Sustainable investment report: ESG – a key tool for emerging and frontier market investments
About East Capital

East Capital is an independent asset manager specialised in emerging and frontier markets, founded in Sweden in 1997, with offices in Dubai, Hong Kong, Luxembourg, Moscow, Oslo, Stockholm and Tallinn. We manage public and private equity funds, real estate funds and separate accounts, for a broad international client base, including leading institutions.

Our investment strategy is based on extensive company knowledge gained through proprietary fundamental analysis and frequent company meetings. We incorporate ESG-related risks and opportunities in our investment process, and favour companies with long-term, sustainable growth perspectives and responsible owners.

As one of the most prominent investors in Eastern Europe and Russia, East Capital has invested in the former Soviet bloc for 20 years. Building on our emerging and frontier market experience, we expanded our investment scope to emerging Asia in 2010, and moved into global frontier markets in 2014.

Frontier and emerging markets have been converging towards developed markets, resulting in long-term growth and structural growth in many sectors. However, emerging and frontier markets are not fully efficient. Information is often incomplete, or not timely available or easily accessible. There are large discrepancies in the performance of companies and in the risk perception of investors.

We believe that by being on the ground, frequently meeting the ‘right’ people at companies, doing proprietary research, applying an active shareholder/ESG approach and focusing on companies with long-term growth prospects, we can generate superior returns.

Long-term
Company fundamentals such as attractive valuations, stable cash flow, strong growth and high dividend yields matter over time.

Global research platform and seasoned regional teams with local know-how

- 5 research/investment offices
- 27 investment professionals
- 20 languages

We position our strategies to outperform the respective benchmarks over a period of three to five years, but with the ability to make short-term allocations.

Local
Frequent company meetings are vital for making informed investment decisions and monitoring existing holdings. We actively seek to establish and maintain unique access to management teams, owners and policy makers.

Research-driven
Diligent research is essential for identifying key performance drivers and correctly assessing risk. We rely on our own research, including risk scenarios and a proprietary ESG analysis, in our investment process.

Active stock pickers
We employ index-agnostic idea generation and invest with conviction on a company-to-company basis. Meeting companies is an integral part of the investment process. We like to “discover” new companies, and have a general bias towards small and mid-caps.
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A hands-on approach to addressing sustainability

East Capital, founded in 1997, is celebrating 20 years of emerging and frontier market investments in 2017. Since day one, we have set out to be a long-term, active and responsible owner. With this perspective, we believe in investing in companies that are fit enough not only to survive, but to prosper over time. This includes identifying, assessing and addressing any risk or opportunity that we believe may impact the performance of the company. This is what, in the investment industry, has become commonly known as integrating ESG (environmental, social, governance) factors. We are certain that a combination of global sustainability-related factors, such as climate change, resource scarcity, inequality, corruption and digitalisation, will disrupt most, if not all, industries over time. Our responsibility as investment manager is to identify the companies with teams and strategies that will thrive in a world in which we expect things will need to be done very differently.

» I am very happy to see sustainability climbing on many corporate agendas in emerging and frontier markets. It is also reassuring. Corporates — across all markets — will need to take bold steps to contribute to achieving the 17 UN Sustainable Development Goals that were agreed in 2015, and which constitute a business plan for achieving a new, universal, sustainable development agenda by 2030.

It is very clear that there is no one model for investors wanting to integrate ESG. From our perspective, investing solely in emerging and frontier markets, we have concluded that an active, hands-on approach is a prerequisite to integrating ESG related risks and opportunities in our work. Our senior investment professionals have together logged a total of 120+ years in these markets, and will bear witness to the fact that there are no shortcuts to making sound long-term investments. It requires being on the ground, seeing things with our own eyes, asking the right questions and drawing conclusions for the long term. We remain confident that ESG and sustainability is not about ticking a box. It is about making better-informed investment decisions to allow us to deliver on our overall aim: attractive long-term returns for our investors.

It comes down to identifying and gaining exposure to the sectors and companies you believe make sense for the long term. When East Capital started investing in the Russian stock market in 1997, most of our competitors saw a country of oil, gas and minerals. We, instead, have always seen a market of more than 140 million consumers and the emergence of a middle class. Moreover, we have always focused on companies that place an emphasis on good corporate governance, by getting to know the owners and managers and confirming that they treat minority shareholders right. The combination of these factors often resulted in investments in some of the best managers and entrepreneurs in Russia. Our way of working resulted in our Russia fund becoming the best-regulated onshore fund in the world, among 94,000 available...
funds, during the first decade of the new millennium, which underscores the clear benefits of classic ESG integration.

Since then, we have consistently worked on further developing how we address sustainability and ESG to ensure that we are able to offer sustainable investment products to our clients (read more about our sustainability journey on page 26). At the end of 2015, we took the next bold step with our decision to create our first thematic product: East Capital China Environmental, which was launched in early 2016.

China’s monumental environmental challenges are well-known to most, from media headlines or from visits to China. The very strong commitment, and extensive policies and initiatives currently being implemented by the Chinese leadership to address the situation should be taken as inspiration for leaders all over the world. Furthermore, it is an excellent example of how a nation can transform dire challenges into attractive opportunities for future growth. China is already home to the largest listed cleantech universe in the world, and many of the global leaders in renewable energy and water solutions have sprung from Chinese entrepreneurship. China’s headship is and will remain especially important when we need to accept the fact that the US, following the election of President Trump, may significantly revise or even withdraw from its commitments to combat climate change.

 Already today, companies inadequately addressing sustainability-related opportunities and risks stand out as laggards, and are thereby much less attractive as investments. It is especially inspiring to meet companies, particularly in China, that are ready to become global solution providers to our common sustainability challenges, and to see the potential impact of their business ideas.

Louise Hedberg
Head of Corporate Governance and Sustainability

We are proud and excited to be able to offer an attractive investment product for investors who are ready and eager to contribute to the imperative of shifting private capital from the companies that are part of the problems, to those solving them. And we are even more so after the

In 2016, East Capital was proud to:

- see the launch of our first thematic product: East Capital China Environmental
- receive our first independent sustainability label - the new LuxFLAG Climate Finance label
- launch our proprietary ESG scorecard, ensuring that we fully integrate ESG in our investment process
- publish our first Sustainable Investment Report
- log more than 1,000 company meetings
- work on 20 major company engagements, predominantly on governance topics...
- ...and contribute to an additional 9 engagements, predominantly on social issues, as members in an external engagement forum
- participate in 10 engagements with governments, regulators and policy makers
- nominate and elect 21 independent directors
- expand our voting activity from 39% to 64% of our AUM

Louise Hedberg
Head of Corporate Governance and Sustainability

We are celebrating 20 years as an emerging and frontier markets specialist during 2017. The many thousands of encounters with entrepreneurs, management teams, employees and other stakeholders we have had during this time, have taught us a lot. Like to take the opportunity to ask questions, to listen and learn something new. And, not least, to look beyond headlines and traditional perspectives, be it the composition of the index, cultural myths or other preconceptions, to form our own opinion of what investments makes sense for the long term. The tangible results we have achieved so far, and our confidence that we will contribute to continuing the advancement of sustainability in our investment universe, inspire and unify our entire company in our daily work. And we will continue to “go our own way,” wisely leveraging our extensive knowledge, experience, local resources and networks in emerging and frontier markets to make sound investments and generate attractive returns.

Peter Elam Håkansson
Chairman and Chief Investment Officer

Louise Hedberg
Head of Corporate Governance and Sustainability
**East Capital as owner**

There are three main characteristics that define our role as owner:

**We are long-term**  
We see beyond the short-term gain and look for long-term investment value

**We are active**  
Face-to-face involvement through company visits helps us make better-informed investment decisions, and we constructively engage on issues that are important to us as owner

**We are responsible**  
Our fundamental bottom-up research process addresses and integrates investment risks and opportunities associated with relevant and material environmental, social and corporate governance factors

**Confirming alignment with the main owner**

When contemplating an investment in a new company, understanding the shareholder structure is key. So, the first page we turn to in the annual report is the list of shareholders. Is there a controlling shareholder? What are the incentives and goals of this shareholder and how do they align with those of us as minority investors? Meeting the main shareholder constitutes an important part in determining alignment. We also aim to use such meetings to build trusting relationships for the future where we can maintain an open dialogue on the company’s progress and, if needed, also be able to convey any constructive suggestions we believe may generate and support shared value creation for all shareholders.

We encourage all companies’ management teams and boards to make sure that rigorous analyses are done to 1) identify and prioritise their relevant and material environmental and social factors on a market, sector and operational level, and 2) address and integrate these into the company’s strategy. We see this as an additional responsibility under good governance, making companies better positioned to react to changes in regulation, consumer demand and other developments, thereby ensuring that they remain relevant in the long term.

