relationships with like-minded investors. These are investors who share our philosophy of investing in a small number of high Quality, robust businesses at attractive valuations and then owning them for the long term. Our average holding period is around 10 years, based on our annualised turnover of 11% since inception. These relationships take time to develop and as such we value them very highly.

7 Factor Screen
5-year Average Return on Equity
Return on Tangible Assets
Return on Capital Employed
Net Debt to EBITDA
Cash Conversion
Capital Intensity
Standard deviation of Return on Equity

Success for Castlebay is having the time to implement and develop our Quality value investment philosophy. Our vision is for Castlebay to remain independently owned by the Partners and to continue to attract the right, like-minded long term investors.

Our team is deliberately few in number to minimise corporate complexity, hierarchy and promote inclusion. This allows us to avoid unnecessary bureaucracy and distractions. Cultivating our culture, where we all continue to develop and learn in a professional but friendly environment is very important to the founders of Castlebay. We intend to continue developing our team and environment and making the best investment decisions we can, whilst finding and developing enduring relationships with existing and future like-minded investors.

Investment beliefs

We are 'Quality-value' investors, in that order and invest in businesses which have demonstrated an ability to generate high returns on their capital and equity over the long-term.

We believe in Charlie Minger's assertion that "over the long term, it's hard for a stock to earn a much better return than the business which underlies it earns". The Retained Return on Equity (RROE) is the compounding rate that we believe, over the long term will result in share price appreciation.

Investment process

When we think about Quality, we set the bar high and want to see businesses which have consistently generated high returns in the past and can continue to do so in the future because they operate in oligopolies, monopolies and niche areas, producing products and services which are difficult to compete against or copy.

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For a company to be considered a candidate for investment, it must first make it into our investment universe. The first part of the investment process is the Quality test, which consists of a seven factor quantitative screen. You will see on the table below that we want returns on Capital and Equity of at least 20% and a return on Tangible assets of at least 15%. We don't like debt or capital intensive businesses and don't invest in companies whose business model is predicated on high levels of debt or capital to produce their products and services. Cash is king and we want businesses ideally, where possible, to have net cash or low low levels of debt on their balance sheet and to generate high levels of cash.

This initial screen reduces the investible universe from circa 4,500 companies to just over 100. We then look at qualitative factors including: management, business models and the operational margin of safety. Using these Qualitative factors we are trying to identify whether a business that has successfully generated high returns in the past can continue to do so into the future.

We assess how the management team have allocated capital, how they are incentivised and how they create value and a winning, sustainable culture inside the business. We want businesses that have prospered in the past and can continue to do so in the future, even if the management make mis-steps. The business model and Quality pillars must remain intact for it to make it into our investment universe or portfolio. The operational margin of safety is how the business can continue to produce products and services that are difficult to compete against or replicate.

The nature of our approach means that there are companies and sectors in which we are unlikely to invest. Big oil and banks are two areas where this is likely to be the case. This is because the returns are too low and particularly in the case of banks, the level of debt too high. It is also unlikely that we would invest in those companies operating in fast changing markets like certain areas of the technology sector - where products cycles are very short and innovation can quickly eat away a competitive advantages. In these instances, it is very difficult for us to ascertain whether a company's past achievements can continue in the future. These businesses tend to be only as good as their last product. We are comfortable that there will be periods when these areas perform strongly and we will not benefit from these share price returns. However, we believe that over the long term the Retained Return On Equity will act as a force of gravity, pulling share prices and valuations towards the underlying returns of these businesses.

The investment universe is reviewed annually, during which time there is an opportunity for companies to come in and out of the universe. There are enough, but not that many businesses which satisfy our strict quality characteristics. We believe that the majority of listed companies operate in perfect or highly competitive markets. These are of no interest to us and we are happy to avoid them completely.

Once companies have made it into the investment universe, the final part of our investment process is looking at the valuation of the businesses. We do not want to overpay for the privilege of owning these high quality companies, because there is a heightened risk of a short term share price de-rating which might impair capital. Alternatively, if we are patient and wait for the valuation to become attractive, we will benefit from a re-rating as well as the retained return on equity driving long term

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returns. An example of this is Diageo. We first invested in Diageo in Q1 2020 during the Covid market weakness, having waited five years for the opportunity since launching our fund! Patience is often rewarded in investing.

Our valuation metrics include the free cashflow yield, a reverse discounted cash flow and the company PE (price/earnings) based on its own long term average. We believe that not all PEs are created equal and companies with high returns on their equity and capital most often justify their higher PE rating because they can continue to make their high returns in the future. We think about the valuation as if it were an elastic band – we want to own businesses and not interfere with their compounding. However, if the elastic band gets stretched too far it may snap back, impacting returns. In cases where valuation risk is high, we will look to reallocate capital towards equally high quality businesses in the fund; but ones being offered at more attractive valuations.

We think about a business in terms of years expensive or cheap, depending on whether the valuation is at a premium or discount to its own long term average. This premium or discount is divided by the Retained Return On Equity (RROE) – the rate at which the business is compounding shareholder value.

For example a business which is 20% expensive and with a RROE of 20% is deemed 1 year expensive. On the basis that we own, on average businesses for nearly a decade (based on 11% annualised turnover) a business which is one year expensive is well within the confines of our long term approach. We have reduced positions as they have neared 5 years which we believe is more extended, both nominally and in relation to our other companies.

Once we invest, we continue to compound our knowledge on the business and watch the incremental returns produced by the business. These incremental returns can often afford us an early warning signal that the business maybe coming under pressure, if these returns start to decline. We create a model on each of the businesses in the universe which allows us to analyse how the shape of the business has changed over time and at what rate.

Supporting effective stewardship

Our aim is to preserve capital and generate returns which exceed inflation (as measured by consumer prices) plus 4% per annum on a rolling three year basis. The implementation of our investment strategy will enable us to exceed our investment aims over the long-term as long as our businesses remain sustainable and we do not overpay for the privilege of investing in them.

The Castlebay team believe in our approach to investment and all members are invested in the Castlebay fund for the long-term. We believe this helps align our interests with that of our fellow investors.

We believe in the long-term importance of stewardship through the lens of sustainability which means our businesses can continue to do successfully what they have in the past.

Creating long term value for clients and benefits for the economy, environment and society.

When we invest, we do so with an owner's eye. That is we invest as a long term owner in the business. We are actively engaging more with our investee businesses, by voting at AGMs and engaging with management, particularly around management incentivisation structures which we want to be focused on long term share holder returns. This is an area we have identified as one where more work is required.

Our aim is to protect and grow our fellow investors' capital by exceeding Consumer Prices (CPI) plus 4% per annum on a rolling three year basis. The fund turned 8 in January 2023 and we have been able to create value for our fellow investors with returns (81%*) that have beaten the market (55%*), our peer group (47%*) (IA All Companies sector) and higher than our CPI+4% per annum measure which is 78% since inception (to 26/4/23). This is despite the recent spike in CPI in the UK as well as recent equity market weakness. We have also protected capital during periods of market distress with the most notable instance occurring during 2020 when we posted a positive return of 2%, when the market posted a double digit negative return in part due to Covid. (MSCI UK TR -11%) *source: FE 2023

The businesses towards which we gravitate tend to be capital light and not involved in heavy or dirty industries. We do not view our fund as an ethical one. However, we do focus a lot on the sustainability of a given business and whether it can continue to produce the high returns it has in the past. These businesses by extension have managed to create their own competitive advantage to stand the test of time and competition. Society benefits at large with the range of products and services produced by our global trading companies. We invest in two Tobacco companies which are bringing positive change to their industry through innovation and the development of reduced risk products. The rate and aspect of positive change is an important aspect we continue to address.

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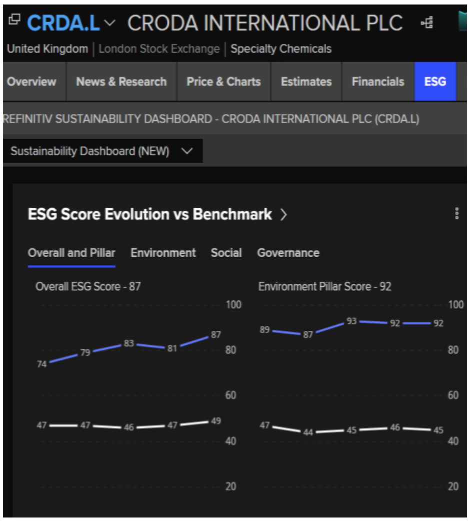
Principle 2.
Signatories' governance, resources and incentives support stewardship.

As we describe in **Principle 1.**, Castlebay was established by the Partners to manage their money alongside their fellow investors. Co-founding Castlebay provided David Ridland, Partner and CIO the opportunity to implement and enhance the Quality value investment philosophy he developed earlier in his career. We invest in a small number of high returning, quality businesses when they are attractively valued. Sustainability is at the heart of our approach. We identify businesses which have consistently generated high returns in the past and have a competitive advantage, enabling it to continue making high returns in the future.

We maintain a small, experienced team at Castlebay to minimise corporate bureaucracy, complexity and hierarchy. The investing ethos is to think like long-term business owners when we invest. Our Partnership structure affords us the time we need to compound our knowledge, returns and trusted relationships. Robust governance and oversight are crucial tenets of our firm.

