

Fundsmith Equity Fund

Annual Sustainability Summary - 2024

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The intention of this Sustainability Summary is to act as a supplement to our Responsible Investment Policy and annual Stewardship Report, providing a more detailed insight into the sustainability-related performance of our companies over the past year and to compare this with the impact of the average company in the MSCI World and S&P 500 indices.

The Fundsmith Equity Fund's (FEF) portfolio is constituted of a small number of high-quality companies, each with an ideal holding period of forever. Given the long-term horizon we invest with, we expect the companies that form the Fund's portfolio to act similarly, prioritising their long-term sustainability and not inflating short-term profits at the expense of the environment or society.

The Fund performed strongly on both an absolute and intensity basis versus the MSCI World and S&P 500 indices across each of the sustainability measures assessed in 2024.

- It had particularly strong environmental performance, with significantly lower levels of waste generation and water and energy use compared to both the S&P and MSCI World indices. Most notably, the Fund's carbon intensity (metric tonnes CO₂e/ £m of free cash flow) was around 50% and 60% lower than that of the S&P 500 and MSCI World respectively at the end of the year.
- The Fund's Science Based Targets initiative (SBTi) alignment, companies having either committed to or already set 1.5°C-aligned emission reduction targets with the SBTi, reached 90%, up from 75% at the end of 2023.
- Women continue to have higher representation at the board, executive, and management levels as well as in the general workforces of the Fund's companies versus the MSCI World.
- Our independent negative impact proxy, RepRisk's 'RepRisk Index', shows that on average the Fund's companies received less negative press in relation to their external impacts compared to the MSCI World's average company during 2024.

One important aspect of sustainability is the positive impact that research and development can have on the products and services provided by businesses. The final section of this Sustainability Summary discusses some of the innovations from the companies held in the portfolio during 2024. This covers the innovative use of artificial intelligence (AI) for water conservation and replenishment, weather forecasting, and the reformulation of detergents to keep up with changing consumer practices.

The Fund does not have a UK sustainable investment label as it does not have a sustainability goal. Sustainable investment labels help investors find products that have a specific sustainability goal.

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Environmental

The quality of environmental reporting has increased significantly in recent years. Companies have been under increasing pressure to quantify their environmental impact and, consequently, the infrastructure/systems to collect and report the data needed for this have improved rapidly. Despite this, not all companies report environmental data and fewer still report using the same collection, processing, and reporting methodologies. The lack of standardisation both within and between industries, as well as the lag in reporting (typically 2 years) often renders comparing companies' environmental performance both unreliable and inaccurate. Additionally, it means environmental data is retrospective and doesn't necessarily have any bearing on how the company will behave in the future.

We estimate the environmental impact for those companies that do not report data by taking the average of the relevant environmental metric per £m of assets for their relevant subsector and then scaling

it to the assets of the company. We don't estimate for hazardous waste as many companies do not produce any. Creating estimates based on the few companies that do produce hazardous waste would result in inaccurate reporting for the many that don't. To produce statistics that are meaningful to investors and that are relevant to all the companies we invest in, we have chosen to track five metrics that are most commonly reported and related to globally pertinent issues. The issues are climate change (greenhouse gas emissions and energy use), resource scarcity (water and energy use) and pollution (non-hazardous and hazardous waste).

As the table below shows, on average, 79% of our companies report these five simple environmental numbers. This compares favourably to the MSCI World or S&P 500 where, on average, 62% and 63% of companies report these metrics respectively.

As at 31/12/24	Weighted average absolute emissions					per £m of FCF				
	Total waste	Hazard waste	Water use	Energy use	GHG emiss	Total waste	Hazard waste	Water use	Energy use	GHG emiss
	k metric tonnes	k metric tonnes	m m ³	k of MWh	k metric tonnes	metric tonnes	metric tonnes	m ³	MWh	metric tonnes
FEF	206	4.4	21	7,799	2,386	14.0	0.3	1,447	528	161
S&P 500	2,371	15	313	18,091	5,609	133.3	0.8	17,622	1,017	315
MSCI World Index	7,757	240	340	16,766	5,044	590	18.3	25,856	1,276	384
FEF portfolio % reported	73%	42%	85%	100%	96%	73%	42%	85%	100%	96%
S&P 500 % reported	58%	40%	66%	87%	92%	58%	40%	66%	87%	92%
MSCI World % reported	66%	42%	66%	88%	93%	66%	42%	66%	88%	93%

Table 1: Environmental look through table showing the weighted average emissions of the different FEF fund vehicles both on an absolute basis and by our measure of intensity (per £m of free cash flow) relative to both the MSCI World and S&P 500. Source – Latest company reported numbers with numbers for those not reporting estimated.