**Putting theory into practice**

In 2010, East Capital decided to evaluate and formally structure and document the more practical ESG-related tools that were being used in our investment activities. A new global specialist function – Head of Corporate Governance and Sustainability – was added to the investment team. This role reports to the CIO and is responsible for overseeing the implementation of the ESG perspective in East Capital’s investment activities, from practically managing the ESG tools, such as screening, voting and engagement, to supporting the investment team in identifying and interpreting the impact and consequences of existing and emerging ESG related factors on issuers and portfolios. Instead of having a dedicated ESG team, all analysts, portfolio managers and portfolio advisors are actively involved in ESG matters as part of their everyday work; through the completion of ESG scorecards, participating and contributing in engagements and proposing and deciding on voting instructions.

As part of the investment team, the Head of Corporate Governance and Sustainability also ensures that relevant and material ESG matters are reported and discussed in daily morning meetings, as well as the regional monthly meetings. An ESG report, updating on the status and results of each of our ESG pillars, is presented to both the Board of Directors and the Investment Committee on a quarterly basis.

**A number of policies guide us in our everyday work as responsible investors:**
- Ownership policy
- Exercising Voting Rights policy
- Conflicts of Interest policy

**Internally, we are furthermore guided by a number of documents, including:**
- Code of Business Conduct
- Procedures against money laundering and terrorist financing policy
- Whistleblowing policy
- Gifts and benefits in external relations policy
- Equality and diversity policy
- Personal trading policy
- Environmental instructions

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Sharing our perspectives on ESG

During the year, members of East Capital’s investment team spoke and presented on sustainability related topics at several conferences and other relevant events in our investment universe.

Notably, our Chairman and CIO, Peter Elam Håkansson, was invited in October 2016 to the VTB Russia Calling Conference, the largest annual investor event in Russia, to participate in a panel together with President Vladimir Putin. Russia has fallen from the 6th to 14th largest economy in the world and the stock market is down 50% since 2011 and 60% since 2008. While this may deter investors with more limited insight into Russia, East Capital sees this as a clear potential for Russia to become one of the best stock markets globally in the coming years.

As the only international portfolio investor represented on the conference agenda, East Capital took the opportunity to present our reflections on how Russia can realise this potential. Peter Elam Håkansson’s speech focused on six main areas:

1. Fuller usage of Russia’s competitive position: Russian wage levels are very competitive on a global basis and the educational level is high. That ensures a strong competitive position. In 2015, the Russian industrial monthly wage was 500 USD, and in China it was 700 USD.

2. Lower interest rates: Inflation has come down from a peak of 15% in 2015 to around 6% at the end of 2016. Lower interest rates imply more attractive mortgage rates, fueling housing demand. The current average mortgage rate is 12% and we expect these rates to fall below 10% next year. This is crucial, as at present levels, only 20% of the population can afford a mortgage, but below a 10% mortgage rate level, twice as many would.

3. More reforms: The economy needs further support, and requires several structural reforms. Russia is understood to be working on a reform agenda to be implemented after the 2018 election. We would urge Russia to start already now.

4. Fiscal rule: We would also welcome fiscal rule, which implies that when the budget runs at a deficit, it is time to review the spending. Balancing the budget leads to macroeconomic stability over time and better valuations by the financial markets.

5. Reliable and stable dividend policy in state-owned companies: The 50% payout ratio for dividends in state-owned companies has been very much discussed. We would welcome it being fully implemented without exceptions. It means that state-owned companies will have to focus even more on allocation of capital and investments. This is good corporate governance. We have seen some really good examples of this already but more can be done. Implementing all this will lead to increased market values for these companies. Increased market values will also mean more income from the coming privatisations of state-owned companies. This is a win-win for the state with more income from dividends and higher valuations when selling shares in the privatisation. Needless to say, it will also benefit the stock market.

6. Rouble strength: We actually think we will see capital inflows rather than outflows. This, together with a more stable oil price, will help to strengthen the rouble.
East Capital launches environmental strategy to engage in China’s “War on Pollution”

Anyone who doubts the volume of investments required to address China’s environmental challenges should go to Beijing and smell the air. In 2016, the city experienced 76 days that recorded an Air Quality Index rating worse than ‘very unhealthy’ – implying that the air was worse than the smoking room of a US airport.

In addition to the bad air quality, as much as 30% of China’s water resources are not fit for consumption because of pollution. Under the previous five-year plan (2010-2015), China started to allocate a substantial amount of investment to environmental protection markets. Focusing initially on air pollution-related issues, the country became the largest cleantech market in the world. Under the current five-year plan (2016-2020), China has set out to double its investments in environmental protection, with a budget of RMB 10tr (USD 1.5tr) – representing an annual spending equivalent to Denmark’s or Singapore’s GDP. This confirms that environmental protection is a true priority for the Chinese government, while also enabling Chinese companies to cement their dominant position globally. A significant amount of the Chinese budget will be in public-private partnerships, with over 1,000 projects announced, accounting for RMB 2tr. Though a significant part, 17%, of the five-year plan is air related, the biggest recipient is water, accounting for 49% of the RMB 10tr.

2016 was a pivotal year for environmental protection industries in China, with a number of major environmental regulations and targeted policies released. At a global level, China ratified the United Nations Paris Agreement on Climate Change in September 2016, and in December, the National Development and Reform Commission (NDRC) confirmed the launch of a nationwide carbon market in 2017. We welcome these developments and look forward to potential benefits for new energy vehicle producers, as they are expected to be included in the Chinese emission trading scheme.

In May 2016, a year after having introduced the ground water pollution prevention plan and two years after the release of the air pollution plan, the NDRC also issued its “Soil Pollution Prevention” plan to curb worsening soil pollution by 2020 and to improve soil quality by 2030. In November 2016, the NDRC released the draft for the five-year plan for urban sewage treatment and water recycling. RMB 592bn (USD 85bn) will be invested in municipal wastewater treatment in the coming 5 years. Under this very supportive fiscal environment, we expect water infrastructure to deliver a strong performance versus other investment alternatives, thanks to a stronger-than-expected project pipeline.

In early 2016, we refocused our China strategy into an environmentally-themed strategy, solely investing in products and technologies that bring sustainable development solutions to environmental challenges in China. East Capital China Environmental is today the world’s only UCITS fund that contributes to China’s “war on pollution” by investing in clean energy, clean water and air, clean transportation, energy efficiency and environmental resources.

Thanks to China’s efforts under the 12th and 13th Five-year plans, China has become the largest cleantech market in the world, where we expect many of today’s domestic champions to become tomorrow’s global leaders.

François Perrin
Portfolio Manager
East Capital China Environmental is able to invest in both listed onshore A-share market (through Stock Connect) and the offshore H-shares which, together, provide access to more than 350 companies that currently offer exposure to environmental protection industries in China. The total market capitalisation of the 100 largest Chinese environmental companies doubled from USD 310bn at the end of 2009, to USD 600bn by the end of 2016, a development reflecting the growth of the sector, today representing an impressive 33% of the global environmental universe in terms of market capitalisation.

Francois Perrin
Portfolio Manager

**Portfolio split by sub-sector, %**

- Clean Water & Air: 25.9
- Clean Transportation: 25.4
- Energy Efficiency: 20.2
- Clean Energy: 16.4
- Environmental Resources & Assets: 8.8
- Cash: 3.2

Sources: East Capital, Bloomberg, all data as of 30 December 2016.

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**Examples of holdings**

**Beijing Origin Water**

In clean water, Beijing Origin Water, the leading Chinese manufacturer of membranes for water and wastewater treatment, is worth mentioning. With 80% market share in China, a strong growth profile and reasonable valuation, the company stands out as a typical domestic champion, with the ability to become a world leader in its industry, leveraging on the support of the government and the international opportunities under the One Belt - One Road strategic initiative.

Felicia Hong, Dmitriy Vlasov and Francois Perrin about to meet with the management of Beijing Origin Water.

**BYD**

In the new energy vehicles space, BYD ("Build your dream"), the world’s largest new energy vehicle company in terms of cars sold – ahead of Tesla – is among our holdings. BYD experienced 87% growth in profits year-on-year for the first nine months of 2016, and 80% growth in sales, to 110,000 units in the same period. Under the 13th Five-year Plan, China aims to have five million new energy vehicles on the road by 2020.

BYD is the only company in the world that has a presence along the entire value chain of new energy vehicles, with technologies in batteries, motors and control systems. It is also the world’s leading manufacturer of electric buses.

**China Longyuan Power**

In wind operation, China Longyuan Power, the largest domestic wind operator with 20GW of capacity installed, also constitutes an attractive investment opportunity. Trading below replacement cost, the company is the first wind developer in China to reach free cash flow positive. It will continue to benefit from operational leverage due to the strong focus of the government on reducing the curtailment rate in the northern part of the country.