We have recently changed our main data provider from Bloomberg to Refinitiv. Part of the reason for this is because we believe it improves the appropriate resourcing of our stewardship activities. Below is an excerpt from the recently developed Sustainability Dashboard for one of our companies, Croda International PLC. Here we can plot and monitor the developing pathway of our companies; to assess how efficiently they are using their resources as well social and governance factors as well.



Source: Refinitiv

Governance & the Team
Castlebay is owned 100% by the Partners who have been in partnership since inception. At Partnership level, there are four Partners, 2 working, David Ridland and David MacNeil and 2 non-working Partners, John Poulter and Alastair Mackintosh. The working Partners are the majority (two thirds) owners of the business and are responsible for day to day management of the Partnership and all investment management activities. The non-working partners own the remaining third of the

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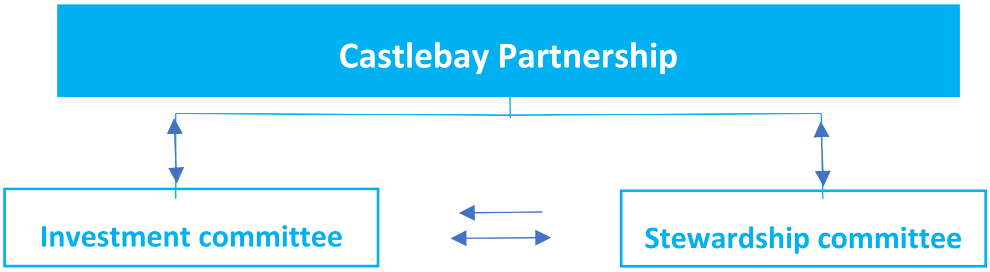
business and are involved in the monthly Board meeting where they discuss ongoing business activities and strategy.

The culture of the Team is one where all members are encouraged to take responsibility and make suggestions which will make us better. We believe a flat organisational structure allows the team to do this whilst at the same time provide oversight and accountability of everyone's actions. Our organisational structure consists of the Partnership and both investment and stewardship committees which are inextricably linked to the investment team.



The Partners discuss and agree the firm's strategy and are responsible for all aspects of the partnership from an investment, investor and regulatory perspective. We invest in companies which have historically generated high returns by producing products and services which have withstood the slings and arrows of competing forces for many decades. We believe good stewardship is a central tenet of these businesses continuing to be successful in the future.

Before establishing Castlebay, the working partners worked for more than a decade each, in large investment companies which provided high levels of training and strong technical expertise. They have also experienced in their careers various financial crises since 1997, providing valuable investing experience. These experiences have contributed to developing our Quality value long-term investment approach and the importance of good stewardship and the right alignment of interests.

Castlebay Roles & Responsibilities	
David Ridland CFA UK: Founding partner and CIO Investment & Stewardship committee	David is a co-founding Partner and CIO of Castlebay with 25 years industry experience and is a member of CFA UK. He started developing our Quality value investment philosophy when he was in the early stages of his investment career as a fund manager at what later became Ignis AM. He is responsible for implementing and developing our investment philosophy and the management of the VT Castlebay UK Equity fund. As CIO he is also responsible for all investment related decisions and activities at Castlebay which he reports on to the Board monthly. He chairs the

	weekly investment meeting where investment and stewardship matters are discussed and actioned.
David MacNeil CISI: Founding partner and Compliance Officer Investment & Stewardship committee	David is a co-founding Partner and the Compliance Officer at Castlebay. He began his investment career in 1999 at what later became Barclays Wealth. He managed private client and charity relationships and their investment portfolios until he left to establish Castlebay. In addition to his compliance duties, David is also responsible for developing long term relationships with like-minded existing and new investors. He sits on the investment and stewardship committees.
Maria Kassapi: Trainee Graduate Graduate investment analyst Investment & Stewardship committee	Maria started her investment career at Castlebay once she graduated from the University of Glasgow with a Masters in Quantitative Finance in October 2022. She joined the team to provide analytical and wider support in the investment team. She will focus on our engagement and wider stewardship activities.
Michael Crawford: MD and fund manager at Chawton Global Investors Investment committee member	Michael joined the investment committee in 2020 having met both Davids when he established Chawton in 2019. He shares a similar approach to investing and is the most likeminded investor we have come across in the decade we have been in business. He has been a professional investor for over 25 years and Stewardship is a key component of his investment process. He attends the weekly investment and stewardship meeting. He is responsible for the investment related decisions at Chawton for his global equity fund.

The Stewardship and investment committees are indistinguishably linked, with stewardship an agenda item during our weekly investment and monthly board meetings. The Stewardship team - David Ridland, David MacNeil and Maria Kassapi, have developed sustainability metrics which we believe are critical to the long-success of our investment. These include Return on Invested Capital (ROIC), Return on Equity (ROE) and our newly integrated Refinitiv Sustainability Dashboard. The Chief Investment Officer is head of both investment and stewardship teams with responsibility for engaging with our investee businesses where necessary.

The investment team comprises of David Ridland, David MacNeil, Michael Crawford and Maria Kassapi. Michael Crawford is the managing partner of Chawton Global Investors. He shares many of our tenets of long-term investing in high quality businesses and he joined our committee to enhance our investment capabilities with his career experience. Maria joined the team in October 2022 to provide additional resource in the investment team. She provides analytical support and will enhance our efforts in our stewardship and engagement activities, bringing her degree skills in Mathematics, Statistics and Quantitative Finance to the investment team.

Before establishing Castlebay each senior member of the investment team gained valuable career experience through working, for more than a decade each, in large investment companies which provided high levels of training and a good grounding in their early investing careers. The teams' investment experiences have contributed to shaping our Quality value, long-term investment approach and the importance of good stewardship of capital entrusted to our management. The partners are in the investment and stewardship teams and have implemented sustainability metrics into our investment process which are reviewed during investment and board meetings.

Sustainability is at the heart of our investment approach. We try to identify businesses which have generated high returns in the past by producing products and services which are difficult to replicate and can continue doing so into the future.

The partners are committed to growing the investment team in the future with a diverse, equal opportunities, meritocratic, inclusive approach to recruitment. We believe that a culture that is flexible, friendly, professional with a good work/life balance results in sound, clear investment decision making.

Systems & Resources

The investment team conducts our own proprietary investment research on all companies in our investment universe using Bloomberg, Refinitiv and Forensic Alpha, our investment database, company reports and accounts, other information provided by companies and sector/industry publications.

Many of our peers rely on broker research but we conduct our own and pay no attention to broker ratings for businesses. The financial models are formed using Refinitiv supplied company data and the investment team carries out the qualitative analysis outlined in **Principle 1.**. The investment team shares investment resources, data, knowledge and experience allowing both team parties, Castlebay and Chawton, to improve analytical frameworks and company analysis and, in turn, enhance our approach to stewardship. Sustainability of our businesses is central to our investment process which is closely linked to good stewardship.

Our database collates data populated by our investment team on our investee firms' sustainability factors and form part of our investment view. Our investment view looks at several factors including sustainability factors such as ROIC, ROE and carbon emissions. The image below is a snapshot of our investment view layout on our database.

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Investment Case ...	RROE & ROIC-WACC x Growth ...	Revenue Pathway ...
Moat & Business Model ...	Operations ...	Sustainability Factors ...
How do they make Money? ...	Power of Incentives/Governance ...	Capital Allocation Analysis ...
Industry Structure/Competition ...	Financial Risk Analysis ...	Red Team/Pre-Mortem ...
Valuation ...	History ...	Surplus Capital ...

Each business has a summary of sustainability factors associated with the company and their business model. This is an area we continue to develop.

Sustainability Factors

Croda has a strong focus on environmental sustainability with the vast majority of its raw material feedstuff coming from sustainable sources. Including the investment in a North American Ethelyne Oxide plant using Biomass to fuel it - the only one of its kind in North America.

Our investment checklist features sustainability factors we want to see from the management and how they allocate capital. In particular we want to identify if ESG is integrated in the firm's business model with a focus on corporate governance sustainability factors. Below is an excerpt from our Dunelm Investment Checklist, showing in two sections the initial part of the checklist and then focusing on the sustainability aspects of it.

