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TRANSCRIPT
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Animal Spirits Podcast

Talk Your Book: Quality Growth

Jensen's Eric Schoenstein joins Michael Batnick and Ben Carlson of the Animal Spirits Podcast for a discussion on quality investing.

Today's Animal Spirits is brought to you by Jensen Investment [Management].

Welcome to Animal Spirits, a show about markets, life and investing. Join Michael Batnick and Ben Carlson as they talk about what they're reading, writing and watching.

MICHAEL BATNICK: Ben, we spoke with Eric Schoenstein about their quality growth portfolio and I feel like quality is sort of a nebulous concept. It can mean different things to different people. They have a fairly strict screen that they're using in concert with fundamental analysis. But I was thinking about this after we got off the Zoom with him: you hear great stories all the time and they're really compelling and they make a lot of sense, then you go check the scoreboard and it's often times disappointing. And in this case, not that past performance is indicative of future performance obviously, but they've done well in an environment where if you're not equal weight to Amazon, Apple, Microsoft[1], it's been challenging.

BEN CARLSON: Especially with a more concentrated portfolio. So they own like this is their Jensen Quality Growth Fund. They own like 25 to 30 stocks. And we looked at the performance and they've beat the market over the long-term.

BATNICK: And they said it couldn't be done.

CARLSON: But you're right. It is true. It's much easier to tell a good story as an active manager then to actually back up that story. Because a lot of times you'll hear a good story and you say, well, we couldn't keep up because these five companies have destroyed everything. And if you're in a concentrated portfolio, that's an easier way

Why Quality Matters

"Over the last three decades, Jensen's research has shown that high-quality businesses are able to show resiliency — regardless of what's happening from a macro perspective.

The real genesis of our information and analysis is our fundamental research. From a long-term perspective, we feel very comfortable that a quality strategy can outperform over full market cycles."

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[1] As of 06/30/2021, the top 10 securities held in the Fund were: Microsoft Corp (7.12%), Alphabet Inc (7.10%), PepsiCo Inc (6.07%), Johnson & Johnson (5.71%), 3M Co (5.28%), Becton Dickinson and Co (5.09%), Stryker Corp (4.84%), Accenture Plc (4.64%), Apple Inc (4.53%), and Nike Inc (4.39%).

to outperform because you're taking those bets, but it's also an easier way to really underperform too. So, the fact that you can actually back it up like that is impressive.

BATNICK: So it cuts both ways and we also mentioned that we'll link to this in the show notes, quality has not been in favor. People talk a lot about value and growth. Quality is its own factor. And you might notice some expensive stocks have been doing quite well. It doesn't always mean that quality won't keep up, but in this case it does mean that. Quality stocks have not done well as a basket. Again, depends how you define it. So the fact that they have done well is even more impressive.

CARLSON: That was always a pet peeve of mine is just you'd hear active managers complaining about a junk stock rally when you have to build that into your process that you know there's going to be the occasional junk stock rally especially after a brutal bear market when those companies get hit even harder. That's just part of the investing cycle; it's going to happen.

BATNICK: All right. So here is our conversation with Eric Schoenstein of Johnson Investment.

We're joined today by Eric Schoenstein. Eric is the chief investment officer and portfolio manager at Jensen Investment [Management]. Eric, thank you for joining us today.

ERIC SCHOENSTEIN: My pleasure to be here. Thank you.

BATNICK: Eric, maybe we could start the conversation by talking about quality, which is the linchpin for your strategies.

How does Jensen think about quality in the framework of developing a portfolio strategy?

SCHOENSTEIN: I think quality is an important linchpin for us. It has been for over three decades. We've been doing this since 1988 as an organization. And the idea of quality, obviously it's become a bit more ubiquitous over the last decade or so, but for us, it's always been a key element where what we want to try to do are invest in what we consider to be high-quality businesses. And perhaps first is why do we want to do that? The most important thing there for us is that high-quality businesses from our research over these last three decades are able to show a resiliency, regardless of what's happening from a macro perspective. They have certain types of characteristics that are tried and true and really help them weather the storms, whether those things are happening positively or negatively.

So it's things like durable, sustainable, competitive advantages, very strong financial positions in terms of how their balance sheets are constructed, high levels of free cash flow generation and all of that cash flow then is reinvested back into business to continue to fortify the growth that the company can produce, whether organically or through acquisition. And that cash flow generation allows them to essentially self-fund their growth and their future business prospects. And those characteristics are not present in every company. We've seen a lot of discussion about zombie companies coming out in the pandemic and things like that. These are businesses that are resilient and as that resilience shines through, it gives investors in those companies an opportunity to invest in businesses that are less likely to have devastating business risk that can frankly impact the investment.

