



# Small Cap and SMID Strategies: 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 and SMID Strategies – ESG Philosophy and Overview

	<b>ESG and Value Creation</b>	We believe value creation occurs by generating sustainably high or improving Return on Invested Capital (ROIC) levels. We recognize that environmental, social and governance characteristics are important elements in a company’s ability to maximize value.
	<b>ESG Integration</b>	Since the inception of the strategies, understanding a company’s commitment to ESG principles has been a key part of our investment process. We believe that by integrating ESG factors into the due diligence process, we inherently increase the return potential of our client portfolios while lowering risk.
	<b>The Importance of Management</b>	Most important to our ESG assessment is interviewing management, both before purchasing a company and while owning it, to understand their knowledge and commitment to these principles as well as their desire to align incentive compensation with them. We combine these ongoing management interviews, corporate filings and Social Responsibility disclosure with third party reports produced by MSCI to create as comprehensive an overview as possible of a company’s ESG metrics.
	<b>Alignment of ESG Framework</b>	We favor companies that recognize the value of aligning the ESG framework as they typically experience secular growth, are viewed favorably by employees, peers, and business partners, and demonstrate an understanding of true value creation by compensating employees in accordance with the appropriate metrics.

# Small Cap and SMID Strategies – Integration of ESG into Investment Process



## IMPORTANCE OF ESG TO INVESTMENT APPROACH

Throughout our four-step investment process (i.e., idea generation, ROIC and niche market/competitive advantage due diligence, risk mitigation and portfolio construction), our team incorporates the analysis of ESG factors. We believe corporate alignment with ESG factors inherently improves the likelihood of value creation of those companies. We also believe analyzing ESG factors prior to and during ownership improves the reward-to-risk ratio by focusing on the holistic benefits of firm culture, alignment of incentive compensation, increasing exposure to secular growth in sustainable environmental trends and identifying potential risks before they occur.



## ESG INTEGRATION

We utilize multiple sources to create as holistic an assessment as possible of a company's ESG commitment. In addition to third party reports from MSCI, our analysis leverages employee/partner interviews, company documents and third-party websites (e.g., Glassdoor). We discuss ESG topics during our conversations with management and with our investment team members.

Our team focuses on the following ESG factors at the company level:

- **From an environmental (E) perspective**, we look for companies that are participating in or advancing environmental sustainability as these companies have tended to benefit from secular growth, particularly in the areas of recycling/natural resource use and reuse, sustainability, pollution reduction, and energy efficiency. We also assess environmental risks and favor companies that not only proactively improve their environmental exposure and impact, but push their suppliers to do so as well.
- **From a social (S) perspective**, we spend time understanding a company's culture, including changes to the culture which are typically driven by management changes. Additionally, health, safety, and the empowerment of employees are key focus areas.
- **From a governance (G) perspective**, we focus on understanding management compensation, changes in compensation, board structure/composition, shareholder rights, and ownership, as changes in these factors often serve as catalysts for value creation.

Over the last several years, the team has evolved and enhanced how we think about governance to acknowledge that the digital world increases the risks that businesses face. In addition to assessing environmental, cultural and shareholder governance risk, understanding governance policies around data protection and privacy, breach response, and employee training has grown in importance for our team.

The risks and opportunities identified through our ESG research are incorporated into our valuation modeling. Over time, we have found the highest probability of improvement in or sustaining high ROIC and a company's competitive advantage occurs when management creates a culture aligning the organization and incentives with company priorities. To the extent we find evidence of these practices in place through our research process, it serves to deepen our conviction in our investment thesis for a company.

**To learn more about our approach to ESG, please email us at [contactus@sbhic.com](mailto: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.*

*All opinions expressed in this paper are solely the opinions of Segall Bryant & Hamill. You should not treat any opinion expressed as a specific inducement to make a particular investment or follow a particular strategy, but only as an expression of the manager's opinions. The opinions expressed are based upon information the manager considers reliable, but completeness or accuracy is not warranted, and it should not be relied upon as such. Market conditions are subject to change at any time, and no forecast can be guaranteed. Any and all information perceived from this paper does not constitute financial, legal, tax or other professional advice and is not intended as a substitute for consultation with a qualified professional. The manager's statements and opinions are subject to change without notice, and Segall Bryant & Hamill is not under any obligation to update or correct any information provided in this paper. **No assurance can be given that any investment will achieve its objectives and avoid losses.***

*\*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/report-and-assessment>.*