Climate change

Climate change has the potential to be one of the most significant risks our portfolio companies face given the consequences of failing to mitigate the drivers behind it and/or adapt to the consequences of it. An essential part of managing this risk is reducing global greenhouse gas emissions. The 2015 Paris Agreement set a target of keeping warming below 2°C and, if possible, below 1.5°C of the pre-industrial global average temperature by the year 2100 to avoid the worst predicted impacts of climate change.

The Science Based Targets initiative (SBTi) was established to provide corporations with a platform to develop and assure emission reduction pathways in support of meeting this 2°C target, as well as the more ambitious 'Business Ambition for 1.5°C' framework. The table below shows the percentage of the portfolio and the percentage of the portfolio's greenhouse gas emissions committed to developing reduction pathways with the SBTi, as well as those that have already aligned with the more ambitious 1.5°C reduction target. Also included are net zero emissions commitments made by the companies held in the portfolio. These commitments are those developed with the SBTi as well as net zero commitments made independently by the company.

This year's Summary includes a new climate metric: weighted average temperature alignment. A company's temperature alignment is the translation of its SBTi-approved greenhouse gas emission reduction targets into a medium-term (5-15 years) temperature alignment. A company with targets validated by the SBTi as being 1.5°C-aligned would therefore have a temperature alignment of 1.5°C and businesses that have already achieved or are committed to achieving net zero within this timeframe have a temperature alignment of zero. Companies without SBTi-approved targets are assumed to have a temperature alignment of 3.4°C, in line with the "business as usual" greenhouse gas emissions trajectory. The calculation uses the methodology developed by the CDP and WWF¹.

	FEF	
	% of Portfolio	% of Emissions
SBTi Commitment	90%	97%
SBTi Validated 1.5°C Aligned	71%	90%
Net Zero Commitment	94%	96%
Temperature Alignment	1.5°C	

Table 2: Percentage of portfolio with different emissions reduction commitments and the percentage of the portfolio's emissions those commitments cover. Temperature alignment is a weighted average of climate impact of portfolio company's emissions and reduction plans.

For comparison, 24% of listed companies have set science-based climate targets and 11% have targets aligned with the 1.5°C pathway².

¹ https://cdn.cdp.net/cdp-production/comfy/cms/files/files/000/009/448/original/CDP%E2%80%93WWF_Temperature_Scoring_Methodology.pdf

² <https://www.msci.com/documents/1296102/51038578/2024+November+MSCI+Net-Zero+Tracker.pdf/f2377c75-70cb-at4c-9c21-eb1d961d3d5e?t=1732289152071>

Social/Society

Social data is far more challenging to collect and report compared to environmental data. This is largely due to environmental data being significantly easier to quantify (e.g. CO₂ emissions) and, if the methods used are the same, compare between companies. The impacts a company has on society are more nuanced and, as such, difficult to compare with other businesses. For example, how can one accurately measure the positive social impact of diabetes medication? How would one then net that with the negative impacts that inevitably come with the supply chain that creates them? To accurately reflect the positive and negative impacts a company has, one needs to look beyond the numbers they report and make an objective assessment of what the company does and the resultant effects on society.

The difficulty in quantifying an impact that fundamentally cannot be quantified results in most investors and companies reporting diversity statistics when looking at the 'S' in ESG. At Fundsmith, we think this data is important as, for a business to adapt and successfully sell their products, their employees should be representative of their customer base. Further, it is important to create an inclusive and supportive working environment as, not only is it the right thing to do, it typically results in lower employee turnover and helps a company attract the best talent to support its long term success.

However, while we think it is important to report what we can, we don't think that these limited numbers reflect the social impact our companies actually have. These impacts can't be quantified, making contrasting the various positive and negative to reach an overall conclusion very difficult. For example, all companies will know the percentage of their board or upper management who are women and will be quick to report it. Nevertheless, obtaining a number that accurately reflects how happy employees are working for the company is far more challenging.

The table below is what we can report for our portfolio and comparable indices. We will continue to add to the statistics below when we have enough companies reporting informative metrics in a comparable way.

Social	FEF	MSCI World	S&P 500
% of employees who are women	41%	38%	38%
% of management who are women	38%	30%	32%
% of executives who are women	29%	21%	24%
% of the board who are women	38%	33%	34%

Table 3: Averages with no estimates. Source - company reports

Governance

Governance refers to the processes and systems a company has in place to protect the interests of minority shareholders, such as ourselves. This can be in the form of independent checks and balances on management's actions by the board of directors, but also anything that influences the decision-making and incentive structure within an organisation. This can be a company's policy toward forced labour, which is somewhat easy to measure, or a company's culture and whether that incentivises employees to do the right thing, which is much harder to assess.