CARLSON; So going into the pandemic when obviously a lot of people were worried about what happens when we shut the valve off and the economy and who knows what's going to happen especially in that March 2020 period, were you feeling at least a little more comfortable than maybe than some of your peers that you had these sustainable businesses that probably could weather the storm and handle that situation better than others?

SCHOENSTEIN: Ben, that's a good question. I think we did feel that we had the right kinds of businesses. I would want to draw a little bit of a distinction that what we experienced last year during that bear market period, from whatever that 16 day period where the market dropped so substantially, we did see our portfolio hold up well against that. That's one of the hallmarks of our quality growth strategy is that when things get tough, when the markets go really upside down, we tend to do better in those environments.

However, when it gets to be something like the bear market, frankly if anything, we were maybe even a little bit disappointed we didn't hold up even better. But part of the reason for that that we found was last year was a little bit more than your normal volatility, clearly. It was frankly a shock, a systemic shock that became, frankly it almost manifested into emotional sort of panicky-type selling.

In those kinds of environments where it's that distressed, it's really hard to find anything that will really hold up well other than cash maybe in your mattress. And so for us, we saw some of that preservation of capital. We just didn't see as much as we would have liked to have seen, but on a relative basis, these are businesses designed to hold up. Our challenge was to make sure, and we still are doing this, make sure that the competitive advantage profiles for these high-quality businesses haven't been permanently damaged as a result of this economic shock that is still frankly very much with us today. And from that perspective, that's been something we're continuing to investigate.

BATNICK: Sorry to interrupt. How do you do that? Is that through quantitative screens? Is that boots on the ground, bottoms up fundamental research? Are you doing channel checks, talking to management? How do you do that?

SCHOENSTEIN: So for us, we have an investment team of six. I'm one of those six for this quality growth strategy. It is bottoms up. We are fundamental investment managers. Macro is used frankly as a way to cross-check our thinking to sort of be at that check that says, well, yeah, but does it stand up against sort of the realities from a macro perspective? But the real genesis of our information and our analysis is all of our own fundamental research. We are six portfolio managers managing this portfolio as one. It's consensus driven in terms of how we think about research and the decision-making, and we're using our own business skills, business acumen from all of our previous experiences to really dig in and study the businesses. And, frankly, when you have businesses that you invest in from a long-term perspective, you also gain a broader perspective than when you're just looking for something to try to trade in a one or two week window.

CARLSON: One of the things that you often hear, especially when you see such a vicious bounce off the lows like we had the past 15 months, I think the S&P is up a 100%, is a lot of people will say, "Well, this is just a junk stock, low-quality rally." You see these junky companies that got thrown out and they were down 50, 60, 70% of the bear market. They're coming back with a vengeance and those are the ones that are leading the way.

Having a more quality bent, how do you prepare your portfolio for those situations? Because obviously that's going to happen over a certain number of cycles. And how do you prepare your investors to understand that this is just something that happens and the high quality names are not always going to lead the way during every environment?

SCHOENSTEIN: That's an important element of all of our conversations with all of our clients and partners. We've been really quite blessed over my nearly 20 years with the organization to have formed a lot of relationships where they understand that quality isn't always going to be in favor. From a long-term perspective, we feel very comfortable that this can be a strategy that can outperform over full market cycles. I'll give you a really quick example of this. If we look back to the last sort of let's call it, "peak-to-peak period," October of 2007 was a peak before the downturn. February of 2020 was a peak before the big bear market. Our fund over that 13 year period or nearly 13 year period on a net basis against the S&P 500, which is our primary benchmark, had an annualized out-performance of roughly, if I recall correctly, about 120 basis points a year.

Now, that was not linear at all. We didn't do 120 every single year. And I think that messaging and that transparency from us as investment managers to our clients helps them to understand that every environment is going to be different. So this last periods, as you refer to as the Big Bounce, those are exactly the conversations we're having. And the good news is the data is there. The early parts of that were a hard rebound turning into something that was led strongly by highly concentrated return patterns in very large tech companies, then sort of shifted into more of what I'll call a low-quality rally on the backs of vaccine progress and reopening of the economy exuberance. None of those environments I would argue are the right or sort of the real good environment for high-quality, consistent companies to shine.