Dunelm

Quality Checklist

Moat & Business Model		**Rationale**
Does the company have an identifiable Moat?	✔	Dunelm has the leading market share in the UK Homeware market. It has an 1
Risks to the Moat?	✔	Supply has come out of the sector, but perhaps Amazon could become a threat
Is the business a No 1 or No 2 in its industry?	✔	**Its operating profitability ranking, relative to industry peers, has remained**
Is the business a monopoly, oligopoly or in perfect competition?	✔	Given their scale advantages as the leading homeware retailer in the UK the ev
Are company's products, low ticket, consumer non-durable?	✔	Yes, generally they offer a quality value proposition which has allowed them to
Bargaining power for suppliers	✔	Gross margin has been stable whilst rising slightly over the last decade, sugge
Pricing Power	✔	**Strong cash gross profit margin of 53%, suggests strong pricing power a**
Has the business already won? Or, is it looking to win?	✔	**The business has already won as operating margins have been consiste**

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Management & Capital Allocation		
Tenure of Management	✔	CEO Nick Wilkinson has been in post for over five years.
Is excess capital deployed by management at high rates of marginal return?	✔	**Incremental 3 yr cash return on Average Gross Equity is 64.4%. The incrementa**
How have shares in issue changed over 10 years? Shareholder focus.	✔	**Shares in issue have increaesd over the last ten years by 1% from 200m to 200**
Dividend policy & share buy backs	✔	**Dividend payout ratio has averaged 46% over the last decade. Dividends per s**
Does management own a material amount of the company?	✔	**CEO Nick Wilkinson owns £4m worth of stock. Not much skin in the game! CFC**
Evidence of management being disciplined stewards of company?	✔	**Shares in issue have increaesd over the last ten years by 1% from 200m to 200**
Is company part family owned – ie with long term horizons?	✔	Yes, over 40% still owned by the founding Adderley family.
Do they prefer to be out of limelight	✔	Generally they do.
Do people matter - ESG	✔	**OP/per employee has increased over the last 5 years 14% and decreased -1% c**
Do management have candour?	✔	Management have always been open in their disclosures to the market
Corporate Governance:		
Is the management team appropriately remunerated?	✔	The CEO owns over 300,000 shares. Nick Wilkinson is fairly remunerated with a cur
Does their recent shareholding activity support a long term view of the company?	✔	Yes it does with purchases made during the period of share price weakness in summ
Is the business operating from a S.R. position that will support future returns?	✔	The long term remuneration structure is a good example of how responsible and sust

The investment team conducts proprietary investment research on all the companies in our investment universe. Robust systems and adequate resources are critical to good long term investing.

Investment database

The CIO constructed an investment database in the early stages of his investment career to enable him to focus on the key tenets of our investment approach. In 2022 and 2023 we have invested in the modernisation of the Database, making it more robust and secure and more easily accessed and used by the investment team. This is framework from which all analytical work is conducted. Each business in the investment universe has a financial model, investment overview, checklist and critical investment factors. The investment journal records company news, proxy voting activities, company engagement and stewardship activities.

Market data

Bloomberg has until recently been our main source of financial data. Data feeds are connected to the investment database to maintain the company financial models and company news for the 65 businesses in our universe. With the upgrading of the database we have switched to Refinitiv which has more robust reporting on ESG factors which will contribute to our sustainability analysis. As we mention earlier, Refinitiv has deeper and more granular detail for ESG factors which was a contributory factor in the change to them.

Forensic Alpha

We subscribe to Forensic Alpha which provides forensic analysis on listed global businesses. They forensically analyse reports and accounts, accounting treatments and use Arteficial Technology to analyse company regulatory news service (RNS) releases. We have collaborated with the management team to enhance their service by suggesting features we would like to see from a fund management perspective. An example of this is providing a graphic on how the "risk score" of a company has changed over time.

Proxyedge

Is utilised to carry out AGM proxy voting which we have consistently done since the fund launched in January 2015. We make our own decision on proxy voting and the record of our voting is available on our website or on this link.

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In addition to the systems we use above we rely on various other resources to learn and better analyse our investee businesses.

Annual reports & accounts
Are a great source of information about a business and how it positions itself and the ethos of the Team. The financial information is only part of the story, it's interesting to see what the focus of the chairperson or Chief Executive is in their summary and their approach to presenting the financial information and plans for the future.

Company investor days
Provide the opportunity to meet other investors and hear directly the management team's approach to sustaining or growing the business in future. We tend to participate remotely than attend in person so focus on the presentation materials.

Industry publications
We subscribe to the FT and Times as a reliable and accurately reported news median. Bloomberg/Refinitiv also have deep sources of news and analysis on sectors, markets and companies.

Incentives
The long-term success of Castlebay is rooted in the incentivisation of the team and a strong alignment of interests with our fellow investors. Our incentive structure integrates and implements effective stewardship.

The team are all invested in the fund for the long-term with the majority of the partners' equity investments in the Castlebay UK equity fund. We eat our own cooking and participate in the performance of our fund. Our own investment in our fund means there is no incentive for short-term unnecessary risk taking by the partners, ensuring that our interests are aligned to that of our clients.

Team members are paid a salary and discretionary bonus based on the individual and firm performance during the year. These team members are not deemed 'investment risk takers' and are not responsible for investment decision making and yet contribute an important part to the overall culture of Castlebay.

The partners receive profit share, based on the financial results of the firm each year. Revenues are derived from investment management fees and the long-term performance of the fund. There are no performance fees which might encourage short term decisions or unnecessary risk taking and we do not take short positions in businesses which might increase the risk profile of our approach to investment. The partners have invested in the firm since inception and will continue to do so as the business grows in the future.

Effectiveness
We believe that our long-term business investing approach is a key driver of stewardship at Castlebay. Our independent ownership, flat structure, team governance, resources and incentives are focused

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on investment in high quality companies which can generate sustainable growth in our fund. We have managed to achieve this in the first eight years of the fund's life and believe our disciplined approach will serve our fellow investors well in the future.

The partners are cognisant that effective stewardship requires ongoing policy and process reviews and a commitment to continue improving all aspects of our approach. Our findings in **Principle 5.** illustrate how we review, assess and improve our policies and approach to stewardship.

We have invested in the investment team with the employment of a graduate investment analyst and in our systems with the modernisation of the investment database. We have changed market data provider for more robust and deeper information on sustainability/ESG.

There are always areas for improvement and we continue to think about how we better engage with our businesses to encourage better stewardship. We also believe these engagements can be better recorded and communicated with our fellow investors. We have recently invested in a new investment team member who will help us achieve better engagement. We continue to invest and improve our investment database and our analytical tools and framework. We have amended our web-site to include our responsible investing and engagement & proxy voting policies and included our proxy voting records.

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Principle 3.
Signatories manage conflicts of interest to put the best interests of clients and beneficiaries first.

When carrying out investing activities or developing investor relationships, conflicts of interest may arise. As a an independently owned investment partnership, a number of day to day conflicts faced by larger, more complex investment firms do not apply or are less relevant to Castlebay.

Our conflict of interest policy is available on our website and available on this link and refreshed at least annually. The purpose of this policy is to identify and manage conflicts of interest, to ensure that our investors are not disadvantaged. Should a conflict arise, it will be discussed and reviewed by the Partners, including the compliance officer. It will be recorded on the conflict register and managed in a way that all clients are treated fairly. In the instances where it is impractical to manage the conflict, it will be disclosed to the client concerned.

Conflict	Example	How we manage them
Castlebay buying and selling shares as part of its daily activities.	If the firm were buying shares the fund was selling or selling shares the firm was buying, it would paint a confused picture - who is benefiting from this situation? Therefore, a consistency of approach in this regard would prevent a conflict of interest.	However, to avoid this situation arising, the firm only ever deals as agent on behalf of clients. We never buy or sell as a principal on our own account.
Personal Account Dealing within the team.	A member of the investment team might wish to invest in the companies in which we are actively invested in or building a portfolio weighting.	Personal Account dealing rules exist to ensure that the compliance officer is aware of all PA dealing and to prevent instances where a member of the team deals in advance of any expected fund deals. All deals are listed on the PA dealing register.
Gifts and hospitality offered to the team.	Members of the team are offered gifts or "experiences" by a broker or company in which we are or might be invested.	Our inducements to staff policy specifies that gifts or entertainment inducements are not allowed.
How the team are remunerated.	Investment teams could be remunerated on the growth of the assets in their fund or short-term performance which	The team are paid a salary and discretionary bonus based on their and the wider firm's performance. The Partners are

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	might encourage shot term thinking and risk taking by investment managers.	remunerated on a profit share basis based on the long-term performance of the wider firm.
Have the decision makers got "Skin in the game?"	Managers who do not have meaningful investment in their fund might be encouraged to manage the fund on a short-term basis and taking unnecessary risks in the process. The downside would be limited to the fund investors and not the manager.	The genesis of Castlebay is to be aligned to the long-term best interests of our fellow investors. The Partners own Castlebay and have meaningful investment in the fund, ensuring strong alignment of interests and skin in the game. This represents an actual example of how we prevent a conflict of interest, as it aligns us strongly with our fellow investors.

We tend not to have many examples where a conflict has taken place given the structure of our firm and the long-term nature of our investment approach. Our conflict of interest policy is reviewed at least annually and the Partners are always trying to minimise potential conflicts for their investors.

Example: Client engagement
We invest considerable time and effort in developing long-term relationships with like-minded investors. We meet potential investors to discuss how they manage their portfolios and what they want to see from their fund manager. We then discuss our investment philosophy and approach to investment in great detail to ascertain whether we are like-minded.

We recently met a large potential institutional investor who had been carrying out their due diligence process on Castlebay. During one of the later stage meetings we were asked if we would manage their allocation of capital on a relative rather than our CPI+4% per annum basis. Our reply was that we do not manage money differently from one investor to the next to ensure there is always a consistency of approach. If they want a relative manager, we are not for them!

Principle 4.

Signatories identify and respond to market-wide systemic risks to promote a well-functioning financial system.