Knowing whether a company has a policy toward something is all well and good, but it doesn't tell us much about how the company actually behaves in the real world nor how it responds when it becomes aware of negative impacts it may be having. Policies provide an expectation of how a company would like to behave but are not necessarily a reflection of its actual actions. Further, while one can measure the percentage of independent directors on a board, which is reported by most companies, it is much harder to know whether they are truly independent. There is also a question over whether someone who is paid more than £100k a year for four meetings can ever really be independent.

Much like the challenges with social data, meaningful data on governance can also be hard to find; what comparable metric is going to reflect a company's culture? Even when one can find it, the numbers can still be manipulated by a company to be misleading should they wish.

That being said, there are some limited numbers we can report but we don't find these to be an effective proxy for the quality of governance in our portfolio. As mentioned above, just because a company has more independent non-executive directors on its board or on various committees, this doesn't say a huge amount about the quality of its corporate governance. It also says nothing about how the company's incentive structure is designed to promote sustainable growth, nor whether the company's culture attracts employees who want to promote the company's purpose.

Like social impacts, a lot of the quality of a company's corporate governance can only be measured qualitatively, making it impossible to aggregate across a portfolio. We would like to report more data but not enough companies produce meaningful and comparable statistics on anything other than the make-up of their boards.

Governance	FEF	MSCI World	S&P 500
% non-executive directors on board	89%	83%	89%
% of board independent	76%	72%	86%
% of executives holding shares in the company	60%	47%	72%

Table 4: Averages with no estimates. Source - company reports

Until the companies we invest in produce better data on their impacts on society and the quality of their governance structure, we will continue to use data from RepRisk as proxy. The reasoning for this is explained in the RepRisk section of this document.

Remuneration

One of the areas of governance that we have a particularly strong view on is the remuneration of our companies' executive management teams. We care more about how our companies' management teams are paid and less how much they are paid.

Usually, executive management have three components to their compensation: 1) a fixed base salary, 2) a short-term bonus (STI), and 3) a pay out from a long-term incentive plan (LTIP). The LTIP is typically paid out in shares or options with the amount that is paid based on the company achieving a set of targets based on a selection of performance-related metrics.

We have come across many different types of metrics in company's LTIPs, with the worse versions including metrics that management have no control over (e.g. total shareholder return) or those that they have too much control over (e.g. adjusted EPS growth).

We will typically vote against remuneration policies without measures of both growth and returns as we believe these are the most effective way of incentivising profitable growth. It is not very difficult to grow revenues if one is willing to make a loss. We also frequently engage with management teams and remuneration committees, putting forward our arguments to better align management's incentives with those of long term shareholders, where necessary.

In 2024, across both FEF³ and FSF⁴, of the 28 companies whose shares we owned at their AGM and were given the opportunity to vote on their executive compensation plan, we voted against 21 as we failed to see how it aligned executive incentives with those of long-term shareholders. In 2024 we voted in favour of 7 companies. 2 of those were companies we also voted of in favour last year, 2 were new positions, while we changed our vote from 2023 on 3 others.

Year	No. of compensation votes	Voted against
2019	26	16
2020	26	16
2021	30	19
2022	29	27
2023	27	25
2024	28	21

Table 5: Source – Fundsmith.

³ Fundsmith Equity Fund.

⁴ Fundsmith Stewardship Fund.

RepRisk

Due to the challenges in reporting effective and meaningful social and governance data, we use a proxy derived from data provided by RepRisk alongside our own qualitative research on the company. RepRisk provides their 'RepRisk Index' (RRI), which is a measure of the reputational risk resulting from a company's environmental, social, and governance performance. It measures this by scanning over 100,000 news sources in 23 languages on a daily basis. They then use a combination of machine automation and human analysis to assess the scale of the negative impact, the reliability of the source, and whether it is a repeated story to create the RRI; a higher score indicates greater reputational risk. Whilst we are concerned about the reputational risks our businesses face, we mainly use the indicator as we think it acts as a strong proxy for the underlying impact companies have.

The RepRisk Indicator gives us an independent assessment which, when combined with what we know about the companies and the other information they give us, means we have what we think is an objective framework to assess our companies' impact on the world.

It is by no means a perfect proxy as it only looks at negative impacts. The majority of companies we invest in are consumer facing and these businesses typically have higher scores due to the public nature of their operations. However, it remains the best proxy we have found for these hard-to-measure impacts and risks.