> *"[We produced] a very nice return last year, almost 19% ... And that's even inside of an environment that wasn't conducive to our style of investing. The key is communication, being transparent about who you are, what you do, what to expect and how to position yourself. And when you can do those four things with clients, you can build relationships that can be long-lasting."*

Nonetheless, we actually did produce a very nice return last year, almost 19% return. We're not disappointed by that. And that's even inside of an environment that wasn't conducive to our style of investing. The key is communication, being transparent about who you are, what you do, what to expect and how to position yourself. And when you can do those four things with clients, you can build relationships that can be long-lasting.

BATNICK: So this might sound like a new ball question, but I'll throw you a layup. Why should quality companies earn excess returns?

SCHOENSTEIN: It comes down to what are the hallmarks of those businesses? They can earn excess returns because when you have competitive advantages, you have pricing power, you have market dominance, you have ability to earn and maintain margins at higher levels than your competitors can. And because you have such free cash flow generation that you're not having to borrow for need, yeah, you go to the debt markets, but you do it more strategically to borrow cheaply, to put aside some dry powder for that next acquisition or whatever it might be coming up. When you can use that cash flow to generate all of the excess business performance that creates the excess return, frankly, what we've identified over our history [is that] when you have a business return that's above your cost of capital and you can do that year in and year out, you have value creation that the market will ultimately turn to and appreciate over the full market cycles that we look to.

And that for us, we need some way to identify those businesses. That's where the screen that we have that cuts this big group of stocks: 4,000 publicly traded companies. We have a screen that brings that down, manifests that quality into a screen that then reduces it to about 300 companies that we ultimately choose from. And those businesses are built for that excess return generation.

CARLSON: How do you balance that looking for that long-term consistency with the fact that there are obviously companies that are newer or at least up and coming and creating those modes? I think that's got to be one of the hardest things to figure out is you've got this company with this great brand or whatever it is or this great business model, but then you maybe have these upstarts.

SCHOENSTEIN: GameStop, for example. Right?

CARLSON: Yeah. But then you have these upstarts coming in, you have these technology companies that are creating these new modes, it seems like in the past 10 or 15 years, in supplanting some of the old ones. So how do you balance that need for consistency in the past with potentially innovative companies coming in and creating their own modes?

SCHOENSTEIN: I'm not afraid to admit that sometimes there will be things that are disruptive, that can appear on the horizon. And we may not capture some of those things, but you have to keep in mind, this screen that we've been using. So, that screen I was referring to that cuts it down to about 300, it's a 15% return on equity every single year for 10 consecutive years at a minimum. Sounds like an exceptionally high hurdle to hit. Particularly, if you think about 15% as a business return. Cost of capital right now, we're nowhere close to 15%. So we're clearly in an era where it's easy to quote unquote "beat the cost of capital," but we want to see it across all sorts of different cycles. And this is, keep in mind, this has been around for 30 years, meaning that some of our first portfolios we're looking at track records back into the early '80s, maybe even the late '70s.

So, will there be times where something comes along, let's call it the hockey stick? Do we miss some of those hockey sticks on when they come out? Yeah, we miss some of those occasionally. But, conversely or, and as importantly, we also miss those hockey sticks when they reverse and not every one of those stays up the whole time.

The other piece to this that we've talked about with clients for a long time is as those companies reach a level of maturity and foundation of quality that we can then investigate and potentially look to, we can own them. And I would say that I don't think that you could say all the growth is suddenly gone because you didn't get the hockey stick at the beginning.

We own Apple. We own Alphabet. We bought them, frankly, not long after they got to that 10-year track record, assuming the valuation was appropriate and it was affordable with a margin of safety. And I would certainly argue that there's plenty of growth happening in both of those companies that hasn't yet happened, but will in the future, even if we missed some of that in the early days. What it boils down to I think is we want to avoid the big mistakes and that risk mitigation, by making sure the foundation is there, allows us to feel better about our chances of avoiding those big mistakes.

BATNICK: Now you're talking. I actually wrote a book called Big Mistakes, so you're pulling out my heartstrings. So, recently, I guess quality is in the eye of the beholder, even though it is subjective, you measure it in an objective way, but recently the [Financial Times] had this really interesting chart showing quality companies are trading at their biggest discount in two decades. And I'm thinking of, and not that I'm the axe on these companies by any stretch of the imagination, but companies like Unity and Snowflake and the Trade Desk and CrowdStrike and all these really traditionally expensive names that I don't think, they don't even have a 10-year track record, so they certainly wouldn't meet your criteria. But, what if there are sustained periods? Not, what if, there are. We're living in a sustained period where the market is favoring these high growth, really high valuation companies. Talk about the challenges of investing it through an environment like this.