As investment managers we are responsible participants and aim to support an effective, well functioning market system and fulfil our obligations to our fellow investors. We identify and monitor market wide systemic risks at a team and Partner level and discuss them during our Board meetings. There are many systemic risks some identifiable in advance. However, most are not. Where we can identify risks ahead of time, we endeavour to proactively plan ahead and where we cannot we monitor and discuss the risks as they occur.

The most recent and ongoing example of an unexpected market wide systemic risk is the Russia-Ukraine war that has triggered an energy shock, disrupted trading worldwide and worsened supply chain pressures causing surges in inflation, not to mention the human devastation that has occurred. The energy shock and inflationary pressures have impacted financial markets but also in everyday things like increased food and energy prices. Our approach to these types of unexpected events is to continue to invest for the long term based on the company's fundamentals. Many of our businesses tend to be able to deal with unexpected systemic risks because they produce products and services which are difficult to replicate and can stand the test of time. These events often represent the best opportunity to allocate more capital when share prices are low.

A more predictable systemic risk, in our opinion was the growth in speculative assets in cryptocurrencies and the egregious valuations of many technology businesses. When we invest, we want to see a track record of high returns and a strong balance sheet, we also want there to be a high probability that the business can continue to produce those high returns in the future. The rate of innovation in assets like cryptocurrencies is so fast moving, that it makes it impossible to ascertain whether companies operating in this area now can continue to do so in the future. The demise of FTX is one of a number of large corporate failures in this area. Our approach would preclude us from participating in this type of speculation. The price we pay is also a consideration in our investment approach. There are many excellent technology businesses in which we have not invested due to high valuations. The banking sector is another area in which we do not invest because we believe that "confidence" is the most important aspect of their model and once this dissipates it can lead to a managed closure and seep into other operators in the sector. It can therefore be argued that 'bank runs' and failures will continue to occur in future due to the way these are managed by senior management teams.

Our response to systemic market risks is to remain rooted to our Quality value investment philosophy at all times. We believe our Quality value approach to investing can mitigate a number of risks because we own a small number of excellent, high quality and resilient businesses that can weather almost any type of crisis that is thrown at them.

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Our quality test screens out those businesses which have low returns on capital and equity, focusing on those that are cash generative and have low or preferably no debt. This generally means that those businesses involved in capital intensive industries like big oil, coal extraction, heavy industries and banks are screened out. This natural sorting of businesses means that those that make it into our investment universe are resilient and excel operationally, with greater levers to pull when recessions, company specific issues or unexpected shocks like Covid or Brexit come along. As 'business-owner' investors we invest in our companies with the aim of holding our businesses in perpetuity, unless the quality deteriorates or the valuation becomes so extended it undermines the prospect of a positive real return being made.

The average age of our investee firms is 77 years and many of our firms have prevailed during periods of war, financial crises, economic recessions, political uncertainty and many economic cycles. The Covid pandemic was a good test for every business and ours came through very well.

We invest in businesses, not share prices. Our annualised turnover is around 10% since we launched the fund eight years ago which suggests an average holding period of a decade. **Long term investment in businesses rather than short term share price speculation promotes a well-functioning system and aligns the firm and our fellow investors.** Our literature, particularly our quarterly letter encourages our other stakeholders to look to the long term and eschew short-term investing fads and trends that could destabilise markets in a systemic way. Also, our market leading levels of transparency where we disclose all the companies in our fund and focus on their liquidity in the market is aimed at encouraging other market participants follow this lead. We have seen in the past how liquidity issues in open ended, daily pricing funds; can impact the trust of investors and the functioning of financial markets. The industry needs to become more transparent and less opaque in its dealings.

During Covid we supported businesses in our universe and portfolio by allocating our cash into new and existing positions in the portfolio. During the worst of the market falls in March 2020, our fund fell (VT Castlebay UK Equity C ACC -26%) a third less than the market (MSCI -36%). Our businesses declined by less than the market and our fund finished the year in positive territory (+2%) when the market produced a double-digit negative return (-11%) highlighting their resilience.

Climate change is an area in which every person and business must do better. Our preference for capital light, niche businesses tends to screen out many of the worst offenders for Co2 emissions or potential environmental harm. Our investee businesses integrate ESG practices into their business models supporting the transition to a green economy in an effort to reverse climate change. Many of our firms have in place goals to reach net zero. However, there is more we can do as stewards of capital to encourage our businesses to do more to address climate change. As a business we can also do more with our own business practices and in particular how we monitor our investee companies' progress in meeting their targets.

We work very closely with Chawton Global Investors with our combined investment committee. Chawton have a similar long-term approach to investment as Castlebay. However, they invest on a global basis whereas we invest in UK equities. We collaborate on research and company engagement (**Principle 9.**) in an effort to maximise our combined resources and promote the improvement of

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financial markets. Both firms are small in AUM terms and so our contribution to the continued improvement of financial markets is very small. However, we do take seriously our responsibilities in this regard.

During the reporting period we submitted our responses to His Majesty's Treasury for the PRIIPs and UK Retail disclosure consultation. The consultation was based on what information is disclosed by firms to investors. We have always tried to lead change with the high levels of transparency. We suggest that all managers should disclose their full portfolio holdings, provide greater clarity on how they charge and the amounts, the level of turnover for a strategy and a broader discussion on "risk" with assets like Fixed Interest - that are deemed 'low risk' when they aren't necessarily depending on when and what you buy. As an FCA authorised firm we engage with the regulator and fulfil all our duties which contribute to sound and improving financial markets.

We believe that our experienced investment team and the firms' Partners are effective at identifying and assessing market-wide and systemic risks and then responding to them. Our long-term business approach to investing in high quality companies means we and our businesses have the best chance to come through known or unexpected shocks.

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Principle 5.
Signatories review their policies, assure their processes and assess the effectiveness of their activities.

The Partners are responsible for ensuring that all policies and processes are in place, effective and implemented by the team. Our flat structure, outlined in **Principle 2.**, minimises corporate complexity, bureaucracy and hierarchy. It promotes clear communication within the team where everyone is encouraged to contribute suggestions to make us better.

The two working partners and majority owners of the business are Chief Investment Officer (David Ridland) and Compliance Officer and Investment Manager (David MacNeil). They ensure all policies and processes are created and maintained. These are discussed by all Partners and approved during monthly Board meetings. They are then implemented by the working Partners and the wider team.

Our external compliance consultant conducts our ongoing compliance monitoring program which routinely checks, tests and updates our policies and processes, including our compliance and operations manual. She also reviews our ICARA, Compliance and Money Laundering Reporting Officer reports which are written by the compliance officer and then reviewed, discussed and approved by the Board.

Internal assurance of our stewardship activities is carried out by the investment and stewardship committees which meet weekly with pre-prepared agendas and minutes. In these meetings we discuss our quality test outcome that screens out circa 90% of UK listed and developed market equities, many of which are involved in activities we don't believe are conducive to sustainable investment. The rationale for his approach is to focus on company fundamental analysis, portfolio management activities and stewardship – all things that we believe will create long term shareholder value. From a stewardship perspective we focus on the sustainability of the businesses in which we are invested and those companies in our investment universe. Our businesses are generally capital light, have low or no debt and generate high returns by producing products and services that are difficult to replicate. Proxy voting is discussed by the stewardship committee and actioned by the CIO as are areas in which we want to engage with a business. The rationale for doing this is to encourage our investee managers to focus on longer term initiatives that will create lasting value, set against the increasingly myopic demands of society and investors, which often have the opposite effect.

The investment meetings minutes are reviewed and approved by the Partners as an agenda item during board meetings. External references to our investment meetings are provided by Chawton Global Investors who participate in our investment committee and make suggestions on how we might improve our practices. One suggestion was to initiate sustainability indicators for each of our investee businesses which we are implementing into our investment database which is being developed by our intern computer science undergraduate.

We aim to report on our stewardship activities in a fair, understandable and balanced manner. Our website (www.castlebayinvestments.com) has a stewardship page in which we confirm our commitment to good stewardship. There are links to our responsible investing policy and proxy voting records. Transparency is a central tenet at Castlebay as we hope you will see from our web-site. Non investment members of the team read our investor letters and the stewardship report and other disclosures like our web-site and fact sheets to ensure they are written in clear, plain English and easily understood before they are sent to investors.

Our Responsible Investment Policy details our approach to investment and how it complements and encourages good stewardship. There is detail on our engagement and proxy voting at company annual general meetings. This can be accessed on this **link**.

We believe that our internal and external framework for reviewing, improving policies and processes is robust and commensurate to our size and resources. Continued improvement is a key focus at Castlebay and we appreciate there are further areas in which we can do better. We have added a new team member in October to the investment and stewardship committee and she will dedicate time and resource to stewardship activities including proxy voting, company engagement and the development of our sustainability indicators. This increase in resource for the business has already led to improvement in our stewardship policies and processes as Maria has helped to challenge our assumptions and created a better framework for interrogating our proxy voting output, found here. The stewardship committee will also better report our activities and progress on all matters associated with stewardship with greater detail provided on our web-site. We can also participate more widely within our industry at conferences and contributing to consultation papers.

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Principle 6.

Signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them.

The VT Castlebay UK Equity fund is a long only, conviction strategy with 27 holdings and an annualised turnover of 11% since launch in January 2015. This indicates nearly a decade long holding period of our investee businesses.

