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ESG is Part of Long-Term Investing

By the Fiera Capital Canadian Equity Team

We are long-term investors in high quality, attractively valued businesses. We follow a conservative and disciplined investment approach with an emphasis on capital preservation.

We believe long-term investing means identifying high-quality, sustainable businesses. Environmental, Social, and Governance (ESG) considerations are integral to our process. We believe it is impossible to evaluate the quality, capital allocation abilities, and long-term sustainability of a business without considering ESG factors.

ESG is a link between short-term behaviours and the long-term value of a business. ESG means evaluating culture, employee relations, community involvement, environmental footprint, efficiency initiatives, capital allocation and much more. The extent to which companies succeed on these behaviours can materially influence, positively and negatively, the long-term value of a business.

In other words, ESG is simply part of long-term investing.

The evaluation of ESG considerations are integrated into our fundamental research process across all mandates.

- › Canadian Equity
- › Canadian Equity Ethical
- › Canadian Equity ex Energy

We want to own companies who think about the environment, their social responsibilities to all stakeholders and demonstrate respect to shareholders through good capital allocation. We want to own companies who do the “right thing” with respect to shareholders, the environment, employees, partners and communities.

For more than 10-years, we have utilized a rigorous, 21-question research template. ESG represents a large part of our quantiative and qualitative analysis helping us assess some of the following:

Environmental	Social	Governance
Cost-conscious culture focused on finding efficiencies	Commitment to treating all stakeholders fairly	Aligned compensation policies
Demonstrated efforts to reduce environmental footprint	Long-term approach to brand loyalty through community engagement, value for customer, etc	Track record of spending shareholder money wisely (good capital allocation)
Ongoing disclosure of relevant metrics	Support for cultural initiatives, underprivileged groups, local communities, etc.	A history of respect for shareholders; candidness and integrity
Track record of mitigating environmental risks	Track record of addressing competitive threats, brand building and community responsibility.	Owner-operator philosophy

Engagement

Engagement is an important part of the process. Ongoing dialogue with the managers of the businesses we invest in extends beyond short-term financial metrics and towards long-term strategy, brand building, customer loyalty, capital allocation, compensation, and much more. This is an opportunity for us to share our opinion to the managers with whom shareholders have entrusted their capital.

We also believe in active proxy voting. We seek to reflect the intentions of our clients in accordance with our investment and ESG integration philosophy. The managers we support must treat shareholders fairly and with respect and behave with integrity.

As long-term investors in high-quality companies, engagement is our preferred method for advocating on ESG disclosure and practices.

Metro

A Penny Saved is a Penny Earned

We believe long-term investing means identifying high-quality, sustainable businesses. In order to be sustainable, a business must demonstrate its durability against competitive threats, allocate shareholder money wisely, treat all stakeholders with respect, build a strong culture, relentlessly search for efficiencies and continually build customer loyalty among a host of other musts. Becoming a great company is not easy.

In recent years, competition, social pressures and activism have intensified the search for efficiencies and cost savings. Complacency is under attack. Not only must a company spend shareholder money wisely but they must also reduce costs in order to remain competitive and relevant to customers.

The search for efficiencies falls squarely under the "E" in our Environmental, Social and Governance (ESG) research. A culture focused on finding efficiencies will inevitably reduce its environmental footprint and, over time, can materially influence the long-term value of a potential investment.

Metro is one example. Their efficiency focus is rooted in strong governance, a cost-conscious culture and a long history of disciplined capital allocation.

Here are some examples of what Metro is doing to reduce both their costs and their environmental footprint:

› Achieved average waste diversion of 64% with a goal of 100% waste diversion by 2020

› Reduced GHG emissions intensity by 19% since 2010.

› Established and expanded local purchasing programs in Ontario and Quebec

› Donated $5.6 million in food products in 2016

Waste diversion is more than just recycling. For example, if Metro improves their purchasing, they should be able to sell higher quality food. In turn, consumers should get better value and hopefully buy more. Ideally, a more efficient organization throws less food away. A penny saved is a penny earned. Waste diversion also means finding ways to re-purpose products such as their growing take-away food program. If employees can identify soon-to-be unsellable products and use them in prepared foods, it lowers the chance they are thrown out as well as providing consumers with an affordable alternative to restaurants.

Good for consumers. Good for the environment. Good for shareholders. The link between ESG and business value has never been clearer.

Waste Connections

A Culture Of Safety Drives Tangible Economic Benefits

We believe long-term investing means identifying high-quality, sustainable businesses that are doing the right thing for all stakeholders. While that statement might sound honourable and principled, the real rationale for this view is that it often makes the difference between an average company, and a great company that will thrive in the long-term. One of our holdings, Waste Connections (WCN) exemplifies this thinking.

In 2016 WCN announced plans for a takeover of competitor Progressive Waste (BIN), with Waste Connections management proposing to "…instill the corporate culture, safety focus, operational excellence and accountability…necessary for long-term success…"

In our time, we have come across plenty of press releases that are littered with these types of boiler plate declarations touting organizational improvements. They're often difficult to quantify when determining business value – but there are exceptions, with Waste Connections being one such example.