SCHOENSTEIN: I'd say that probably one of the bigger challenges is that valuation piece that you referred to. It's one thing to invest in high growth companies. There's a lot of merit to that. We like high growth companies. Certainly let's be clear. We're not trying to buy, when I say consistent growth, we're not looking at, "hey, let's buy really slow growth companies." I love to buy really high growth companies, but I also want to make sure that we're not overpaying for them because you don't give yourself as an investor room for the valuation to run as the growth continues. Frankly, over our history, the predominant amount of returns that we have generated have been from the growth of the businesses, i.e., that business value and dividends act as a kicker. Very little of our return pattern has been from say multiple expansion.

But to the extent we do get multiple expansion, that also adds as an enhancement to the return because we ensure there's a margin of safety through our valuation discipline. Buying at any price, I think I heard this last year: it went from growth at reasonable prices to growth at any price to growth at stupid prices. We called it "silly" just to make it sound a little nicer. At those prices, you have very little room for errors should there be any kind of dislocation. And, yes, there's some other elements obviously with the Fed at very, very low interest rates, meaning everybody's crowding into the markets, but at some point there is going to be some challenges to that from a strictly valuation perspective. And those premium companies will not remain premium companies over that entire course and we'd like to protect against that sort of volatility that can come.

CARLSON: So you mentioned the macro stuff earlier and then the Fed and interest rates. I think that's one of the most bizarre things going on in the market right now. You have these inflation numbers coming in much higher and then you have bond yields continuing to drop. I guess, could you make the argument that these quality companies would actually do better in an inflationary period or just maybe better on a relative basis if we do have some sustained high inflation?

SCHOENSTEIN: I do believe they can do better in a more inflationary environment. Frankly, we've been hearing this already from the companies this year, and it goes back to that idea of the competitive advantages that they have, the market dominance and things like that. What you hear is a resilience to inflation because of the pricing power that they have. They can absorb those higher costs and still be able to generate profits. I mean, think about all the small businesses that are out there that are frankly unable to get key supplies or are being limited in how much they can buy and they're frankly losing money because they are literally sort of living order to order, day to day.

And when you have the types of businesses that we can look at, that's just simply not the case for them. They have that market presence and they provide key elements to whoever their customers are. And through whether it's network effect, key brands, patent protection, high switching costs, there's something that creates an element with their customers where their customers say, "I can't do without what you provide and my end clients can't do without what you provide, and so I'm willing to pay those higher prices." That inflationary element, frankly, would certainly in our minds be something that would be favorable to our businesses. And that would be something that would be differentiated against companies that don't have that same level of pricing power.

BATNICK: You're looking for companies that are growing. Obviously you're not looking for deep value companies that are growing because those are sort of diametrically opposed, but how do you think about the value overlay? And as we've looked back on markets, valuations have been rising over time. Markets in the '70s and '80s looked different than they do today. So how has your value discipline adapted with the times and how do you think about that overlay?

SCHOENSTEIN: The value of discipline for us is we're still doing it the same way we started doing it all those years ago. It's discounted cash flow models. It's building out what we think all of those future cash flows are going to be in the business and then discounting that back. I think the valuation overlay for us adds an element of rigor and risk mitigation because it helps us to be more comfortable that we've got a portfolio of businesses that have room to run, as I was saying a few minutes ago. And I think that for us, we're high conviction. We only own generally 25 to 30 companies today. We own 28 businesses. So, in a high conviction portfolio like that – that is actively managed – you need some rigor on the pricing side to make sure that you don't have sort of any sort of difficulties sitting in your portfolio.

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And the valuation overlay for us, yes, it shifts over time. And I'm certainly not going to sit here and try to tell you that our margins of safety are as wide as they were a decade ago. That just simply wouldn't be fair. But, because these businesses continue to grow through the cycle, we don't have to necessarily think or be as concerned about, well, yes, but it's fully priced today and there's no future growth, therefore it's overpriced potentially. As these companies continue to grind on and continue to generate growth moving up into the future, we can let the valuation continue to run up alongside that. Even as the valuation may look a little bit expensive, as long as the growth is still there, we're going to look at the valuation as a way to capture that growth as the price sort of oscillates its way up.

BATNICK: So let's say that you were the best business analyst in the world and you accurately forecast it to the penny, the future 10 years worth of cash flows or whatever you're modeling. What sort of discount rate are you using, because obviously that has an enormous impact, and does that differ from business to business? And how do you think about discounting all those future cash flows back to the present?