In 2016, China installed 23.3GW of wind power capacity which is the largest amount in the world, almost three times the 8.2 GW of the US, which took second place.

East Capital China Environmental was one of the first three funds in the world to be awarded the new ‘LuxFLAG Climate Finance’ label by the Luxembourg Finance Labelling Agency in 2016. The label certifies that the fund invests at least 75% of its total assets in companies with a clear and direct link to climate change mitigation and/or adaptation.
ESG in each step of the investment process

East Capital's investment process is designed to systematically select the companies with the best risk/return profile. All East Capital strategies are following the same investment process, adopted for local market conditions. During 2016, we took further steps in confirming that relevant ESG considerations are integrated into each step of our investment process.

**Screening**
The overall investment universe is divided into regions, countries and themes and screened by market cap, free float, liquidity filters and sector exclusion criteria (tobacco, weapons and pornography).

**Idea generation**
The focus lies primarily on companies benefiting from structural growth. Long term ESG developments may impact our view on the attractiveness of different themes. Investment themes are used in idea generation, but not solely.

**Fundamental research**
Company meetings are an integral part of the investment process to support and complement the fundamental analysis. Proprietary research is performed on revenue drivers, cost drivers, competitive strength, financial capabilities, management and on ESG factors such as ownership, management, placements, dividends, extraordinary events, accounting, audit, environmental and social factors, corruption and ethical issues.

By combining both proprietary financial analysis and our ESG scorecard, our fundamental analysis helps us identify sustainable companies with capacity to perform and create value over the long term:

- **Positioning** - Is the company well positioned in a market we believe has solid structural growth prospects? Will the company benefit from disruption in certain industries?

- **Corporate Governance** - Who are the main owners? Are their incentives fully aligned with minorities? Is appropriate accountability ensured and capital allocated in a transparent, efficient way? Does the company act with integrity in a way which minimises risk for corruption?

- **Environmental & Social factors** - Does the company demonstrate a clear understanding of relevant and material environmental and social issues, and how these are likely to change over time? Is the company able and willing to adapt to these issues?

**Portfolio construction**
Key Active Positions* Overweight (>1.5% versus benchmark weight) meet several criteria: quality companies with a significant upside, quality management/owners and strong ESG standards in accordance with the proprietary ESG scorecard. These companies we endeavour to meet four times each year, we engage as active shareholders, create our own model and research to understand key performance drivers in detail.

**Implementation & monitoring**
Apart from regular risk reporting, all portfolios are screened for norms-based controversies twice per year. Our ESG scorecards are reviewed annually, or upon a major event, and voting and engagement activities are carried out continuously throughout the year.

* Key active positions (“KAP”) are our largest overweight positions, several of which are not in the benchmark or, in other words, represent how we deviate from the broad market.

The investment process is designed to systematically select the companies with the best risk/return profile and combine them in the portfolio:
ESG related tools at East Capital

The practical ESG tools currently used in our investment activities are organised in four pillars: sector exclusions (negative screening), controversy (norms-based) screening, proprietary ESG scores, as well as voting and engagement. The third pillar was introduced in 2016 and it further structures, refines and documents how we assess and integrate ESG related risks and opportunities in our investment process. All tools apply to all East Capital strategies.

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<thead>
<tr>
<th>ESG pillar 1: Sector exclusions (negative screening)</th>
<th>ESG pillar 2: Controversy (norms-based) screening</th>
<th>ESG pillar 3: Proprietary ESG scores</th>
<th>ESG pillar 4: Voting and engagement</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>WHAT:</strong></td>
<td><strong>WHAT:</strong></td>
<td><strong>WHAT:</strong></td>
<td><strong>WHAT:</strong></td>
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<tr>
<td>• All portfolios exclude companies that are known to generate significant share of revenues from:</td>
<td>• Semi-annual screen and &quot;alerts&quot; in between</td>
<td>• 10 Red Flags section + more extensive ESG scoring section</td>
<td>• Active ownership to add value post investment</td>
</tr>
<tr>
<td>- Weapons</td>
<td>• Alerts us of suspected breach of international conventions and norms on human rights, labour standards, environment, health &amp; safety or bribery</td>
<td>• Leverage our unique resources, experience and track record in EM and FM</td>
<td>• Communicate our views and expectations as owner</td>
</tr>
<tr>
<td>- Tobacco</td>
<td>• Input for dialogue and engagement</td>
<td>• Focus on most relevant and material ESG risks AND opportunities in our markets</td>
<td>• Initiate engagement where relevant</td>
</tr>
<tr>
<td>- Pornography</td>
<td><strong>HOW:</strong></td>
<td><strong>HOW:</strong></td>
<td><strong>HOW:</strong></td>
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<tr>
<td><strong>HOW:</strong></td>
<td>• Screening implemented in analyst’s/PM’s initial analysis</td>
<td>• External research partner</td>
<td>• External research partner</td>
</tr>
<tr>
<td>• External screen available if uncertain</td>
<td>• Portfolios re-confirmed annually, controversial weapons confirmed semi-annually</td>
<td>• Start with Red Flags for all holdings, full ESG score for all Key Active Positions</td>
<td>• Proxy voting</td>
</tr>
<tr>
<td>• Portfolios re-confirmed annually, controversial weapons confirmed semi-annually</td>
<td><strong>ESG pillar 1:</strong> Sector exclusions (negative screening) Since 2007</td>
<td>• Scores reviewed annually or upon major event</td>
<td>• Filing shareholder proposals</td>
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ESG pillar 1:
Sector exclusions (negative screening)

**Background**
Ten years ago, in 2007, we decided to exclude certain sectors that we do not believe offer our clients attractive prospects of long-term returns. The sectors we identified were tobacco, weapons and pornography. The obvious negative social impact of these sectors, and the significant costs they generate for society, have convinced us that they do not make for appealing long-term investments.

In our view, these exclusions have resulted in a non-significant reduction of our investment universe. And rather than creating a “special” fund that excludes these sectors, we decided from the outset that it made better sense to apply this restriction to all our fund products.

The criteria are confirmed upon investment in a new company and the process and exclusion thresholds are reviewed annually in conjunction with reconfirming that all portfolios are still in compliance with the exclusion criteria. Compliance with the controversial weapons criteria, i.e. Cluster munitions, Anti-Personnel Landmines, ABC-weapons, Nuclear Weapons, and similar, is confirmed semi-annually by our external research consultant, GES Investment Services. If the investment team was to come across a breach of any of the exclusion criteria, the team would initiate a divestment of such holdings.

**Results 2016**
No breaches were identified during 2016.
ESG pillar 2: 
Controversy (norms-based) screening

Since 2010, East Capital has been conducting controversy screening on all portfolios, using an external research partner, GES Investment Services. The screening alerts us of any holdings that are alleged to conduct business in a manner contrary to well-established and generally agreed international norms on ESG issues, based on the prerequisite that companies have a responsibility to comply with international norms even though they are not legally bound to.

This means that companies are systematically monitored regarding their compliance with international conventions and guidelines on human rights, labour rights, environment, corruption and controversial weapons. The scope is based on the ten principles of UN Global Compact, which are derived from: the Universal Declaration of Human Rights, the International Labour Organization’s (ILO) Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention Against Corruption.

GES’ research process seeks to deliver timely, actionable information on issues identified as having severe consequences from an environmental or social perspective. The analysis includes an assessment of the company’s response to the event, as well as an evaluation of relevant policies, management systems and the company’s implementation thereof, in order to understand the risk of the company being involved in similar controversies in the future. The criteria for the controversy screening process are decided, reviewed and updated by GES, whose team has a long experience of this type of norms-based assessments.

Rather than automatically divesting companies with reported allegations, East Capital has decided to use the screening results and conclusions as an input for any decision to initiate an engagement dialogue with the company, either on our own or together with other investors, in order to suggest and encourage that the company responds to and, if needed, improves on the specific issue. East Capital’s experience has shown that an engaged and constructive dialogue will more often lead to convincing the company to initiate positive change – as opposed to simply exiting the investment. We are, however, upon severe and systematic breaches or where active shareholder engagement is deemed to have limited effect – as a final resort – either ready to refrain from investing or exit our holding. Read more under Engagement on page 17.

Results 2016
During 2016, GES worked on evaluating a total of 19 cases of potential norms-based violations in 13 different companies in our portfolios. Of these, 8 cases were old cases that emerged before 2016, while 11 emerged during the year. At year end, 14 of the cases (in 10 companies) were still open. See graph and some example cases in the table on the next page.