First, it's important to understand that the waste management industry in the U.S. has been ranked one of the top 10 most hazardous industries to work for over the past decade. Interestingly, Progressive Waste (before being acquired by WCN) faced a track record that was one of the worst in an already dangerous industry, with an incident rate of 50%. That meant one out of every two employees at the company would be involved in some sort of accident in a given year – something as minor as running over a mailbox, or something more catastrophic including loss of limbs or death.

Clearly, safety was not a focus at BIN. And it seemed to have permeated to other aspects of the organization. Employee turnover was 43%, with most of that representing people walking out the door. Who would want to work at a company when there was such a high chance of getting injured on the job? Not us.

Contrast that with Waste Connections – a company with a strong focus on safety, where incident rates are closer to 12-13%, representing some of the best rates in the industry. Retention was also much better at Waste Connections with turnover a modest ~18% (with half of that number representing active dismissals by the company). The cultural focus on safety certainly matters. Waste Connections cares about its employees and considers safety above all else. In fact, WCN has often shed customers if they deemed a certain type of business was unsafe.

	Waste Connections (WCN)	Progressive Waste (BIN)
Incident Rate	12.5%	50%
Turnover Rate (at time of acquisition)	18%	43%

As an investor, some might conclude so what? Incident rates and turnover aren't really quantifiable metrics in any valuation methodology, so why bother?

In the case of WCN, the safety focus comes with meaningful financial benefits. Improving the incident rate on BIN's assets is expected to yield $25-$30M in sustainable savings per year. So far, a year into the BIN acquisition, Waste Connections has already seen a 40% improvement in the incident rate, with knock-on benefits in employee turnover as well. Safety, in this case is financially quantifiable.

But if we step back even further, we can make broader conclusions about WCN's focus on culture and the company's ability to compete and win. WCN and BIN operated in the very same industry, yet the two organizations had two very different set of results leading up to the acquisition. The table below highlights that while the two companies had fairly similar revenue rates pre-deal, Waste Connections had a superior ability to translate every dollar received to Free Cash Flow.

	Waste Connections (WCN)	Progressive Waste (BIN)
Revenue (FY pre-acquisition)	$2.1B	$1.9B
Adj. Free Cash Flow (FY pre-acquisition)	$343M	$150M

* Revenue and adjusted FCF for FY2015; All amounts in U.S. dollars.

Market selection and contractual positioning at Waste Connections are part of the reason for the difference between the two organizations, but so too is the culture, with an unparalleled level of safety the cornerstone of this company. The goal for WCN is to make the BIN metrics look increasingly like WCN's. In doing so, both employees and shareholders stand to benefit from a safer work environment and a more successful business.

We believe long-term investing means identifying companies that are focused on all stakeholders. Continually building customer loyalty is important, but so too is building loyalty among employees. The ability for a company to thrive means all stakeholders are being counted, and those that keep this focus prove their worth in the long-term.

Constellation Software

Governance & Frugality

Good governance has long been core to our process. The alignment, incentives, track record and capital allocation abilities of management are critical to identifying quality businesses and making long-term investment decisions. Governance allows us to assess management capabilities, motivation, and, most importantly, integrity.

While all ESG considerations can impact the financial results and value of a business, the "G" has perhaps the most direct link because it best reflects capital allocation or, in other words, how well management spends shareholder money.

Sometimes studying Governance leads us in unexpected directions. We were recently studying a potential opportunity when we noticed the Board of Directors had hired 3 outside executive compensation consultants. Immediately, we wondered "why do they need 3 compensation consultants?".

This led us to study how prevalent compensation consultants are amongst Canada's largest public companies.

We found:

› The use of at least 1 compensation consultant is normal

› Three companies needed extra help determining executive compensation and used 3 separate consultants

› Only 5 companies in the TSX60 did not use them (Brookfield Asset Management, Restaurant Brands, Blackberry, Franco Nevada and Constellation Software)

› The average amount spent on compensation consultants was modest at just over $200,000

We then expanded our study to look total Board compensation. Among Canada's largest companies, we found the average amount spent on board compensation is about $3 million and, on average, each member is paid just over $250,000.

A few things stood out. First, unlike with executive compensation, most companies don't link company performance to board compensation. Second, directors rarely purchase stock outright; most companies award directors a combination of cash and stock or options. Third, many directors are paid exceptionally well. We found only two instances where members were paid well under the average and where total board compensation was less than $1 million.

Those two instances were Constellation Software and Dollarama.

Constellation Software stood out for other reasons too. Despite being one of Canada's largest and most successful companies, we found Constellation spends the least amount on Board of Director compensation. The company spends $500,000 on annual total board compensation and individual members earn approximately $100,000.

This is unusually frugal behaviour – relative not only to other Canadian companies (both big and small) but also relative to the amount of value created for shareholders. Most companies must spend large amounts to attract and retain skilled board members; in contrast, Constellation has not needed to.

Perhaps, however, the most important conclusion is not what they spend but how they incentivize. Like executives, all directors are required to invest the majority of their director fee in shares of Constellation. No special grants of options or shares but direct purchases at market prices to align directors with common shareholders.

We think the compensation strategy highlights Constellation's respect for shareholders as well as a culture of spending wisely, alignment and straightforward disclosure. While compensation is just one of many factors we assess when evaluating the "G" in ESG, it helps link the short-term behaviour of management and the long-term value of a business.

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