SCHOENSTEIN: It does differ from business to business. Frankly, we actually look at a number of metrics on what we call our dashboard. It's a valuation dashboard with all sorts of different things on it. The two key areas, there's different ways to look at this kind of cash flow. You could frankly produce a discount rate that's the same for every company and say, okay, treat it like an internal rate of return. This is what I expect and there you go. The other way would be create a discount rate that's responsive to each and every one of your securities based on relative risk and inside the business and things like that. Frankly, our dashboard encompasses both. So we have one set of discounted cash flow opportunities that are based on the same discount rate for every company and one that's based on a different discount rate for every company.

We have data that supports that supplied by third parties. We do our own analysis to try to ensure that we've got a discount rate that's accurately reflective or as best we can reflective of the risks in the business, the correlations that make sense. It's very statistically driven, certainly. And we use both of those against each other to make sure that we can say, "yes, we believe this stock is attractively valued under both metrics." If it was only attractive under one versus the other, then we'd have to think a little bit harder about it. But I do think that the discount rates idea certainly we've had to adjust over time to think differently about it, but it hasn't been something that has drastically changed other than certainly the risk-free component has obviously compressed. And so therefore the overall discount rates have come down.

> *"There's a natural alignment or correlation with ESG as a way to reduce risk in a portfolio and quality growth, which is what we're ultimately trying to pursue ... What we end up with is almost what we would call **a dual mandate**. It can be value-aligned with our client's values and also be a good quality growth portfolio from an investment return perspective, and the two can ... operate side by side."*

CARLSON: So reading through some of your old letters, I found it interesting. You said that your quality screen, that you've been talking about having that high ROE over time has actually helped you avoid the energy sector, which over the past decade has probably been the worst performing sector, so, I'm sure it's worked out great for you. But you also said that your portfolio companies have played this prominent role in reducing greenhouse gas emissions. So, was that an actual choice you guys made to have this almost ESG, [Environmental, Social, Governance,]component to the portfolio or is that just an outcropping and an unintended consequence of having higher quality companies? Is ESG almost a quality screen at this point now?

SCHOENSTEIN: Yeah. That's a very good way to think about it. I think you could argue that in a manner of speaking, ESG is a way of finding another way to screen for quality. Now, the energy piece is a by-product of the higher return on equity screen. And that's simply because if you think about it, we didn't start out just to exclude any sectors, but sectors that can't produce the consistency we demand won't qualify. It doesn't mean they aren't good businesses in some way, shape or form, but they just simply won't qualify.

Commodity costs related to oil and gas mean $140 oil, everything's a home run. $40 oil, everything's much, much more challenging. So we're naturally fossil fuel-free as a consequence of the screen. The ESG part of it, which is a little bit further than just simply fossil fuel-free, it really is more of a framework or a lens that looks at it and says, "You know what? Good environmental practices, good social practices, good governance policies. Those are all good business practices or business policies." And, therefore, there's a natural alignment or correlation with ESG as a way to reduce risk in a portfolio and quality growth, which is what we're ultimately trying to pursue. So what we end up with is almost what we would call a dual mandate. It can be value aligned with our client's values and also be a good quality growth portfolio from an investment return perspective and the two can frankly operate side by side. And the other piece that we've now added to this, where the data shows up, is on the carbon side, where you're seeing scope one, scope two emissions being much lower as an overall perspective for our portfolio.

This is an evolving area. I think there's going to be more work to be done by us and by others frankly, because how do you go deeper and think beyond simply say carbon offsets and, actually, what is true reductions of carbon rather than just net zero through some sort of offsets or things like that. We're going to think about those things too and that gets into other elements, but these companies across the board by and large are looking for ways to be good stewards, be good employers, reduce their footprints. All of those things frankly serve the business at the same time they serve some of those stakeholders that are interested in those outcomes.

BATNICK: Eric, I think a good way to bring this home is to talk about the portfolio. So you run a concentrated portfolio, 25 to 30 holdings, which I love. I feel like if you're going to pay an active manager, you want an active portfolio, a portfolio that looks different from the index. So I love that part of it. Can you talk about holding period turnover? How you enter a position, how you exit it, that sort of stuff?