Open evaluation cases split by type of issue, %

<table>
<thead>
<tr>
<th>Type of Issue</th>
<th>%</th>
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<tbody>
<tr>
<td>Environmental issues</td>
<td>57.1</td>
</tr>
<tr>
<td>Social issues</td>
<td>21.4</td>
</tr>
<tr>
<td>Governance issues</td>
<td>21.4</td>
</tr>
</tbody>
</table>

As of 31 December 2016

UN Global Compact’s ten principles

<table>
<thead>
<tr>
<th>ALL BUSINESSES SHOULD » » »</th>
<th>Human rights</th>
<th>Labour standards</th>
<th>Environment</th>
<th>Anti-corruption</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Support and respect the protection of internationally proclaimed human rights</td>
<td>Human rights</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>Make sure that they are not complicit in human rights abuses</td>
<td>Labour standards</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td>Uphold the freedom of association and the effective recognition of the right to collective bargaining</td>
<td>Labour standards</td>
<td></td>
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<tr>
<td>4.</td>
<td>Uphold the elimination of all forms of forced and compulsory labour</td>
<td>Labour standards</td>
<td></td>
<td></td>
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<tr>
<td>5.</td>
<td>Uphold the effective abolition of child labour</td>
<td>Labour standards</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6.</td>
<td>Eliminate discrimination in respect of employment and occupation</td>
<td>Labour standards</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7.</td>
<td>Support a precautionary approach to environmental challenges</td>
<td>Environment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8.</td>
<td>Undertake initiatives to promote greater environmental responsibility</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9.</td>
<td>Encourage the development and diffusion of environmentally-friendly technologies</td>
<td></td>
<td></td>
<td>Anti-corruption</td>
</tr>
<tr>
<td>10.</td>
<td>Work against all forms of corruption, including extortion and bribery</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Case description</td>
<td>Related norms/principles</td>
<td></td>
<td></td>
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<tr>
<td>-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>---------------------------------------------------------------------------------------------------------------</td>
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</table>
| In January 2016, Amnesty International and Afrewatch, published a report listing several electronics companies across the world, including some of our holdings in Asia, as potentially using suppliers that source cobalt extracted by illegal artisanal miners in the southern region of the Democratic Republic of the Congo. This type of mining is associated with an elevated risk for child labour, and often implies a very hazardous working environment. **Action:** East Capital decided to engage through various initiatives as well as initiate a dialogue directly with the company in scope to encourage greater transparency on supply chain issues, including cobalt.                                                                 | - UNGC Principle: 1 & 5  
- OECD Guidelines for Multinational Enterprises: V  
- UN Guiding Principles on Business and Human Rights: Chapter 2                                                                                      |
| In recent years, one of the Russian oil companies in our Russia fund has experienced a series of oil spills and accidents, including both minor incidents and some more severe and even fatal. **Action:** East Capital has been in contact with the company to try and assess if the recurring nature of the incidents should be seen as an indication of insufficient procedure for maintaining higher health, safety and environmental standards.                                                                 | - UNGC Principle: 1, 7 & 8  
- OECD Guidelines for Multinational Enterprises: V & VI  
- UN Guiding Principles on Business and Human Rights: Chapter 2                                                                                      |
| Recurring reports alleging child labour, excessive overtime, and health and safety violations in the operations and supply chain of one of our Asian holdings indicated an elevated risk for insufficient labour standards within the group. The company has since audited all its suppliers’ facilities which revealed certain issues relating to labour rights which the company promised to correct, but no instances of child labour. **Action:** The company is kept under evaluation, and future engagement can hopefully lead to positive improvements.                                                                 | - UNGC Principle: 4, 5 & 6  
- OECD Guidelines for Multinational Enterprises: V  
- UN Guiding Principles on Business and Human Rights: Chapter 2                                                                                      |

All portfolio companies are expected to provide adequate solutions for human health and safety in their operations as outlined in, among other, OECD Guidelines for Multinational Enterprises. We also expect companies to address these issues in their supply chain through a comprehensive, transparent and responsible supply chain management program.
ESG pillar 3: Proprietary ESG scores

During 2016, we took the next major step on our sustainability journey by developing and launching a proprietary ESG scorecard, concluding the project that was initiated at the end of 2015.

The decision to develop our own scorecard was mainly driven by the desire to formalise and structure our own knowledge, experience and views of relevant and material ESG-related risks and opportunities. It was further compounded by the lack of coverage of external ESG research on emerging and frontier markets.

We have witnessed how emerging markets are converging towards developed markets, resulting in long-term growth prospects and structural growth in many sectors. However, emerging and frontier markets are not fully efficient. Information is often not complete, timely available or easily accessible. There are large discrepancies in the performance of companies and their ESG standards. It is often difficult to access the “right” people and companies, and risk perception is frequently distorted. However, we believe that we can generate superior returns in these markets by being on the ground, frequently meeting companies and the right stakeholders, doing proprietary research, being an active shareholder with an integrated ESG approach and focusing on quality companies with long-term growth prospects and responsible owners.

Our new proprietary ESG scorecard helps to formalise and refine this approach and guides us in our assessment of relevant and material ESG risks and opportunities from an emerging and frontier markets’ perspective. As the scorecards are filled in by the relevant research analysts, portfolio managers and portfolio advisors, with the support of our Head of Corporate Governance and Sustainability, we ensure that the entire investment team integrates relevant and materials risks and opportunities in their fundamental analysis, ensuring a more holistic analysis of company quality.

Our scorecard comprises 10 Red Flag questions and 50+ additional questions within E, S and G, which structures our review to consider relevant and material ESG risks and opportunities.

Some of the main benefits of the ESG scorecard are that it:
• ensures that we consider relevant and material E, S, and G related factors;
• generates a list of issues/questions to research further or raise with the company;
• identifies areas of improvement that we can address through constructive engagement;
• helps to focus our internal resources and ensures that we bring sustainability topics onto corporate agendas;
• executed by the investment team, it also ensures an integrated approach and a holistic analysis of company quality;
• allows us to adjust our scenarios and modelling assumptions, if needed;
• helps to determine a level of conviction (together with financial quality, significant upside, etc.).

Felicia Hong, analyst based in our Hong Kong office, speaks both Mandarin and Cantonese. Local language skills are instrumental in analysing and following the development of the Chinese A-share universe where full disclosure in English is not always available.
## East Capital’s proprietary ESG scoring model

<table>
<thead>
<tr>
<th>Holdings</th>
<th>Aim</th>
<th>Areas covered</th>
<th>Score levels</th>
</tr>
</thead>
<tbody>
<tr>
<td>All existing holdings</td>
<td>At the outset, consider the 10 most critical ESG questions in EM and FM</td>
<td>Focuses on major Red Flags related to corporate governance, ethics and corruption, and severe or systematic environmental or social controversies</td>
<td>Maximum 2 Red Flags for Key Active Positions</td>
</tr>
<tr>
<td>When initiating research on new companies</td>
<td>Gives quick ESG overview and understanding</td>
<td></td>
<td>More than 3 Red Flags should not warrant further research or investment unless specific reason to accept higher ESG risk is warranted, accepted and documented</td>
</tr>
</tbody>
</table>

| ESG score | 50+ questions to consider relevant and material ESG risks and opportunities in EMs and FMs | Helps to determine level of conviction (together with financial quality, significant upside, etc.) | Generates a list of issues/questions to research further or raise with the company |
| All Key Active Positions and top holdings to start | Helps focus research resources | Allows us to adjust our scenarios and modelling assumptions, if needed |
| Over time, other relevant long-term holdings and new investments | | |

### Governance (75%)
- Shareholders/board/management
- Dividend policy
- Capital allocation
- Ethics and corruption
- Transparency

### Environment (12.5%)
- Impacts on CapEx/OpEx next 5 years
- Management’s understanding of relevant risks and opportunities, incl. climate change
- Significant controversies

### Social (12.5%)
- Impacts on CapEx/OpEx next 5 years
- Supply chain
- Health & safety
- Significant controversies

### Key Active Positions should have an ESG score of at least 70%

### Score ESG conclusion Engagement

<table>
<thead>
<tr>
<th>Score</th>
<th>ESG conclusion</th>
<th>Engagement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strong, &gt;80%</td>
<td>High, comfortable with key active position</td>
<td>Feedback on positive results, highlight any areas for improvement</td>
</tr>
<tr>
<td>Good, &gt;60%</td>
<td>Medium, careful consideration of risks</td>
<td>Engagement on specific issues raised by scorecard</td>
</tr>
<tr>
<td>Laggard, &lt;60%</td>
<td>Highly case specific, i.e. liquidity reasons</td>
<td>Highlighting realistic areas of improvement</td>
</tr>
</tbody>
</table>

Elya Kiselev and Aatman Ajmera, Research Associates based in our Stockholm office, using the ESG scorecard to determine the ESG score for a Key Active Position in our Global Frontier Market portfolio.

