



Small Cap Growth: Approach to ESG

Our firm understands that a company’s relationships with its stakeholders—including customers, suppliers, employees, communities, governments, creditors, shareholders, and the broader environment—can have meaningful implications on its future investment value.

As such, we methodically review the outcome of corporate behavior of companies within the investable market. Our research teams have integrated environmental, social and governance factors (ESG) into the firm’s multi-faceted analysis processes to ensure our investment conclusions are conscious of the risks that unsustainable business practices pose to economic outcomes. Although we consider ESG exposures material to a company’s future investment prospects, these dynamics are considered in the context of the issuer’s underlying business model, operating fundamentals, and market position. This disciplined structural review is accompanied by thorough valuation analysis. The merits of our thorough security evaluation process have been proven over multiple market cycles.

Our Commitment to ESG

SBH became a signatory of the United Nations’ Principles for Responsible Investment (PRI)* in 2017. Signing the internationally recognized PRI reflects our commitment to responsible investment within the global community, seeking companies that exhibit positive stewardship in their environmental, social, and corporate governance practices. To assure quality control in the arena, senior management at SBH is highly involved in the firm’s ESG efforts and we have formed an internal ESG committee tasked with developing best practices across the organization.



Small Cap Growth – ESG Philosophy and Overview

	ESG and Value Creation	We recognize a company’s relationships with its stakeholders can have meaningful implications for its financial profile and future investment value. We believe ESG factors are important drivers of value in conjunction with the underlying strength and potential of a business.
	ESG Integration	Our investment process is designed to integrate ESG factors into our research, which includes a quantitative and qualitative assessment of each company’s level of commitment to ESG principles.
	MSCI Data	We utilize ESG data and reports from MSCI to assess ESG considerations for potential and current portfolio companies. We discuss our findings with the management teams to deepen our understanding of their ESG efforts.

Small Cap Growth – Integration of ESG into Investment Process



INVESTMENT APPROACH

Our investment approach is designed to invest in companies with fundamentally stable growth prospects that have a measurable competitive advantage by being leaders or disruptors in their industries. We utilize proprietary research to identify companies we believe have the potential to exceed the market's implied expectations and select companies that are attractively valued relative to the future growth opportunity.



ESG INTEGRATION

We take a holistic approach to incorporating ESG factors into our fundamental research process. Our investment process is focused on investing in companies that operate in such a way that all stakeholders benefit, including customers, suppliers, employees, the local community, and the environment.

Investment discussions around ESG for potential and current holdings leverage MSCI data and reports in addition to information gathered from our fundamental research. This research includes, but is not limited to, relevant ESG commentary in financial filings and specific ESG documents available on company websites. While there is more limited ESG data available for many companies in the small cap universe, we supplement any missing information on a company we are researching with our fundamental research.

The team's ESG analysis is incorporated into its proprietary valuation modeling to generate a clearer sense of the range of investment outcomes, helping to understand the potential opportunities and risks of the stock.



THE IMPORTANCE OF MANAGEMENT

We discuss the findings of our ESG analysis with management teams to better understand their efforts as a company. Further, as part of our management evaluation process, we make it a priority each time we meet with management to understand how leadership contemplates ESG in various aspects of its business. Through these discussions, we have noticed that companies vary greatly in their ESG efforts; some have ESG considerations that permeate throughout the organization while other companies have very limited efforts in place.

** On 9/8/22, SBH received the UNPRI (Principles for Responsible Investment) signatory review for the 2021 period. SBH pays an annual signatory fee to UNPRI for its review. Fees are calculated based on signatories' AUM (for asset owners and investment managers) as reported in the PRI's 2021 Reporting and Assessment Framework. You can learn more about UNPRI methodology, signatory reporting and assessment here: <https://www.unpri.org/signatories/reporting-and-assessment>.*

Research Example of ESG Integration

The following is an example that illustrates how we incorporate ESG into our research process. The name of the company has been changed.

RESEARCH EXAMPLE

CBMC



COMPOSITE BUILDING
MATERIALS CORP



IDEA GENERATION

We first identified Composite Building Materials Corp (CBMC), a leading industry player in the composite outdoor building materials industry, through our proprietary fundamental screening process, which streamlines our idea generation and increases the likelihood of identifying attractive stocks. The company was the leading manufacturer of premier composites-based outdoor building materials and had the leading brand in the market.



RESEARCH PROCESS

1. Fundamental Evaluation > 2. ESG Analysis > 3. Financial Modeling and Investment Conclusion

Fundamental Evaluation

To better understand the financial opportunity at CBMC, our team engaged in our 360-degree assessment of the strength and sustainability of the company's competitive advantage.

- Our investment process is focused on identifying companies that demonstrate fundamentally stable growth over time. Additionally, we believe that companies that recognize the importance of environmental, social and governance matters, and how they impact their stakeholders, are typically positioned better for longer duration growth opportunities. CBMC had this long duration growth opportunity given its dominant product suite with attractive economics and its innovative approach to the market.
- Our competitive analysis confirmed the quality of the company's product, the durability of its competitive positioning, and the reputation of the company as a category leader and environmental steward. Our discussions with many distributors of the company's product were a very important part of understanding the key competitive strengths of the product and the company and provided unique insight into future growth opportunity.