SCHOENSTEIN: You're absolutely right. We talk with our clients all the time. If you're going to own something active, have it truly be active in that quasi index. That's the only way you can have it truly be something differentiated. Turnover for us is, again, sort of as a consequence of the idea that we want to invest in these companies over full cycles is relatively low. Since inception of our funds, which was 1992, it's been basically in the mid-teens. If you think about it, if the company does what we expect or even exceeds expectations on the fundamental side of things, the business performance side of things, and doesn't get overpriced in the market, I'll hold onto it. Frankly, I might hold onto it forever. We've held companies for 10, 15, even 20. And I can think of one that was in the portfolio for 26 years.

BATNICK: How hard was it to let that go?

SCHOENSTEIN: Well, for those of us who've been around here a long time, there was a little emotion involved. Some of the newer folks, maybe not so much. I think it was more, just a hallmark of the way we invest. And it's not that we don't want turnover, but we want to make sure that we're controlling the reasons for the turnover. It's because we found something that can upgrade the portfolio from a fundamental perspective. Or we've found something that frankly is even cheaper than what we already own in the portfolio and we'll create that turnover rather than having the other elements outside of our control do that for us.

And that's again where we also then want it to be truly active with a limited number of holdings because we can concentrate on what we see as the very best ideas. And the thing I would say is, we're not trying to find the 25 to 30 fastest growing companies. We're not trying to find the 25 to 30 cheapest companies out of our universe. We're trying to find the 25 to 30 best combinations of fundamentals and valuation and allow them to work in concert together. We absolutely will sell positions and we absolutely will look to upgrade. Generally, we're going to buy a new company, but at least 1% just to have it be meaningful when you're dealing with a 28 stock portfolio. But depending upon our conviction, we may make it a bigger position. And that's just something that we manage stock by stock.

CARLSON: Thanks Eric. Where can we send people to learn more about your strategy or funds or your company? Where should they go?

SCHOENSTEIN: The best place to get it all is just right through our website. It's actually been redesigned and has a lot of great information on it: jenseninvestment.com. It lays our strategies. It lays out a lot of information. A lot of our insights are there. I think it's probably the best composite of everything we do.

BATNICK: Great. Thanks for coming on.

SCHOENSTEIN: Appreciate it. Thanks guys.

CARLSON: All right. Thanks to Eric. Thanks to Jensen Investment. Again, go to jenseninvestment.com and check out more from them. And send us an email: animalspirits@gmail.com.

BATNICK: Nope. animalspiritspod@gmail.com.

CARLSON: Animalspiritspod@gmail.com. One of those. Thank you.

BATNICK: We'll see you next time.

Definitions

Free Cash Flow: Is equal to the after-tax net income of a company plus depreciation and amortization less capital expenditures.

Basis Point: Is a value equaling one one-hundredth of a percent (1/100 of 1%).

Dry Powder: Cash reserves kept on hand by a company.

Institutional Shareholder Services (ISS) Environmental Social Governance (ESG) Corporate Ratings: Provides ESG data and performance assessments on companies, countries and green bonds to offer investors insight on the carbon footprint of public equity portfolios. Companies are assessed against a standard set of universal ESG topics, as well as additional industry-specific topics, and are measured based on self-reported data verified by the ISS. For companies that do not report emissions data, ISS ESG applies its 800 sub-sector specific models to estimate their emissions. ISS ESG then applies approximately 100 social, environmental, and governance-related indicators to calculate each rating. For more information on the ISS ESG methodology, please visit: www.issgovernance.com/file/publications/methodology/Corporate-Rating-Methodology.pdf.

Margin of Safety: A principle of investing in which an investor only purchases securities when their market price is significantly below their intrinsic value. In other words, when the market price of a security is significantly below your estimation of its intrinsic value, the difference is the margin of safety.

Return on Equity: Is equal to a company's after-tax earnings (excluding non-recurring items) divided by its average stockholder equity for the year.

S&P 500 Index: The S&P 500 Index is a market value weighted index consisting of 500 stocks chosen for market size, liquidity and industry group representation. The Index is unmanaged, and one cannot invest directly in the Index.

Scope 1—Energy Direct Emissions (tCO_2e): This factor provides the issuer's Scope 1 Direct emissions (tCO_2e), which includes owned and controlled sources. The Direct emissions data represents the final, Institutional Shareholder Services (ISS) ESG reviewed and approved value based on the ISS ESG methodology, which selects the most accurate value from available sources.

Scope 2—Energy Indirect Emissions (tCO_2e): This factor provides the issuer's Scope 2 Energy Indirect emissions (tCO_2e), which includes indirect emissions from purchased energy. The Energy Indirect Emissions data represents the final, ISS ESG reviewed and approved value based on the ISS ESG methodology, which selects the most accurate value from available sources.

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