The scorecard’s summary sheet provides a quick overview of the company’s score, and upon completion, the 2-3 main insights from completing the scorecard, are filled in.
ESG pillar 4: Voting and engagement

As active investors, we hope to play a key role in implementing and enforcing improved ESG standards and strengthening the chain of accountability in portfolio companies through our monitoring capacity and constructive engagement – or in the worst case, through litigation or exit.

**VOTING**

**Background**

The majority of the companies in which East Capital invests on behalf of our clients are limited liability companies, where the ultimate decision-making body is the shareholders’ meeting. Although a still highly manual, complex and costly process, we believe investors can and should exercise their voting rights at annual and extraordinary shareholders’ meetings (AGMs/EGMs) where this makes sense for their investment. Shareholder participation in AGMs and EGMs serves as a monitoring effect on the company’s management and board and instils respect for the highest decision making body – and ultimately the entire governance structure of the company. We see voting as a key component of active ownership and one important way for us to communicate our views to the companies and their management.

East Capital uses an external proxy voting platform, which provides an efficient voting interface towards our custodians who then forward our voting instructions to the issuer, via their sub-custodian network. The platform is also an important source of information on upcoming AGMs/EGMs and their respective agendas, as well as a tool for tracking and reporting on voted meetings. Given that East Capital’s funds are highly diversified comprising mainly minority stakes in a large number of markets, we are unable to attend all AGMs/EGMs in person. More often, we vote by proxy or issue a power of attorney and voting instructions to someone who can represent East Capital at the meeting.

Agendas for upcoming AGMs and EGMs are sent to each regional team on a weekly basis. Follow-up and the results of voting is presented at relevant monthly meetings and board meetings.

In determining if and how the voting rights related to a meeting shall be exercised, relevant members of the investment team, comprising research analysts, portfolio managers and portfolio advisors, will consider all available information related to the meeting as well as our own analysis of the specific company, including contacting the company to get further clarification on specific resolutions. East Capital’s general views on typical resolutions and other ownership-related issues are described in East Capital’s Ownership Policy. The investment teams will use this policy as a base when deciding on how to vote in a meeting, while taking into account relevant market specifics.

Voting decisions are independently reached within the investment team and East Capital will not delegate decision making to any third party, although we may take third party recommendations into consideration. Ultimately, all voting decisions are made on a case-by-case basis, in the best interest of clients.

**Results 2016**

We have increased our voting activity significantly over the past couple of years. During 2016, we voted at 127 AGMs and/or EGMs in 99 different companies (out of a total of approximately 274), corresponding to 64% of the market value of our assets under management, which is a very high coverage ratio given the complexities of voting often encountered in our markets. Historically, East Capital has focused on voting in Russia, Turkey, the Balkans, Baltics and CIS countries. In early 2016, we expanded our voting activities to include shareholder meetings in Asia, as well as certain other frontier markets on the African continent and in the Middle East.

As illustrated in the table below, we increased our voting in East Capital Russia, from 56% to 67%*, East Capital Turkey from 46% to 77%, East Capital Eastern Europe from 48% to 75% and East Capital Balkans from 50% to 81%, of the funds’ respective AUMs. Even though it was the first year of voting in our holdings in China and Emerging Asia, we were successful in voting as much as 26% and 3% of the AUM of East Capital China Environmental and East Capital Emerging Asia, respectively.

It was also decided that, as of 2017, we will aim to vote at all AGMs and EGMs in all of our most significant holdings, defined as our Key Active Positions (“KAPs”) and the 10 largest holdings in all fund strategies. We will also vote in any additional holdings where it makes sense and is important from a shareholder perspective.

During the year, we, together with the Russian Association of Institutional Investors (API), initiated a dialogue with certain international custodians and investors to address the fact that shareholders’ votes were at risk of being blocked from the AGMs/EGMs of Russian companies under US’ sanctions or in companies where an individual named under US’ sanctions was blocked due to US sanctions.

* An additional 11% of AUM in Russian companies where we voted, was held through preference shares that do not carry voting rights. Furthermore, voting was attempted in Russian companies corresponding to an additional 6% of AUM, but was blocked due to US sanctions.
appeared among the candidates nominated to the board. Although we note the custodian’s aim to remain compliant with sanctions, we believe that the very blunt practice of altogether blocking shareholders from voting such meetings disenfranchises these shareholders of their right and ability to vote on other important matters such as approving dividends, blocking certain negative proposals and electing competent independent directors. Ironically, blocking these investors from voting at these meetings actually actively assists the sanctioned individuals to get elected as all the votes intended for the non-sanctioned independent director are never cast at the meeting, allowing the sanctioned individual to gain a greater relative share of the votes actually cast at the meeting.

Further reading: East Capital’s Voting Policy

ENGAGEMENT

There are numerous examples where our assessment of ESG standards has helped us avoid investments in companies that later failed, or where we have preserved value by blocking unfavourable resolutions at shareholder meetings. But more importantly, East Capital has decided to use its role as an active owner to engage with portfolio companies to ensure that the ESG risks and opportunities that, in East Capital’s view, are relevant to a company’s operations, are strategically assessed and integrated. East Capital’s experience has shown that an engaged and constructive dialogue will more often lead to convincing the company to initiate positive change – as opposed to simply exiting the investment. We are – as a final resort – either ready to exit our holding or willing to take the legal route, if such is deemed to be part of our fiduciary duty.

East Capital’s on the ground team and extensive local networks provide us with a range of valuable tools that can be used to initiate and advance engagement. These include:

- Own dialogue with company representatives
- A letter from our CIO to new portfolio companies, communicating on our role and aim as active owner
- Membership in an external engagement forum that unites the interests of asset owners and asset managers with USD 1 trn in AUM
- Nomination or endorsement of suitable independent directors to the board
- Collaboration with other shareholders on specific topics or situations
- Own dialogue with company representatives

- Dialogue with governments, stock exchanges and other authorities and institutions on improvements in the market framework
- Legal action

During 2016, we further formalised how we allocate our internal engagement resources and how we log and document engagement activities. For example, we:

- prioritise engagements in our key active positions and 10 largest holdings;
- prioritise any ESG topic seen as especially important to our EM/FM investment universe;
- identify topics that are either reactive, generated through a severe or systemic controversy, or proactive, generated through specific areas of improvement identified in our ESG scorecard;
- keep a common engagement log for all regions where notable updates and developments are shared and discussed at each monthly meeting on a regional level;
- update the board of directors and investment committee on notable developments on a quarterly basis, including the full engagement log.

Results 2016

During 2016, East Capital pursued 20 company engagements, predominantly on governance issues. Some examples are provided in the table on the next page.
Sample of engagement cases 2016

<table>
<thead>
<tr>
<th>Topic of engagement</th>
<th>Objective</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>International investor concerns for the involvement of Turkish banks in financing of a dam project with potentially severe negative environmental consequences. A lack of responsiveness on the part of one of the banks, compared to the other Turkish banks involved in financing the project, led to a de-rating and “recommendation to disengage” by our external service provider.</td>
<td>Encourage the bank to engage with the international investor community on environmental risks in project financing activities.</td>
<td>Several meetings between the company and our portfolio advisors in Istanbul resulted in the company agreeing to open up to dialogue and engagement. This will hopefully lead to improved procedures for addressing environmental risks in project financing and a re-rating among international investors.</td>
</tr>
<tr>
<td>Inefficient capital allocation and dividend policy in a Romanian bank.</td>
<td>Constructively encourage the company to consider the positive impact of ensuring an efficient capital structure to create long-term value for all shareholders through an extraordinary dividend.</td>
<td>Company proposed to increase the ordinary dividend for 2015, corresponding to an increase of the dividend yield from 5% to 16%.</td>
</tr>
<tr>
<td>Address the health and safety situation in a Russian materials company.</td>
<td>Following certain significant incidents with fatalities in 2013 and 2016, East Capital requested the company to engage on the issues and violations identified and actions were taken/will be taken to mitigate this happening in the future.</td>
<td>The company has responded positively so far; work is in progress and will be followed up.</td>
</tr>
</tbody>
</table>

As part of our review of the investment process and our use of internal resources during the year, we also decided to formalise how we prioritise company meetings:
- Key Active Positions: meet 2-4 times/year
- Any other top 10 holding: meet 1-2 times/year
- Other holdings: at least 1 time/year

Further reading: East Capital’s Ownership Policy

External engagement forum

Background
Since 2013, East Capital has been a member of the GES Engagement Forum managed by GES, our external partner for norms-based screening. This forum engages on all confirmed controversies identified through the Controversy screening process described above. The forum provides East Capital with access to an experienced team of ESG analysts with specific sector competence, which is a key strength, specifically with regards to assessing more complex environmental and social issues. Engaging through a forum also means strength in numbers, which is valuable in markets where we are not as large shareholders or have a shorter track record of engagement.