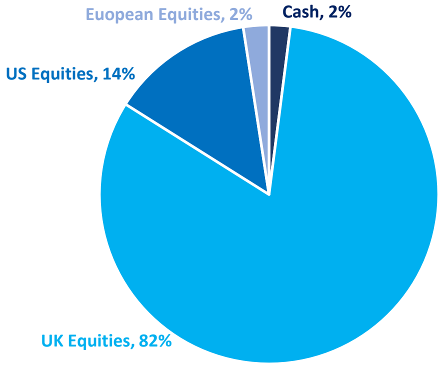
Investor breakdown

The breakdown of our client base is as follows: the majority is institutional investors which include Wealth Managers, stockbrokers, financial planners and fund of fund managers. Most investors use a variety of "platforms" to buy and hold OEICS and so it is challenging to ascertain 100% the split between institutional and retail clients. However, we approximate that 95%* of our investors are institutional and 5%* retail who are all UK based geographically (*source: VT shareholder register as at 31/03/23).

We prefer to have a direct relationship with our fellow investors and patiently develop long term relationships where we get to know each other well. Developing relationships in this manner allows our investor to understand how we think about investment and Stewardship and how we make investment decisions and hopefully results in long-term shareholders in our fund.

Asset breakdown

The fund at the end of March 2023 had a Net Asset Value of £167M and invests predominantly (minimum 80%) in UK Equities. However, as an unconstrained strategy, we are able to hold a maximum of 20% in either cash, International equities or Fixed interest securities. Since launch though, the fund has never held or invested in fixed interest securities.
As at end of March 2023 the fund had the undernoted allocation to UK (82%), US (14%) and European (2%) equities with 2% cash.



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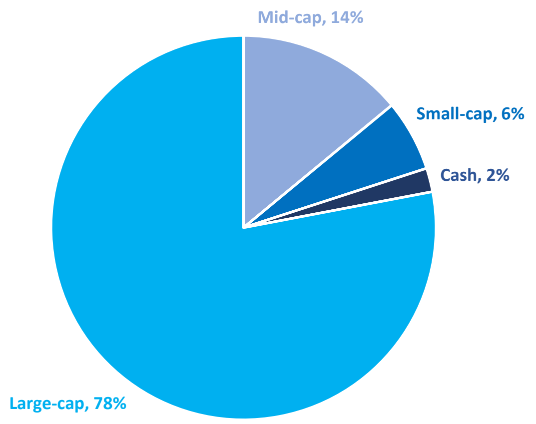
At the end of March 2023 the fund portfolio comprises of 78% in large capitalised (£4Bn+) businesses, 14% in mid-capitalised businesses (£0.5Bn-£4Bn), 6% in small capitalised businesses (<£0.5Bn) and 2% in cash.



Client communication & investing time horizon

We invest considerable time in identifying and then developing relationships with like-minded investors for the long term. That is, investors that share our investment philosophy. It is important that we establish early in a relationship whether a potential investors shares or values our approach to investing. We appreciate that our approach is not for every investor and focus our efforts on engaging those who are likeminded.

Finding like-minded investors and developing a long-term relationship with them, means that there is a natural alignment with their own stewardship and investment policies. For example, Quantitative, momentum orientated or passive investors would not be considered like-minded. Neither would short term investors, who try to speculate on share price movements. We make it very clear to potential investors that we invest in businesses not share prices. We stress that for the power of compounding to benefit us as investors, we need time to be on our side, with an investment time horizon of at least 5 years. Since we launched in January 2015, our annualised turnover is 11% which indicates an average holding time period of nearly a decade.

If investors do not have the same investment time horizon as us, they will not qualify as a like-minded investor and we cease any further engagement with them. Our database has a list of those who are like-minded and those who are not! Thus, we can ensure that assets are being managed in alignment with our clients' own stewardship and investment policies.

Our communication with our clients consists of at least an annual meeting, preferably in person, with updates provided on video calls or in person to receive their views and communicate ours. We provide monthly factsheets which include details of our full list of invested businesses, liquidity, costs, our turnover and performance statistics. We are available to speak with our clients when they have questions or would like quick updates.

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Our quarterly investor letters are written with an eye to our long-term approach to investment and are based on an investment theme with a stock in focus and a note on our Quality table which highlights key performance indicators we look at in our businesses (Return on Equity, Operating profit margins, Debt to equity, cash conversion and free cashflow yield) compared to the market. These letters provide the opportunity for us to communicate in writing directly with clients to discuss how we think about Stewardship and the sustainable nature of our businesses. Our website has a Stewardship page which outlines our thoughts on Stewardship and our commitment to the Stewardship code, all of which is free to view for any visitor to the web-site.

In evaluating the effectiveness of our understanding of the needs of our clients and their beneficiaries, our very high investor retention rate since we launched the fund, in part indicates that we have been effective in communicating our approach. Also, this retention rate signifies that we are aligned to our fellow investors' stewardship and investment policies and that they are being implemented by the investment team consistently. We take account of the views of our clients through the regular meetings and discussions that we have with them. By searching for the appropriate investor initially facilitates our investment process and engagement. For example, many of our clients have told us how they like the fact that we are business owners as well as investors. They tell us that this aligns us more closely with their interests, in contrast to large listed fund managers, who with many more stakeholders find it harder to accommodate all their views. Taking such a client view into consideration reaffirms our commitment to staying as an independent boutique investment business.

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Principle 7.

Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues and climate change to fulfil their responsibilities.

As we describe in **Principle 1.**, our focus is on identifying, analysing and investing in high quality, sustainable businesses when they are attractively valued. We want companies which have consistently generated high returns on their capital and equity with a high probability that this can continue into the future. In assessing the long-term sustainability of a business, there are important aspects of Environmental, Social and Governance which we analyse during the construction of our investment universe, where circa 4,500 businesses must pass our quality test.

Quality test
The first part of our investment process is to construct an investment universe which consists of only those businesses which pass our Quality test. The quality test consists of two stages;

Stage 1: 7 factor quantitative screen. This focuses on:

- **5 years average Return on Equity**: we want businesses which can generate a consistent RoE of at least 20%.
- **Return on tangible assets:** we want businesses to generate a return of at least 15% through the cycle.
- **Return on Capital Employed:** similarly to RoE we want a consistent return of at least 20%.
- **Net Debt to EBITDA:** we want businesses with low or no debt.
- **Cash conversion:** we favour companies with high cash conversion.
- **Capital intensity:** capital light companies don't require much capital to carry out their operations, therefore reducing the risk to investors.
- **Standard deviation of Return on Equity:** looks at the consistency of the RoE over time. Businesses with a low standard deviation of RoE have lower dispersions to the mean.

If a business meets our criteria for each factor it scores 1 and if it doesn't, it scores 0. Companies with a score of 5,6 or 7 are of most interest and the number of companies reduce from around 4,500 to 100. Bloomberg historically and more recently Refinitiv are our primary service providers for market data used to conduct the quantitative screen.

Stage 2: Qualitative factors:

- **Moat & business model:** We want a business to have an enduring competitive advantage by producing products and services which are very difficult for businesses to compete against. This provides confidence that what has happened in the past can continue in the future.
- **Operational margin of safety:** The Retained Return on Equity (RROE) which is the rate at which the shareholder equity compounds over time.
- **Management:** We want management with "skin in the game" i.e equity ownership and are aligned with shareholders with the right incentive structures. This should drive good capital allocation and guide management teams to making long term decisions for the benefit of the business and shareholders.

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We conduct all our own research and analysis with company reports, Bloomberg, Refinitiv, Forensic Alpha and industry publications. We are increasingly engaging with management teams, in a structured way. For our smaller, AIM listed companies where the disclosure levels are not as high as for the main listed businesses, we tend to engage more directly with senior management. However, we also understand it is important that this engagement takes place in a measured way. Chief Executives and Financial Directors tend to be charismatic and good salespeople, who have "sold" well their own attributes, making their way to the top of their respective corporate ladders. We believe they can often tell shareholders what they want to hear or sell a change in strategy. Also, the tenures of CEOs and FDs tend to be significantly shorter than our own investment horizons, so we have to be careful to ensure that they are aligned with the longer-term stewardship of our businesses. We prefer to focus instead on what management teams are actually doing and determine whether it is consistent with our investment views.

The businesses which pass the quality test have sustainability at the heart of their business model which has enabled them to win in the past and keep winning in the future, by producing services and products which are difficult for companies to replicate or compete against. **Crucially, we want our companies to be very focused on producing sustainable products and services that delight their customers. This is how superior returns are delivered and maintained over the long term. Our quantitative screening highlighted above is really just gathering together the businesses that have demonstrated these characteristics in the past. What we must then do is determine how likely these attributes will persist in the future and from a valuation perspective if we are being asked to pay a fair price for such companies.**

The quantitative first stage of the quality test screens out those businesses which operate in industries which are normally responsible for high levels of pollution or environmental damage. For example, it is very unlikely that we will ever invest in big oil businesses. They do not generate returns on capital or equity anywhere near the level we require, they have high levels of debt and are capital intensive. Not to mention the consequences when disaster strikes, as it did in Gulf of Mexico in 2010 when BP's Deepwater Horizon rig exploded and sank, resulting in the largest spill of oil in the history of marine oil drilling operations. The effects of this were felt environmentally, socially and financially to BP and the region of the spill.