Below is a table showing the weighted average RRI for the portfolio broken down by environmental, social and governance risk components. It also shows how the RRI has changed over the past year, and what the weighted average of the peak RRI for each of our companies is. We also give tables showing the highest and lowest RRI companies in the portfolio, which we think is a relatively good proxy for the ranking of negative impacts.

	FEF	MSCI World
Environmental	4.1	4.8
Social	17.2	14.2
Governance	12.8	14.2
TOTAL	34.1	33.2
Change YoY	+5.9	+3.3
Peak RRI	46	43

Table 6: Total RepRisk Indicator (RRI) for the fund split by proportion of score from Environmental, Social and Governance factors. Peak RRI is highest RRI in the last 2 years. Source – RepRisk/Fundsmith..

As at the end of last year the companies with highest/lowest RRI in the portfolio:

Highest ranked portfolio firms

1. Alphabet (63)
2. Microsoft (61)
3. PepsiCo (61)
4. Meta Platforms (57)

Lowest ranked portfolio firms

1. Waters (0)
2. Idexx (0)
3. Amadeus (0)
4. Mettler-Toledo (0)

Table 7: Source RepRisk.

Innovation

As well as assessing a company's negative impacts on the environment and/or society, we also look at the positive impacts they have through innovation. Improving existing products and innovating to create alternatives is an important aspect of many of our companies' business models. Innovation allows businesses to maintain or gain an advantage over the competition and to meet unexplored or emerging areas of demand, generating growth.

Product innovation is also the area where the most tangible examples of a company's adaptation to minimise its impacts are present. For many of our companies, reducing the impact of their product's lifecycles is beneficial not just to sales but also to their sustainability targets. Reducing the energy and raw materials required to make a product, using sustainable alternatives, and increasing the efficiency of the production chain can all result in significant reductions to the business's environmental and social impact. As well as minimising impact, innovation also allows our companies to create a positive impact, for example, through creating new products that are beneficial to the environment and/or society by giving a solution to some unsolved problem or by simply giving consumers a wider range of choices.

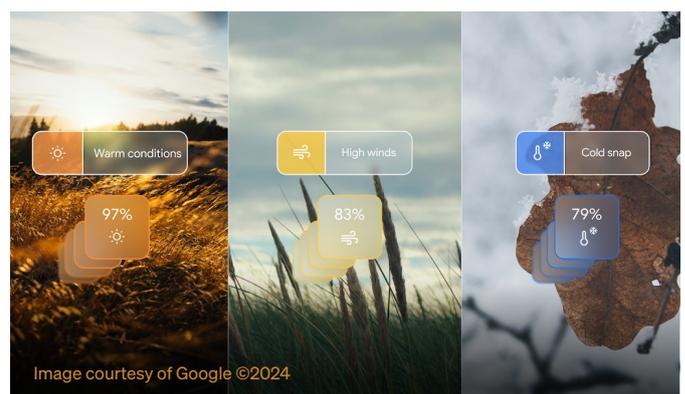
Accounting for the advances made through innovation is vital, as increasing sustainability and generating positive impacts directly influence the long-term sustainable outperformance of a company. Moreover, identifying companies failing to reduce negative impacts is an important aspect of our risk analysis. This final section gives some brief examples of some of our companies' innovations over the past 12 months to give you an idea of what the companies in the portfolio have been working on.

Google

In 2024, Google's DeepMind division presented GenCast, an AI weather forecasting model. GenCast is designed to improve weather forecasting and the prediction of extreme weather events with a high degree of accuracy. Unlike DeepMind's earlier weather model, GraphCast, which provided a single best estimate of future weather, GenCast's forecasts comprises an ensemble of 50 or more predictions, each representing a possible weather trajectory.

To train the AI model, DeepMind provided it with forty years of historical weather data from the European Centre for Medium-Range Weather Forecasts' (ECMWF) ERA5 archive. The ERA5 data includes variables such as temperature, wind speed, and pressure at various altitudes. The model used this data to learn global weather patterns with incredibly detailed resolution and uses this to generate detailed forecasts for up to 15 days ahead. Compared to the existing industry gold-standard ECMWF's ensemble (ENS) system, GenCast was able to produce more accurate results 97.2% of the time and, for lead times over 36 hours, it was more accurate 99.8% of the time.

What's more, using the model Google DeepMind were able to generate these 15-day forecasts in just 8 minutes via Google Cloud. Whereas ENS forecasts made at a similar resolution can take hours and require a supercomputer with tens of thousands of processors.