As incidents are identified, they are assessed and researched in order to confirm the incident and understand the potential impacts and underlying causes. If the incidents are severe and systematic, the forum, on behalf of its institutional investor members, will initiate a constructive dialogue directly with the company in order to suggest and encourage that the company addresses and improves on the specific issues. The forum focuses on company actions that will contribute to durable change and support continued investment in the company.

Board members should be selected based on skill, integrity and the ability to devote a sufficient amount of time to their work. East Capital also strives to influence companies to ensure that an appropriate ratio of the board of directors/supervisory board is independent in relation to the company and its executive management. Although the definition of independent director may vary between markets, the essence is the same – that directors should have a proven ability to exercise objective judgment in making decisions that are in the best interests of all shareholders.

Over the years, East Capital has participated in the nomination and election of 20-30 independent directors per year in our investment region, primarily in Russia, South East Europe and the Baltics. In Russia, we either nominate directors on our own or in collaboration with other minority investors through our membership in the Russian Association of Institutional Investors of Moscow (API). Throughout the years, the API and its members have contributed to nominating and electing approximately 500 independent directors to Russian boards.

Our experience has shown that independent directors are able to contribute with many improvements to the work of the boards, including:
- establishing board committees and improving board practices;
- improving transparency and investor relations;

Results 2016
During 2016, GES Engagement Forum managed nine structured engagements in eight different issuers that were part of East Capital’s portfolios. In addition to this, the GES team logged numerous telephone meetings, written correspondences and physical meetings related to 19 cases of potential norms-based violations in 13 different companies in our portfolios as an integral part of the process to research and assess indications of violations generated in ESG pillar 2, the Controversy screening process.

Nomination of board members

Background
East Capital encourages all portfolio companies to appoint a board of directors that represents an appropriate and diverse range of competencies and backgrounds to enable it to effectively carry out its duties.

Our experience has shown that independent directors are able to contribute with many improvements to the work of the boards, including:
- establishing board committees and improving board practices;
- improving transparency and investor relations;
• proposing revised dividend policies;
• implementing KPI-based executive compensation plans and new, financially-based KPIs;
• challenging and blocking problematic deals.

See also the separate interview with Maria Gordon and Alexey Germanovich, two of the independent directors that East Capital, together with other minority investors, has nominated and elected to the boards of Russian issuers, on pages 20-21.

Results 2016
In 2016, East Capital continued to participate in several engagements initiated and led by investor members of these associations, not least the Independent Director programme coordinated by the API.

During the year, we also decided to join a new initiative, the China Environment Chamber of Commerce (“CECC”). Set up in 2007 by a group of leading domestic environmental protection companies, including Beijing Capital and Sound Group, CECC is a nationwide environmental industry organisation under the supervision of the NDRC (National Development and Reform Commission) and NEA (National Energy Administration). CECC is committed to promote environmental protection and environmental services development in China, spanning across water supply, wastewater treatment, sea water desalination, waste incineration, industrial solid waste treatment, resource recycling, air pollution treatment, denitrification and desulphurisation, environmental equipment, etc. CECC now has over 100 members, which cover different segments in the whole environmental protection value chain (from financing, construction, operation, equipment supply, to consulting and services). The role of the organisation is to promote industry discipline and market order, participate in industry policy making, and encourage peer communication in both domestic and overseas markets to facilitate international development of our companies.

Further reading:
api-russia.org
acga-asia.org
bicg.eu
cecc-china.org

Collaborating with others
East Capital sees a significant potential in collaborating with other investors on specific ESG topics, especially when issues are more complex. We have identified a number of initiatives that we have decided to support as signatories or active members.

Local governance associations
The Association of Institutional Investors in Moscow (API), the Asian Corporate Governance Association (ACGA) and the Baltic Institute of Corporate Governance (BICG) have all contributed to improved standards and initiated dialogue around new legislation in their respective regions. Common strengths for these associations are broad networks, a deep understanding of the local financial market, significant knowledge of international best practice, legal competence, a desire to contribute to educational efforts, active investor members, and not least, a constructive and collaborative approach.

Further reading:
api-russia.org
acga-asia.org
bicg.eu
cecc-china.org

Percentage of total AUM with board composition influenced by East Capital, %

<table>
<thead>
<tr>
<th>Percentage of AUM with board member in our funds, %</th>
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</thead>
<tbody>
<tr>
<td>Balkans</td>
</tr>
<tr>
<td>Balkics</td>
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<tr>
<td>China Environmental</td>
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<tr>
<td>Eastern Europe</td>
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<tr>
<td>Emerging Asia</td>
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<tr>
<td>Global Frontier Markets</td>
</tr>
<tr>
<td>Russia</td>
</tr>
<tr>
<td>Turkey</td>
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</table>
Interview

We took the opportunity to sit down with two of the independent directors that East Capital, together with other minority investors, has nominated and elected to the boards of Russian issuers – Maria Gordova and Alexey Germanovich. We wanted to hear more about their thoughts about the catalyst behind better corporate governance in Russia in recent years and their practical recommendations for the future.

The Russian nomination system, in combination with the cumulative voting system, is one of the more transparent we have seen in our investment universe. With two percent of the local shares, a shareholder, or group of shareholders, has the right to nominate one or even several candidates to the board. At the AGM, each shareholder is given votes corresponding to their number of shares times the number of board seats. The shareholders are then free to place their votes on one or more candidates of their own choice.

The candidates with the most votes are elected to the board until the next AGM. This means that not only majority owners, but also minority shareholders, have a real opportunity to elect their candidate.

Whereas the Russian nomination system formally remains a way for minority investors to ensure representation on the board, the actual act of nomination is today preceded by an increasingly collaborative process. This includes discussions with the company and its current board members, meetings between the proposed candidate and the controlling shareholder and a more open dialogue between shareholders and the company about what additional qualities and skills would benefit the board. We appreciate and welcome this type of dialogue as we believe professionalisation on both the investor and issuer side, will translate into better boards.

» Continuity of governance remains key to the well-functioning of companies. My wish would be for the Russian company law to migrate to three-year directorship cycles for independent directors to allow for greater long-termism.

» I always recommend top management to be more open to investors, to have more direct personal meetings. Not only the CFO and his IR team, but the CEO and heads of the key business units should regularly participate in non-deal roadshows, providing accurate information on the company’s activity and opportunities for investors.

Maria Gordova has extensive experience of both local and international capital markets and a strong understanding of investor expectations. Among other directorships, Maria is an independent director in Russian state-owned Alrosa, a world leader in diamond mining, and Moscow Exchange, Russia’s main listing destination.

Alexey Germanovich has significant experience of implementing share-based linked management incentive programs, increasing issuers’ market capitalisation through improved transparency and better IR functions. Alexey is, among other board engagements, an independent director in Russia’s state-owned airline, Aeroflot, and in Bank Saint Petersburg. He is also EBRD’s nominee to Ameriabank, the largest bank of Armenia.
What are the biggest positive changes that you have seen in Russian corporate governance in the past 5 years?

Maria Gordon (MG): I would say the revised Russian Corporate Governance Code, presented in 2014, setting out key stewardship principles that help steer processes in Russian boardrooms towards greater transparency and better governance. This includes a minimum number of independent directors, membership of critical board committees and greater transparency over procurement and related party transactions. While ultimately it is the execution of those principles which is key, the very notion that these principles exist, steers the standard of governance to a higher level.

Alexey Germanovich (AG): I very much agree, and it was clearly supported by Moscow Exchange deciding to include many of the code’s principles in the listing rules that are mandatory to all issuers, as opposed to the voluntary nature of the code. Higher standards are further stimulated by a wider range of stakeholders than before, promoting good corporate governance. Stakeholders such as the Russian Direct Investment Fund, different governance. Stakeholders such as the Russian Direct Investment Fund, different independent director’s associations that are emerging and others. I also welcome that several Russian government bodies are setting up advisory councils on best practice in corporate governance, for example The Federal Agency for State Property Management (Rosimushhestvo).

What can an independent director expect to achieve in a Russian company or state-owned enterprise?

AG: In Russia, as in other emerging markets, one can talk about an independent director’s real achievements after a three-five year period. Directors’ individual initiatives may stimulate long-term changes in dividend pay-out, share price value, internal regulations or strategy.

MG: Indeed, the art of directorship in any public company – not just Russian ones – depends on a director’s ability to form relationships, exercise pragmatism and pick the battles that are most salient for stewardship issues. You are typically one out of 12 or 15 other members of the board. Therefore, your ability to influence the agenda and, ultimately, outcomes, rests on the respect you gain through thought-leadership and the relationships you develop in the boardroom.