Whilst our businesses do not tend to operate in "dirty industries" we do still have environmental considerations like packaging for our consumer goods businesses and whether our investee businesses are trying to use their resources more efficiently. Bloomberg and Refinitiv provide data on carbon emissions, for example and the rate at which businesses are reducing their emissions.

Governance is a key area of focus for us. We analyse how management teams are incentivised, which tends to drive behaviours through an organisation. We want to see long term incentive plans with a return on equity metric which we believe keeps management focused on the right long-term allocation of capital. We utilise our proxy votes at company Annual General Meetings and will vote against compensation proposals if we do not believe they are aligned to shareholder long term best interests. For example: we abstained against the remuneration report and policy at Domino's pizza in

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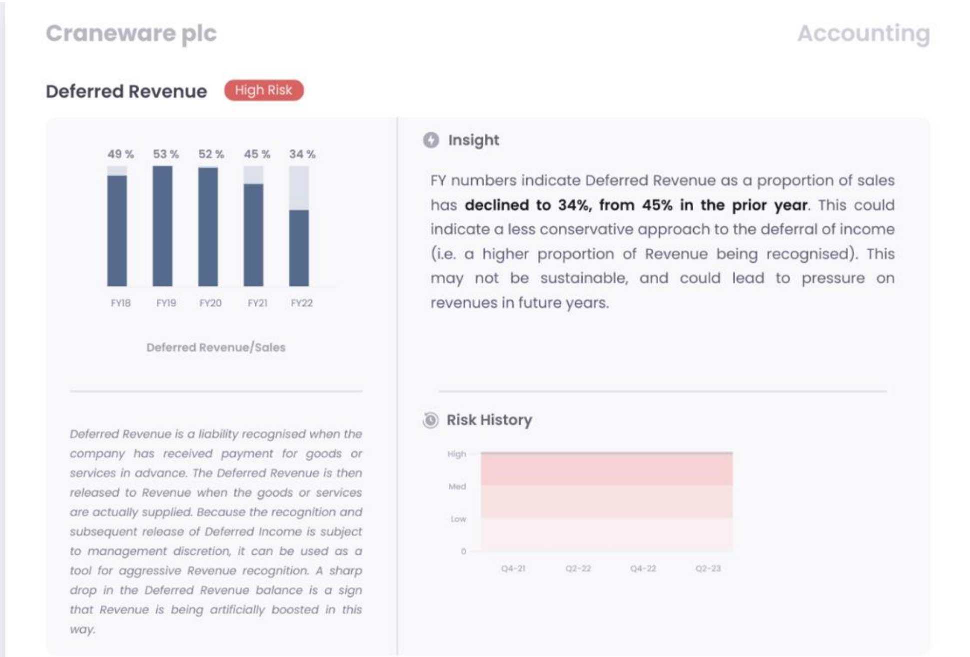
May 2022 because there was no mention of Return on Invested Capital. Our normal process here is to **abstain, engage and only then vote against** if we don't see the change we require.

Other Governance factors we assess include how the company presents its financial information and accounting practices. Forensic Alpha through their software services provides forensic accounting analysis on company reports and accounts. They provide details of a firm's governance structure and raise red flags when an accounting practice is used which is deemed high risk by a management team. For example, Craneware was flagged because deferred revenue reduced from 45% to 34%, the release of this liability could suggest that revenues are being more aggressively recognised. This was investigated by the investment team and not considered a material red flag due to its recent acquisition of Sentry, which led to the change of this ratio.



Source: Forensic Alpha

We have a close working relationship through regular meetings and engagement with Forensic Alpha. One suggestion we have made is for them to provide more historic data on their company snapshots so investors are able to see the rate of change of the risk scores over five years and more. This could then be linked to the changing returns profile of the business, with greater insights created to determine how the management of the business is changing and whether there is an increase in alignment with us as shareholders, or not.

From a Social perspective we try to assess how workers are treated and the culture of the businesses in which we are invested. We want to see businesses treat their workers well and prevent human and labour rights' violations. The average age of our businesses is around 77 years which demonstrates that they have been able to withstand a number of challenges thrown at them over three quarters of a century. Having a strong culture and a happy, productive workforce tend to be found in these types of businesses.

Our current investment universe consists of 65 listed businesses or fewer than 2% of the 4,500 companies we started with at the outset. The average age of our businesses is nearly 80 years, demonstrating their ability to overcome periods of recession, technological disruption in the past and more recently large exogenous shocks like Covid and rising inflation. They have demonstrated to us their sustainability over long periods of time and we still own over a quarter of the businesses we bought at the fund's inception.

At the conclusion of the quality test, there are between 64-68 businesses from which we invest when the valuation is attractive. The universe is refreshed annually, with all companies going through both stages of the quality test again.

The businesses we own score positively on our environmental, social and governance metrics, Examples of some of the sustainable businesses we have owned in the portfolio for several years and are ESG aware are listed below.

BATs and Imperial Brands
Our tobacco companies are ESG aware; they have integrated the practice into their business models.

We invest in tobacco businesses which are moving into alternative products to become more sustainable over the long-term. The Chief Executives of these companies invested in a new sustainable business model moving away from traditional cigarettes to producing Vapours, Heat-not-burn (HNB) and Oral products.

According to BATs these new products contain 90-95% less toxicants. Given the existence of cigarettes in the world, it is much better to have a regulated sector where the increased risks associated with illicit trade are reduced. In particular, BATs have in a place a Race to Zero campaign and were awarded with the UK National Equity Standard and the Global Equality standard in 2021. Similarly, Imperial brands aim to be Net Zero by 2040, send zero waste to landfill by 2025 and promote their consumer-led harm reduction strategy by strengthening their next generation products.

Case study: Unilever
Unilever is a consumer goods company that operates in five Business Groups: Beauty and Wellbeing, Personal Care, Home Care, Nutrition and Ice Cream. A joint investigation between BBC Africa and Panorama exposed acts of sexual abuse between supervisors and tea field workers on Unilevers' plantations. Unilever is being accused of workers' sexual exploitation on their Kenyan tea farms where more than 70 women accused their supervisors of sexual harassment.

According to the BBC, similar events and allegations transpired more than 10 years ago with Unilever implementing a "zero tolerance" approach to sexual harassment and introduced preventive and reporting measures. However, despite the efforts to eliminate acts of violence against women the issue still exists indicating that the measures in place have failed. The article pointed out that reports

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of sexual abuse against women failed to surface suggesting that the procedure to report these types of issues lacks power and that the company may not monitor and act upon these matters.

We engaged with Unilever suggesting that the process is not independent enough such that the victim cannot report the incident without the knowledge of the perpetrator.

As a long-term investor the focus lies on the sustainability of returns. But the goodwill associated with the brand name has been harmed leaving us concerned about the negative implications on growth.

Unilever’s Investor Relations team replied to say that despite Unilever no longer owning any tea estates, they are considering the lessons which can be taken and transferred to other elements of their Supply Chain where rural/agricultural conditions are involved and help them gain insight as to why their preventive measures placed on their tea estates failed to prevent this abuse.

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Principle 8.
Signatories monitor and hold to account managers and/or service providers.

Castlebay has few dedicated third party service providers in the area of stewardship, because the investment team carries out all its own research, utilising the services of market data providers, company provided information and industry/sector publications.

One service provider which has a focus on stewardship is Forensic Alpha which is a software tool using Artificial Intelligence to analyse forensically company reports and accounts and other specific market related news releases.

During 2022 we have invested significant time and financial resource in further developing our proprietary investment database. The database is subsequently more robust with access now on a web-based application and includes additional features such as our investment journal, critical investment factors and sustainability factors we assess during the fundamental analysis activities. For example, we now record our interactions and engagements with our investee businesses including AGM voting in the investment journal which is incorporated to the database.

We utilise the services of third parties in areas including custodianship, audit, IT and cyber security which are reviewed annually and covered by Castlebay policies and risk management documentation.

We do not buy broker research or subscribe to ESG ratings for businesses because we prefer to do our own research on sustainability factors which we believe are important. Bloomberg and Refinitiv provide market data and sustainability information which is directed to the database. Following a period of review we have decided to end our Bloomberg relationship and will instead use Refinitiv going forward. This is partly because we believe there is a greater depth to the ESG data provided by Refinitiv which will augment our sustainability scores within the investment database. So this is an example of an action taken by us where we believe our new service provider can offer a superior service to the previous one. Other sources of data are provided in company presentations, investor days and report and accounts.

We have worked closely with the team at Forensic Alpha to help improve their product and provided suggestions in areas which they can provide more clarity for their users. An example of engagement with Forensic Alpha was the suggestion to provide a risk history score for companies so fund managers can see the rate of change in the scoring over a period of time. The snippet below is an example.