Microsoft

In 2020, Microsoft committed to becoming 'water positive' by 2030. By this, the company is committed not only to consuming net zero water but also to replenishing more water than it consumes each year from 2030 onwards. In 2023, the company consumed almost 8 billion litres of water across its operations. Meeting this commitment will require a huge amount of innovation in both reducing the quantity of water the business withdraws and increasing the amount it replenishes. The company found innovative approaches to contribute towards both in 2024.

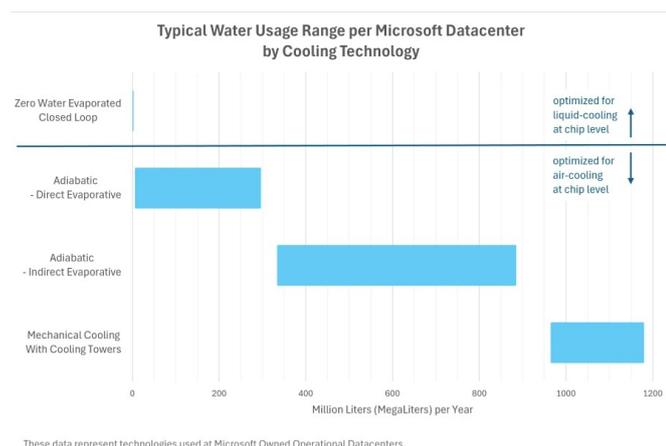


Image courtesy of Microsoft © 2024

The first was innovation in the way Microsoft designed and operated its data centres. From August 2024, all new Microsoft data centres will use a design that consumes zero water for cooling. Traditional cooling methods within Microsoft's data centres use the evaporation of water to remove the heat generated by servers and maintain optimum operational temperatures, either via direct evaporation, indirect evaporation or mechanical cooling with cooling towers. Large quantities of water are wasted during these processes due to the reliance on the evaporation of water to remove the datacentre's excess heat.

Microsoft's updated design uses chip-level cooling solutions to maintain optimum temperatures without relying on the evaporation of water to remove heat. Instead, the new technology uses water to cool the servers within a closed-loop system. That means that once the system is filled during the construction of the data centre, that same water will continually circulate between the servers and chillers to dissipate heat without the addition of any fresh water.

The company claim that, on average, this new design will avoid the withdrawal of more than 125 million litres of water per year per datacentre.

Microsoft has also been working with UK-based FIDO Tech to advance its water replenishment goals. Microsoft and FIDO's relationship began at Microsoft's hackathons in London where the company helped FIDO develop a new leak detection technology. From this, FIDO has been able to develop an acoustic AI tool using OpenAI's GPT-4 on Microsoft's Azure OpenAI Service which not only detects leaks in potable water pipes, but also ranks them by size.

The World Bank estimates that on average 30% of the world's piped freshwater is lost to leaks before it reaches consumers. Traditional leak detection methods rely on manual surveys, visual inspections or basic acoustic analysis. None of these approaches provide detail on the exact location or scale of a leak, and surveys and inspections can take days or weeks to identify them.

FIDO's AI tool takes acoustic files from small mobile sensors placed along water pipeline networks and, without needing to know the depth, material, or size of the pipe, can accurately identify a leak. Not only that, the tool can also assess how big the leak is and pinpoint its location, even with plastic piping, which has long presented a challenge to the industry due to its lack of resonance. Microsoft has partnered with FIDO to reduce water loss from leaks in water distribution networks in London, Queretaro (Mexico), and Phoenix, Arizona. So far, FIDO's AI tool is monitoring over 350km of water pipelines for leaks across these networks.

Unilever

Consumers are increasingly moving towards doing some laundry on quicker cycles, with almost 80% of consumers using a 'quick wash' at least once a week. Unilever was quick to spot that their regular laundry detergents were not as effective in these short cycles.

Most detergents are designed for tough stain removal in full-length cycles but, when used in a short cycle, consumers were finding that odours and stains remain, frequently accompanied by soapy residue. Unilever have created a new product designed for these quick washes called Wonder Wash. The company reconstructed how laundry detergent is made so Wonder Wash could achieve the performance consumers want from cycles as short as 15 minutes.

Short cycles are generally used for clothes that don't have heavy stains. Longer cycles are used to clean them if they do. Knowing this, Unilever developed its patent-pending Pro-S technology. Pro-S is a blend of fast-acting ingredients that activate rapidly to clear invisible dirt (such as sweat and oils) and stains. The company also used ingredients more frequently associated with fine fragrances, which, due to their composition, deposit more effectively onto fabric, even in quick cold washes. Because of this rebalanced detergent design, Wonder Wash products do not leave the sticky residue unlike with normal detergents.



Image courtesy of Unilever ©2024

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