AG: If you want to propose, for example, a revised dividend policy, it of course entails a longer process where you need to gain the backing of the full board and main owner. Before I joined the board of “Bank Saint Petersburg” (BSPB), the bank’s dividend payout ratio was 1.5% of profits. After being elected in June 2014, I quickly initiated a discussion on dividend policy. It took a while to find agreement with the bank’s controlling shareholder, but in February 2016, a dividend policy that envisioned a 20% payout was in place. Now I am working to improve it further by encouraging them to change the base for dividend calculation, using profits based on IFRS accounts rather than Russian accounting standards (RAS). This would result in significantly higher dividends to the bank’s shareholders, as the profit for 2016 based on IFRS was RUB 4.3bn as compared to RUB 2.3bn under RAS standards. Improvement of the bank’s dividend policy will be one of my key targets for next year.

MG: The key for any director is to remain cognisant that he or she is not there to replace the management but rather to oversee and enforce governance principles. There is a huge difference between the two.

What would you recommend Russia do to strengthen its attractiveness in the eyes of international investors?

AG: Despite negative news coverage in international media, Russia is, and will remain, a very attractive market for investors. Most Russian companies have incredible potential for shareholder value growth, and it is important that these companies speak out directly to investors. I always recommend top management to be more open to investors; to have more direct personal meetings. Not only the CFO and his IR team, but the CEO and heads of the key business units should regularly participate in non-deal roadshows, providing accurate information on the company’s activity and opportunities for investors.

MG: I would also like to add that continuity of governance remains key to the well-functioning of companies. It takes time to understand the drivers of the business and form relationships in the boardroom and with the management in order to leverage director experience. The Russian annual nomination and reelection cycle impedes that. My wish would be for the Russian company law to migrate to three-year directorship cycles for independent directors to allow for greater long-termism.

» The key for any director is to remain cognisant that he or she is not there to replace the management but rather to oversee and enforce governance principles. There is a huge difference between the two.

Maria Gordon
Principles of Responsible Investment (PRI)

In 2012, East Capital decided that we were ready to become a signatory of the Principles of Responsible Investment (PRI), as an important next step in our work to integrate the ESG perspective into our investment process. The PRI, which was initiated in 2006 with the support of the United Nations, has over the past 10 years quickly developed into the world’s largest investor initiative for responsible investment, representing more than 1,700 investors, from over 50 countries, togethe managing more than USD 62tr (unpri.org, April 2017). The PRI works to support its international network of investor signatories in understanding the investment implications of environmental, social and governance (ESG) factors, and to support them in integrating these factors into their investment and ownership decisions.

The PRI also offers access to an organised clearinghouse that facilitates investor collaborations on various topics, making stakeholder engagement more efficient and streamlined, and less costly, while lowering barriers to company access and helping to share company and sector knowledge, engagement experience and strategy.

In September 2016, we attended the annual “PRI in Person” event, in Singapore. This was the first time it was held in Asia, attracting over 600 attendees, of which 40% were from Asia. The conference offers an important platform for exchanging ideas about ESG and establishing valuable new contacts for future collaboration and engagement.

Further reading: unpri.org
Our latest PRI Transparency Report is available here: eastcapital.com/esg

CDP

In early 2014, East Capital decided to become an investor signatory of CDP (formerly Carbon Disclosure Project), an independent, not-for-profit organisation. CDP has made an important contribution to increasing awareness of and attention to climate, water and forest issues by providing a transformative global system that helps and motivates companies to measure, disclose, manage and share relevant environmental information (emissions data, water data and most recently, forest data). This is done through sending questionnaires to thousands of listed companies around the world. CDP makes company responses freely available via its website, through financial data vendors, broker reports, and research houses and is an important source in the growing practice of calculating carbon footprints for investment funds.

In 2016, more than 5,600 companies responded to CDP’s questionnaires, sent on behalf of CDP’s 827 investor signatories.
representing USD 100tr in assets. The response rate from companies in our investment universe is unfortunately still very low, with companies representing less than 20% of our AUM reporting to CDP in 2016. East Capital therefore works actively to contribute to an improved response rate through direct engagement with portfolio companies, encouraging them to respond, and highlighting the growing importance of carbon disclosure to investors.

During 2016, East Capital participated in CDP’s carbon action project which aimed to specifically encourage the most significant emitters to start reporting to CDP. As part of this project, East Capital sent additional letters to the Central European companies that had been targeted to be in scope, hopefully contributing to them starting to report in the future. In August, East Capital hosted a CDP seminar in Stockholm for CDP’s wider stakeholders, such as policymakers, corporates and NGOs, as well as investors, where CDP’s sector research on the environmental risks faced by the cement industry were presented and discussed.

Further reading: cdp.net

Dialogue with regulators and other market participants
Our experience from 20 years in emerging and frontier markets is that an effective corporate governance system, not only within individual companies, but across the entire capital market, is a clear prerequisite to stand out in what today has become a truly global competition for capital. It also makes life easier for investors who can spend time on performing investments, and creating value, rather than fighting to protect and regain investments in companies where they have been mistreated.

Throughout the years, East Capital has, by invitation or through own initiative, engaged in numerous dialogues with governments, stock exchanges, regulators, standard-setters, industry initiatives and other market participants to promote improvements in the institutional and legal framework of specific markets. We appreciate the opportunity and see it as a very worthwhile investment of our time and knowledge to constructively contribute with our views on what we as investors believe could strengthen the attractiveness of that particular financial market in the eyes of the international investor community.

Results 2016
During 2016, East Capital participated in 10 such engagements. Some examples in the table below.

Legal action
Since its founding in 1997, East Capital has invested in more than 1,300 companies in emerging and frontier markets. As detailed above, we always prefer active engagement above exit or legal action and have a long track record of successfully resolving issues and preserving minority shareholder rights through open and constructive dialogue. However, if dialogue fails and East Capital deems that it has a responsibility and duty to take further steps to protect the capital that our clients have entrusted us with, we will evaluate the cost-benefit of initiating legal

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<tr>
<th>Region</th>
<th>Area of engagement</th>
<th>East Capital’s role</th>
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<tbody>
<tr>
<td>Middle East</td>
<td>Proposal to implement certain improvements in the capital market to attract increased international investment.</td>
<td>Participate as an investment expert in a bilateral working group that will continue its work during 2017.</td>
</tr>
<tr>
<td>Baltics</td>
<td>Address signs of deteriorating corporate governance in certain segments of the market.</td>
<td>Held several meetings with the regulator (central bank) and other market participants to voice minority investor concerns that will hopefully lead to improved corporate governance standards.</td>
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<tr>
<td>Russia</td>
<td>Market consultation on amended quarterly reporting rules.</td>
<td>Provided detailed comments from the perspective of an international minority investor in order to ensure that Russia strives for international best practice.</td>
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<tr>
<td>Hong Kong</td>
<td>Proposal to reform listing committee structure to ensure a clearer division of responsibility on the stock exchange.</td>
<td>Submitted comments and support via letter.</td>
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<td></td>
<td>Encourage greater understanding for, and interest in, different types of green investments.</td>
<td>One of the organisers behind a green finance event with representatives from both the Swedish Government and the Hong Kong investment community.</td>
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action. On average, East Capital is involved in one to two legal processes per year. This means that East Capital, since 1997, has been involved in 20–25 legal disputes, of which some have carried on across more than one year. Not all legal disputes have gone to court.

**Results 2016**

During 2016, East Capital was engaged in 3 separate legal disputes against portfolio companies where the transgressions against us as minority investors led us to conclude that it is our duty to pursue a legal remedy on behalf of our funds and clients. One dispute was related to a Russian company while the two other disputes were in the Baltics. In August, one of the Baltic legal disputes was ultimately resolved out of court, implying that East Capital funds could exit the holding at a higher price than originally offered. The other two processes are still ongoing, with outcomes expected to be communicated during 2017 and 2018, respectively.

**Carbon analysis**

One of the most urgent sustainability issues among politicians, investors and media in recent times is climate change. There is today clear consensus among climate scientists that the consistently increasing human activity on our planet generates greenhouse gas emissions at levels that put us dangerously close to certain “planetary thresholds,” beyond which we do not know how our planet may react, nor its resilience for adapting. This presents a global challenge, shared by all nations. The Paris agreement reached among more than 190 nations in Paris in December 2015, was a major positive milestone in addressing climate change. Agreeing that temperature increases must be capped at two degrees at the very most, ideally closer to 1.5 degrees, will now allow governments, companies and individuals to shift focus to executing on national action plans detailing how they intend to decrease national emissions in contribution to the common global goal.

From a fund perspective, we need to consider how we can invest in support of the generally agreed two-degree goal. We acknowledge that carbon footprint is seen as one way of understanding the portfolio’s exposure to emissions and climate-related investment risks. When looking closer at all our funds, we can conclude that East Capital’s investment strategy typically results in an active underweight in the energy sector, which translates into lower carbon intensity than the funds’ respective benchmarks.