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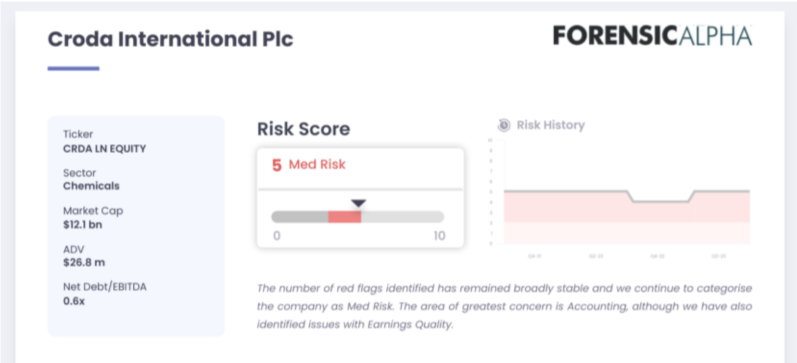

The investment team identified that Novo Nordisk's LTIP structure as reported by Forensic Alpha, does not capture the weight placed on ESG metrics. Thus, we engaged with Forensic Alpha to verify that reports are being updated regularly to reflect information that is up to date.

Furthermore, proxy voting is completed through Proxy Edge, a service provided by our Authorised Corporate Director. We do not outsource the voting and instead carry out our own due diligence when deciding how to vote. During 2023 we have been investigating the services provided by Glass Lewis to improve how we vote and record our interactions at company AGMs. We discuss this further in **Principle 12.**.

Principle 9.
Signatories engage with issuers to maintain or enhance the value of assets.

As we describe in **Principle 1.** and throughout the course of this paper, we invest in high quality businesses for the long term at attractive valuations. Our annualised turnover since we launched our fund in January 2015 is 11% which suggests an average holding period of nearly a decade. Our quality test is designed to filter out those businesses which generate low returns on capital and equity or require more debt or capital than we would like. The starting number of businesses is circa 4,500 with only around 65 businesses making it into the final investment universe.

This means that many businesses we screen do not make it into our final investment universe. Those that do have to demonstrate a consistent history or high returns and operational excellence. We prioritise engagement based on the significance of the underlying issue which we discuss in some examples below. It is true to say that given our investment philosophy outlined in previous 'Principles' above, we have a particular focus on governance. This is an area where we feel we can make the greatest impact through engagement; and which can deliver a greater focus on long term value creation in the widest sense. Our engagement policy is outlined here**.**

Castlebay defines engagement as proactive interactions aimed at accomplishing a specific objective with an investee company. Engagement is prompted from factors that differ from company to company. Keeping in line with **Principle 1.** and **Principle 6.** we engage to ensure the long-term growth of shareholder value. Importantly, this shareholder value is created over the longer term by our companies engaging in sustainable activities – making products and services that customers want and competitors struggle to replicate. Engagement efforts may be undertaken either individually or in collaboration with other stakeholders.

Factors that prompt engagement with our investee business involve operational, strategic, financial and incentivisation structures that may concern ESG issues. Changes in these factors can negatively impact the sustainability of returns. Engagements are discussed and monitored amongst the investment team. We do not prioritise engagement on the position size of the holding in the fund. Over the past year the investment team engaged with some of our investee companies through calls with investor relations teams, letters or emails to management, attendance on company calls or reviewing transcripts of these calls. The means by which we engage vary and depend on the issue.

Our interactions with our businesses are recorded in our investment journal, part of our investment database. This allows the team to keep abreast of the company interactions across the portfolio efficiently and use company feedback as part of the ongoing investment analysis.

The main area of focus of engagement has been investigating how management teams are incentivised. The right incentivisation structure will result in the right type of behaviours from the management team in their allocation of capital and business decision making. Poorly aligned incentivisation structures often lead to poor capital allocation decisions. When analysing compensation schemes, we want to see Return on Invested Capital (ROIC) included in the Long Term Incentive Plan (LTIP) because it is measure of how well a company and its management team uses its

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capital, both equity and debt to generate earnings. If a company is not generating a return above our cost of capital, it is destroying shareholder value. We invest with conviction in between 25-30 businesses with 49% of the fund invested in the top ten holdings (as at 31DEC22).

Our aim over the long term is to preserve the capital entrusted to our management and to generate a total return that exceeds inflation (as measured by consumer prices) plus 4% per annum on a rolling three-year time period. We believe that companies that generate high returns on capital and equity will compound in share price terms. If we invest at attractive valuations, we reduce the risk of a de-rating and the potential for a short-term impairment of capital.

Company management is one of the qualitative factors we assess during the second part of our quality test. However, we take a measured approach when meeting or engaging with the management of our investee businesses because we believe that Chief Executives tend to be charismatic salespeople, who have "sold themselves" well on the way up the corporate ladder. Instead of spending time developing relationships with CEOs and falling for a great story about a new strategic change in direction of one of our companies, we prefer to analyse what management are actually doing, in the course of running the business. With an average holding period of nearly a decade, we tend to see CEOs come and go and we must ensure that during their tenure, capital is allocated well and they are incentivised in alignment with their shareholders for the long term.

Our performance since inception suggests we have enhanced the value of the assets of our fellow investors with returns (81%*), that have beaten the market (MSCI UK TR All Cap 47%*) our peer group (IA All Companies sector(47%*) and higher than our CPI+4% per annum measure which is 78% since inception (to 26/4/23). This is despite the recent spike in CPI in the UK and equity market weakness.

Examples of company engagement in the year include:

Avon Protection

Description:

Avon Protection acquired Ceradyne from 3M in 2019 which developed and manufactured helmets and body armour for the Department of Defence in the US. Having won an order for a new body armour product, the armour went on to fail the testing carried out by the Defense Logistics Agency (DLA). Paul MacDonald (CEO) decided to close down the armour facility resulting in a profits warning and capital write down. He subsequently resigned his post and left the business. We engaged with the management team on three separate occasions during late 2021 and early 2022 to discuss these issues on several Teams calls.

Objectives:

The focus of the last engagement was to hear what the new Finance director's observations were on the body armour issues and determine whether his views and strategy for the business were aligned with ours, with no further value destroying acquisitions planned.

Outcome:

The CEO and FD are focusing on restoring trust with the market and focusing on their core business of respiratory and helmet protection for first responders and the military. They are running down the

Body Armour division and saving costs, helping to reduce the scale of the write-down. We agreed with the management's course of action and concluded our engagement on this issue.

Imperial brands

<u>Description:</u>

Imperial brands LTIP does not include an element of Return on Invested Capital. Adding ROIC to the incentive structure ensures good allocation of capital. We have written to the Chair of the Remuneration committee.

<u>Objective:</u>

The goal was to talk through why they haven't Included ROIC in their LTIP structure.

<u>Outcome:</u>

We await their response and have abstained in the AGM Remuneration Resolution.

Domino's

<u>Description:</u>

Domino's change from a vertically integrated model to being on Just Eat's platform in the UK and Ireland, led to market penetration concerns and a meeting with the Investor Relations team.

<u>Objectives:</u>

The aim of the meeting was to discuss the following three points: if Just Eat's incremental customer base will negatively impact Domino's results, the potential for penetrating the market further and to investigate the franchisees' relationships.

<u>Outcome:</u>

The Investor relations team informed us that there is more growth on offer post consolidation back to the UK. Domino's are using the Just Eat platform for brand awareness and order taking with everything else, including sole delivery, being controlled directly by them. Margins for the franchisees increased though lockdown and settled back but are still above pre Covid levels, improving the relationships between franchisees. The meeting helped resolve our concerns.

Dunelm

<u>Description:</u>

Dunelm's LTIP does not include Return on Invested Capital. Adding ROIC to the incentive structure ensures good allocation of capital. We have addressed this during an earnings group call with Dunelm's management and fellow investors.

<u>Objective:</u>

Discuss why they haven't Included ROIC in their LTIP structure.

<u>Outcome:</u>

Low spending on capital expenditure suggests that incorporating ROIC in their LTIP wouldn't have a significant effect. This was a satisfactory response to our query.

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Admiral

Description

Milena Mondini became CEO following the retirement of David Stevens in 2021. David was a co-founder of the business and his retirement follows Henry Engelhardt's retirement in 2016. The company for the first time since it launched is now no longer managed by a founder.

Objective

The culture at Admiral has always been very strong, led from the top by David or Henry. How will this change following Milena's appointment?

Outcome

A call with head of investor relations to discuss this issue is held. Milena follows David and Henry's footsteps as an Insead graduate and has been with the business for 15 years, starting as CEO of ConTe in 2007. She is fully versed in the culture of the business and well placed to take it on. This is a watching brief. However, short term engagement has concluded.

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Principle 10.
Signatories, where necessary, participate in collaborative engagement to influence issuers.

Castlebay is open to participating in collaborative engagement in the right circumstances as long as it does not prove to be too much of a distraction from the effective stewardship of our fellow investors' capital.

As long-term investors our interests as business investors are often not as aligned to short term activist investors who are seeking to make changes to serve their own shorter-term needs. Our preference is to engage with a business on specific issues raised with management teams on calls, wider investor presentations and written communications.

Nevertheless, sharing views and opinions with other like-minded long-term investors can be constructive in engaging with management and trying to bring about the type of change in approach for which are we are looking.

We work closely with Chawton Global Investors, as we discuss in **Principle 2.**, who are similarly minded to Castlebay in our respective approaches to investment. Chawton also invest in Quality businesses for the long term, albeit on a global basis. There are several businesses in which both Castlebay and Chawton are both invested and we have collaborated in our engagement with Unilever and Bioventix.