- Discussions with the company provided insight into its fundamental approach to the business and how ESG components were a bedrock of its strategy. The focus of management had evolved over time to address multiple areas of its ESG mandate, which continued to be a focus for management and a key part of the company's "DNA."
- We then modeled the potential value creation and upside CBMC could achieve given its focus on growing a business that generated substantial Return on Invested Capital (ROIC) and benefited its stakeholders in the process.

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RESEARCH PROCESS (Continued)

1. Conversation with Management > 2. ESG Analysis > 3. Financial Modeling and Investment Conclusion

ESG Analysis

In parallel with our financial analysis, our team also conducted a deep review of the company's ESG exposures to evaluate potential risks and opportunities resulting from its operations.



Governance. This is where the entire ESG effort started for CBMC. The company recognized that strong and effective corporate governance was the foundation of a well-run, sustainable business. At the heart of the company was the core value "Do the Right Thing" with integrity and respect. With this as the guiding principle for all decisions, the company had positioned itself well to excel in the categories of ESG.



Environmental. The E in ESG is where CBMC stood out and the management team had placed a lot of emphasis over time. The company's residential products were up to 95% reclaimed or recycled wood and plastic. It had embarked on multiple recycling programs as a source of materials. Water management had been a primary focus and the company operated with a closed loop system for its water needs at its manufacturing facilities. Finally, recent initiatives had focused on energy efficiency and energy savings. Importantly, management strived to continuously improve its environmental impact.



Social. Workforce diversity and inclusion had been a focal point for the company at both a corporate and board level. Training and development were other points of emphasis for the company to help drive workforce satisfaction and engagement. The company rounded out the social element with its commitment to safety, significant community involvement and charitable giving initiatives.

Financial Modeling and Investment Conclusion

After conducting both financial and ESG research on CBMC, we refined our valuation modeling. Our team uses a proprietary expectations-based discounted cash flow model to identify where internal estimates differ from the long-term expectations

implied in the current stock price. Our internal cash flow forecast led to a valuation estimate over 25% higher than where the stock was trading at the time. Given the company's position as an industry leader with strong competencies around environmental, social, and governance topics, it was our belief that this valuation was deserved. We had strong conviction that CBMC's strategy and culture would continue to drive future growth and continue to drive fundamentally stable cash flow generation for years to come. The analyst presented the thesis in one of the team's weekly research meetings. Included in this presentation was CBMC's financial model, end market forecasts, scenario analysis, management assessments, ESG considerations, and a detailed review of the fundamental research conducted in support of our investment thesis.

The process led to an investment in the security with a portfolio weighting representative of our risk-adjusted return expectations. After the position was established in the portfolio, we continued our rigorous analysis of interim financial results, competitive dynamics, and ESG developments. While the ESG analysis integrated into our stock evaluation by no means guaranteed success of the investment, we believe it better framed both the risks and opportunities of CBMC.



ESG FACTORS THAT MAY BE CONSIDERED IN RESEARCH PROCESS



- ✓ Carbon Emissions
- ✓ Water Stress
- ✓ Clean Tech Opportunities
- ✓ Electronic Waste Policies
- ✓ Sustainability Initiatives
- ✓ Raw Material Usage
- ✓ Packaging Solutions & Waste
- ✓ Renewable Energy Opportunities
- ✓ Chemical Management
- ✓ Biodiversity Policies
- ✓ Energy Efficiency Policies
- ✓ Green Building Policies
- ✓ Environmental Accounting Costs
- ✓ Hazardous Waste Policies
- ✓ Sustainability Initiatives
- ✓ Ecosystem Integrity



- ✓ Product Quality & Safety
- ✓ Community Relations
- ✓ Product Testing
- ✓ Vendor Management Policies
- ✓ Supplier Training
- ✓ Government Contracting
- ✓ Employee Turnover
- ✓ Employee Training
- ✓ Gender Composition
- ✓ Labor Management & Productivity
- ✓ Collective Bargaining Exposure
- ✓ Employee Surveys
- ✓ Equal Opportunity Policies
- ✓ Workforce Accident Rates
- ✓ Supply Chain Management
- ✓ Privacy Practices
- ✓ Ethical Marketing
- ✓ Product Pricing & Affordability
- ✓ Employee Health & Safety
- ✓ Brand Perception
- ✓ Consumer Data Protections
- ✓ Employee Incentive Structure
- ✓ Intellectual Property Management
- ✓ Regulatory Relations



- ✓ Board Composition
- ✓ Board & Executive Diversity
- ✓ Board Committee Structure
- ✓ Board Independence
- ✓ Director Election Procedures
- ✓ Accounting Practices
- ✓ Tax Transparency
- ✓ Business Ethics Policies
- ✓ Anti-competitive Practices
- ✓ Ownership & Control Dynamics
- ✓ Investor Communication
- ✓ Shareholder Rights
- ✓ Management Experience
- ✓ Risk Management Practices
- ✓ Anti-corruption Procedures
- ✓ Management Compensation
- ✓ Management Accessibility
- ✓ Audit Oversight
- ✓ Capital Structure
- ✓ Exposure to Geopolitical Instability
- ✓ Succession Preparation
- ✓ Strategic Planning Process
- ✓ Capital Markets Access
- ✓ Industry Thought Leadership

To learn more about our approach to ESG, please email us at contactus@sbhic.com.

Environmental, Social and Governance (ESG) Risk: The ESG screening process may affect exposures to certain companies or industries and cause the strategy to forego certain investment opportunities.

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