For example, as at 31 December 2016, East Capital Eastern Europe and East Capital Russia, were 12 and 9 percentage points underweight in traditional fossil fuel-related holdings, respectively.

We are considering also how East Capital can report on our funds’ respective carbon impact in the future. The main limitation, currently, is the lack of reliable self-reported emissions data. When looking at our portfolio companies, less than 20% of the companies that we have invested in (measured as % of total AUM), report relevant emissions data. In order to increase the level of self-reporting of greenhouse gases data in our markets, we actively engage with companies in our portfolios, both through letters and/or company meetings, to highlight the importance of this information to investors. We have also been an investor signatory to CDP since 2014, and in addition to publicly endorsing their work as widely as we can, we have participated in some of their more specifically targeted company engagements and workshops for reporters. Read more on page 23.

**East Capital Best Corporate Governance Award**

East Capital firmly believes in recognising exceptional companies in our investment region through the annual East Capital Awards, which were initially launched in 2004. The Awards are presented in the following four categories: Best Growth, Best IPO, Best Corporate Governance, and Discovery of the Year. The “Best Corporate Governance Award” was added to our awards in 2013 – to recognise a company that demonstrates a clear aim to create value for all shareholders by demonstrating strong standards in the area of corporate governance and addresses the opportunities and risks related to environmental and social concerns.

In 2016, East Capital decided to present this award to Vietnamese dairy company, Vinamilk. In the under-penetrated dairy sector in Vietnam, Vinamilk is the market leader, with a market share in excess of 50%. The company’s management and investor relations team have outperformed their peers with an explicit disclosure policy, realistic guidance, stable dividend policy and timely access to key management staff. We welcome both the removal of the foreign ownership limits, as well as the partial divestment by the state.

Vinamilk has consistently generated value for shareholders over the years, while simultaneously creating one of the strongest consumer brands in Vietnam. The company has also demonstrated excellent operational results over the past five years, with the company’s revenue and net profit growing by 21% and 14% CAGR respectively. In the first nine months of 2016, revenues grew by 18% year-on-year, while net profit grew by 28% year-on-year. In 2016, the stock price increased by 19.5% in EUR terms and outperformed both domestic and regional benchmark indices.
Investing in the community

Although we are mindful of the fact that East Capital’s greatest opportunity to have a positive impact on important sustainability issues is through our investments and our role as owner, we also believe that there are certain sustainability issues that we can address as a firm. These include understanding and reducing our own carbon footprint as well as supporting our investment universe through certain social contributions, primarily focused on helping children and young people to ensure a better future. We prefer to build long-term relationships and we actively ensure that any initiative that we support is efficiently run with lasting positive effects that are congruent with the aim of our support.

Climate neutral company since 2012
For a number of years now, East Capital has been a climate-neutral company in accordance with the UN definition of climate neutrality. Our clear ambition is to actively decrease our negative climate impact. This means that we every year calculate our greenhouse gas emissions, according to the international standard Greenhouse Gas Protocol, implement measures to reduce our emissions and offset any remaining emissions. Our emissions are mainly related to our business travel and offices. The Stockholm office pioneered this effort by becoming a climate neutral office already in 2010, and as of 2012, all offices are included in emission calculations and our efforts to reduce climate impact.

During the past couple of years we have taken several systematic steps to reduce our environmental impact and choose more sustainable alternatives where possible. Good examples include:

- Use of video conference calls as the preferred venue for most internal meetings requiring participation of more than one office, limiting unnecessary travel
- Use of tablets and software for meeting notes and materials, to facilitate knowledge sharing and eliminate unnecessary printing
- Recycling of waste in our offices
- Choosing eco-friendly options when procuring office supplies, fruit, beverages and other catering
- Imposing environmental criteria on our suppliers regarding their policies on low-emission company vehicles
- Using only eco-labelled electricity, heating and cooling on our business premises
- When travelling by taxi, using eco-certified taxi companies

The emissions that we are unable to eliminate are offset by carbon credits in various projects that create renewable energy or have other positive sustainability effects in our investment universe. During the years, the projects that East Capital has selected have contributed to several environmental and social benefits, including:

- Supporting the shift to low carbon renewable energy in Turkey, while the country meets growing electricity demand through wind farms
- Reducing deforestation while improving local health and safety in Uganda through improved cooking stoves
- Increasing biodiversity and carbon sequestration capacity while supporting local employment in Georgia through reforestation using hazelnut forests

SOS Children’s Villages
Since 2007, East Capital has been a proud partner of the SOS Children’s Village in Keila, Estonia, a small town 30 kilometres west of Tallinn. SOS Children’s Villages is providing a loving home to children who do not have the opportunity to grow up with their biological family. SOS Estonia is part of SOS Children’s Villages International, with high standards in operations, quality control and organisation.

Throughout these years, we have been funding a family with five children who live with their SOS mother in the SOS Children’s Village in Keila. Our relationship with the family offers our employees a lot of joy, as we regularly visit the family in Keila, and they also have come to Stockholm to stay with us on a couple of occasions.

RAOUL
Since 2014, we have also been engaging with the charity foundation RAOUL in St Petersburg. The charity was founded in honour of Raoul Wallenberg, a Swedish businessman and diplomat who became legendary through his efforts to rescue Hungarian Jews during World War II. East Capital is focusing on a special project called “Rabota-i”, which aims to help young people with special needs and orphanage graduates to enter the workplace. The support involves education, arranging employment, and provides training in social adaptation and self-organisation. “Rabota-i” has trained over 1000 young men and women in how to find a job and has provided personal job coaching to over 170 young people, enabling them to get and retain a job with an official income.

RAOUL

Little Angel
In 2016, East Capital decided to support the victims of the war in Iraq and Syria by engaging with “Little Angel”, an initiative to build an orphanage outside of Damascus in Syria. Here, children who have lost their families will get accommodation, food and schooling. The orphanage is for all children regardless of religion and will accommodate 120 children. In Sweden the project is led by the entrepreneur and philanthropist Gunilla von Platen together with Nuri Kino, founder of the network “A demand for action”. At the time of writing “Little Angel” has raised EUR 600,000 which is enough to start building the actual orphanage. The project continues to look for funding to add a kindergarten, medical clinic and a playground.
Sustainable investment report

East Capital’s sustainability journey

As an emerging and frontier markets specialist, we know that our markets face significant challenges related to sustainability, but are also encouraged by the rapid developments we have witnessed since we made our first investments in 1997. Sustainability and ESG is no longer predominantly seen as a risk area, as investors are rather gearing toward identifying the opportunities which will generate exciting long-term investments. Since day one, we have set out to invest in a responsible and thoughtful manner.

Over the years, our investment teams have interacted with thousands of companies, management teams, regulators, governments and other investors. During this journey, we have developed our understanding of the nature and potential impact of typical ESG factors on markets and companies, and have identified and implemented the ESG tools that we have identified as value-adding to our investment process. This has resulted in a unique and proprietary approach that has been extensively carried out by our investment team for almost 20 years.

We will continue to develop and refine our ESG approach to stay abreast the exciting developments in our investment universe. Our ultimate goal will remain the same: to make better informed investment decisions and enhance the value of our portfolio companies through active ownership.

1997
East Capital is founded. Based on sound Nordic values, we set out to be a long-term, active and responsible owner. Start engagement and voting.

2002
Send our first letters to all our portfolio companies, detailing our expectations as owner and our priorities for the coming year. Become active members of Russian corporate governance association, API.

2004
Launch of East Capital Awards to highlight outstanding achievements in our portfolio companies.

2007
Implement sector exclusion criteria (weapons, tobacco, pornography) for all fund products.

2010
Start controversy screening of all funds. Establish new role within investment team: Head of Corporate Governance and Sustainability.

2011
Expand voting and nomination and election of independent directors.

2012
Become signatory of UN-backed Principles for Responsible Investment, PRI.

2013
Join likeminded investors in external engagement forum which engages on ESG controversies. Launch of East Capital Best Corporate Governance Award.

2015
Integra, a landmark court case, puts East Capital on the map for protecting minority investors all over the world.

2016
Develop our own proprietary ESG scoring model. Launch of our first thematic fund – the East Capital China Environmental.

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East Capital is an independent asset manager specialised in emerging and frontier markets, founded in Sweden in 1997, with offices in Dubai, Hong Kong, Luxembourg, Moscow, Oslo, Stockholm and Tallinn. The company manages EUR 2.7 billion in public and private equity funds, real estate funds and separate accounts, for a broad international client base, including leading institutions.

Our investment strategy is based on extensive company knowledge gained through proprietary fundamental analysis and frequent company meetings. We incorporate ESG-related risks and opportunities in our investment process, and favour companies with long-term, sustainable growth perspectives and responsible owners.