The nature of our collaboration begins with the fundamental analysis and ascertaining how a business generates its returns and maintains its competitive advantage. Areas in which we would like to engage with the business are discussed and Castlebay or Chawton will communicate with the business to arrange a call or direct management to the area of focus in a written communication.

Unilever

Objective:

News reports from a joint investigation between BBC Africa and Panorama highlight sexual abuse cases occurring at Unilevers' plantations. These events had a negative implication on Unilever's brand name, impacting goodwill and potentially destroying shareholder value. Therefore, as we are small shareholders of Unilever we collaborated with Chawton by writing a letter to Unilever's Chief Sustainability Officer to raise concern about their current sexual harassment prevention and reporting policies.

Outcome:

A member of Unilever's Internal Relations team replied to highlight that although Unilever no longer owns any tea estates, they are considering the lessons which can be taken and transferred to other elements of their Supply Chain where rural/agricultural conditions are involved and help them gain insight as to why their preventive measures placed on their tea estates failed to prevent this abuse. Engagement efforts will continue with Unilever.

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Bioventix

Objective

Concerns about key man risk for the CEO and whether there is a succession plan in place. We collaborated with Chawton by writing to the Chairman to highlight our concerns and ask if there is a plan for succession at the board.

Outcome

The Chairman replied to confirm that this was very much in their thinking and they would hire a suitable replacement with a scientific background to replace the CEO as and when he wants to retire. This isn't an entirely satisfactory response because the reply doesn't consider a sudden departure through ill health for example. We are engaging further on this topic.

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Principle 11.
Signatories, where necessary, escalate activities to influence issuers.

As discussed in **Principle 9.** and throughout this report, we engage with our investee companies with the aim of promoting their long-term business performance. Our engagement and proxy voting policy details our approach to engagement with our investee companies and is available on this **link**. We also understand that as a relatively small shareholder in the larger businesses we own, management teams will not always act on our suggestions. This will not deter us from engaging and we will in some circumstances collaborate with like-minded investors when we believe it is appropriate (as mentioned in **Principle 10.**). Our engagement policy is consistently applied to our sole fund regardless of different assets and geographies.

The investment team is responsible for discussing stewardship during our weekly investment meetings. They discuss areas in which we want to engage with our investee businesses and then actions are allocated to a team member who will then engage with the business and report to the team.

Engagement is not prioritised according to the portfolio weighting but is carried out on a case by case basis. The decision to escalate engagement with a business is based on the importance and risk of the issue at hand. That is, we define escalation as a further engagement attempt in circumstances where the objective of the initial engagement effort has not been achieved. Examples of escalated engagement include Avon Protection following their failed first article testing of their body armour division and Craneware following their acquisition of Sentry where they have to some extent destroyed shareholder value. These were prioritised over other ongoing engagement activities because they were time critical. When there is an issue we deem to be a priority, we will seek to arrange a call with the investor relations or management team.

The final escalation step and ultimate course of action for us as shareholders is to liquidate our holdings if we believe the company has either not engaged with us or continues on a path of value destruction despite our best efforts to highlight this. There have been instances outside of this reporting period where Aveva and Mitie Group have allocated capital in acquisition strategies which resulted in the quality of these businesses and their returns on incremental capital to decline. In both instances this resulted in us selling these positions.

Avon Protection

<u>Objective</u>

Engagement with management on several calls following failed first article body testing on their body armour division (Ceredyne) bought from 3M to ascertain what they intended to do next.

<u>Outcome</u>

Following discussion with us and other investors, the management team decided to not re-start product development and testing and instead to wind down operations and write down the cost of operations. Management couldn't ascertain why testing had failed and decided not to throw good money after bad. We agreed with this course of action. They also decided to embark on a share buyback which we suggested during one of the calls.

Craneware

Objective

Engagement with management on several calls following the acquisition of Sentry which has resulted in circa. £226m of goodwill on the balance sheet – indicating the company has overpaid for the business. As a result, incremental returns have declined and we are concerned about these actions destroying shareholder value. We wanted to discuss this and whether management planned further acquisitions.

Outcome

Management hadn't thought about the acquisition and how it has impacted the company's incremental returns and instead focused on the EPS growth of the new consolidated entity. We will see whether returns start to recover and will review our position should they acquire another business.

Principle 12.
Signatories actively exercise their rights and responsibilities.

We fully participate in proxy voting during AGMs and EGMs. Our Proxy voting policy exists to ensure there is a consistent approach to how votes are cast with the best interests of our investors in our objective of maximising long-term investment returns for investors. The full voting proxy policy can be reviewed on this **link**.

The CIO is responsible for all proxy voting decisions in accordance with our policy and we aim to exercise all our voting rights for our investee companies, except in circumstances where we deem an abstention is necessary. We assess each vote on a case-by-case basis after careful consideration, we do not employ the services of proxy advisors.

When exercising our right to vote, we do so in a way that is aligned to the long-term best interests of our investors and the long-term sustainable performance of our investee businesses. We vote in favour of resolutions that encourage effective management and vote against resolutions which we believe do not achieve this aim. Our engagement policy provided in **Principle 11.** details our approach to engagement and escalation and where we are actively engaging on a specific issue, for example the inclusion of a Return on Invested Capital in management compensation, we will likely abstain, or vote against. One area we have consistently voted against is where companies are seeking to make political donations which have voted against in all instances. Due to the fact we run one fund and vote across all the companies within it our policy for our client investors not to vote directly on resolutions. We do not currently run segregated or pooled accounts. However, were we to take on a segregated account where custody, settlement and voting were managed by the client investor we would liaise with the client to communicate how we were voting on resolutions and our motivation for doing so. Under such a relationship, it would be possible for the client to vote against our voting intention on a specific matter. However, we would anticipate such an occurrence to be very rare, as it has the potential to misalign the incentives we are trying to encourage for the long-term management of our businesses.

Our proxy voting policy is applicable to our fund and is not overridden by any members of the investment team. We do not manage segregated or pooled accounts, however, in these circumstances we would ascertain whether the segregated investor would like to utilise their proxy vote or prefer Castlebay to vote according to our policy. We do not engage in stock lending and there are no plans for us to do so in the future.

Proxy Edge is the platform used to analyse our company resolutions and vote. It is where we monitor what shares and voting rights we have as it is linked to our ACD's fund accounting and reconciled with any dealing that takes place. It also allows us to efficiently monitor our companies and provides the necessary alerts ahead of voting deadlines. The investment team is responsible for reviewing and executing the votes whilst taking into account engagement activity. Both Castlebay and Proxy Edge maintain our voting records, which are available **here**. The table below highlights our voting records in this reported year.

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VT Castlebay UK Equity Fund	
Number of Resolutions	553
% of votes cast	100%
Number of votes in favour	528
% of votes in favour	95%
Number of votes against	15
% of votes against	3%
Number of votes abstained	10
% of votes abstained	2%

The table below depicts the rationale for voting decisions where we have voted against the resolution. At Castlebay we always vote against making political donations as we don't believe that the long-term sustainability of returns and shareholder value will benefit from such a transaction. We have abstained, pre-engagement, on Remuneration policies where we believe that return on capital components don't have sufficient weighting. We are encouraging management to allocate capital effectively over the long term, because capital flows away from value destruction towards value creation. From our perspective when returns are lower than the cost of making those returns, businesses are destroying value. Return on capital components attached to Long Term Incentive Plans (LTIPs) can ensure instead that business create value rather than destroy it.

COMPANY NAME	MEETING DATE	NUMBER RES. VOTED	NUMBER RES. PRO	NUMBER RES. AGAINST MANAGEMENT	NUMBER RES. ABSTAINED	TOPIC: VOTE AGAINST MANAGEMENT	EXPLANATION: VOTE AGAINST MANAGEMENT
Admiral Group PLC	28/04/2022	23	22	1	0	Political Donations	We vote against making political donations

The outcome of the Admiral's resolution is displayed in the table below.

COMPANY NAME	RESOLUTION	VOTES FOR	PERCENTAGE FOR	VOTES AGAINST	VOTES TOTAL	VOTES WITHHELD
Admiral Group PLC	Authority for political donations and expenditure	232,724,961	99	1,690,677	234,415,638	1,072

Moreover, we tend to abstain from voting on topics such as the approval of a remuneration report or policy if the LTIP does not include a ROIC metric and we are in the process of engagement. If a firm comes back with an unsatisfactory reply, we would then vote against the resolution.

COMPANY NAME	MEETING DATE	NUMBER RES. VOTED	NUMBER RES. PRO	NUMBER RES. AGAINST MANAGEMENT	NUMBER RES. ABSTAINED	TOPIC: ABSTAIN	EXPLANATION: ABSTAIN
Next PLC	19/05/2022	21	20	0	1	Approve remuneration report	There is no ROIC measure included in the LTIP

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The outcome of the Next's resolution is displayed in the table below.

COMPANY NAME	RESOLUTION	VOTES FOR	PERCENTAGE FOR	VOTES AGAINST	VOTES TOTAL	VOTES WITHHELD
Next PLC	Approval of remuneration report	956,291,633	93	72,716,731	1,029,198,024	189,660

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