Teviot Partners

Governance Policy and Stewardship Code Disclosure

Teviot Partners is a recently formed business which focuses on investing in UK smaller companies. The partners in the firm have extensive experience of the sector. In particular, Andy Bamford has taken a keen interest in the evolution of corporate governance in the UK market over the last 25 years and helped to form policies for engagement in his previous roles.

There may be a perception that the commitment to effective stewardship scales with the size of assets under management and the size of stake held in investee companies. In certain respects, this may have some validity in the sense that the relative scale of resources devoted to the area will be different and companies will be more responsive to larger stakeholders.

However, the relatively small scale of Teviot should not deter it from contributing to effective engagement. Our experience suggests that successful engagement depends on the quality of your argument as much as the leverage of your ownership position. Investors rarely force change on companies; more often it is a question of directors coming around to a different point of view. Indeed, engagement often gives boards the confidence to make changes to their policies and structures.

The most important element in shifting opinion is demonstrating to boards that you understand their business and you empathise with the challenges they face. Teviot aspires to punch well above its weight in this regard. The whole investment approach is focused on developing a deep, fundamental view of each investee company. In our view, engagement is far less effective when it is delegated to discrete corporate governance teams who are viewed differently from investment managers. Regardless of the size Teviot grows to, the firm's approach to stewardship will be based on investment managers engaging directly with companies, founded on a sound underlying knowledge of the business.

Anyone wishing to discuss our Stewardship policy should contact Andy Bamford who is the partner with responsibility for these matters.

Approach to Stewardship

Teviot has a number of attributes which naturally lead to the firm actively engaging with investee companies. Our chosen asset class is UK Smaller Companies, a diverse and dynamic part of the market. Many of these companies will be younger, with a more entrepreneurial approach and it is important to help these companies develop sound governance structures. We are aided by the fact that the UK is a well regulated market which has a long tradition of evolving its approach to corporate governance. We expect all our investee companies to comply with the UK Corporate Governance Code. Where companies deviate from best practice, as described by the Code, then we expect companies to explain their approach. We will treat each company on a case by case basis.

Teviot is an active investment manager with a clear motivation to preserve and enhance the value of it's client's capital. If a company's governance is causing it to perform sub-optimally or poses a risk of eroding value in the future then Teviot will not hesitate to engage. The partners' are significant investors in the Fund which aligns us in acting in the best interests of all investors.

Teviot is a value investor. It tries to identify companies where the valuation of the company trades below its intrinsic value. By analysing why this discount arises, it can judge whether there is scope for the discount to close. It is often the case that the discount reflects an issue that requires to be addressed. Teviot will proactively engage in a constructive manner when it identifies an addressable issue.

A core part of the investment process is to carry out thorough fundamental research on potential investments. We place a strong emphasis on having regular contact with management to deepen our knowledge of the companies. We are naturally inquisitive and challenging. These dialogues are often the catalyst for a more structured engagement with the company. They also allow us to approach engagement from an informed prospective.

The business is wholly owned by the partners. This reduces the risk of conflicts of interest. Our engagement with companies is aligned with the best interests of our investors.

We outline below our policies in relation to Voting, Remuneration, Board Composition, Sustainable Investing and other policies:

Voting

Teviot is the delegated investment manager to the VT Teviot UK Smaller Companies Fund. The firm exercises voting rights on behalf of the Fund. We cast votes on all resolutions after due consideration as what is in the best long term interests of our investors. The voting decision is made by the investment manager with specific responsibility for the investment.

Wherever possible we will alert the company to a negative vote, either by abstention or vote against, so they understand the rationale for our decision. This is a good opportunity to raise concerns with the board as a whole. A negative vote should be taken as a firm expression that we want something to change within the current approach of the company.

We will become insiders when it is appropriate as we see this as consistent with the stewardship responsibilities of long term investors. It is preferable to be made inside for the shortest period that is practical and for this step to be taken only when our views will be additive to the choices faced by the company.

Remuneration

Teviot is not prescriptive when it comes to constructing remuneration schemes. Remuneration should show an appreciation of the circumstances of the company and the key performance metrics that will deliver the best outcome for investors over the long term. Accordingly we welcome schemes that are tailored to a specific set of circumstances.

We list below a range of principles and guidelines that point to our thinking on remuneration. It is not designed to be exhaustive or prescriptive. We are willing to provide feedback on scheme proposals and constructively consider policies where the approach is properly explained and justified.

-All schemes should reward long term value creation.

-The rewards should be proportionate to the size of the company and the value created.

-Schemes should promote building an effective team with scope for succession. Rewards loaded to a single individual risk distorting behaviours and creating a key man risk.

-Schemes should be simple and clear with a single, long term structure for remuneration.

-The remuneration committee should avoid re-testing or resetting of options and should avoid making discretionary awards.

-Long term equity ownership by executives should be promoted. Minimum equity ownership levels should be established and these should be achieved, at least in part, by cash purchase of shares. Failure to reach minimum levels could restrict their ability to participate in incentive plans.

-Bonuses should be paid in shares rather than cash, with minimum ownership periods attaching to these awards.

-Claw-back provisions should be in place in the event that fraud or wrong-doing are subsequently discovered.

-In the event of management under-performance and dismissal, the remuneration committee should work to minimise the cost to investors.

-Incentive schemes should set stretching targets which are beyond the base level of performance budgeted by the company. Where possible, they should incorporate a range of performance criteria. The criteria should include targets which are definitively aligned with the return received by investors. Total Shareholder Return metrics are viewed favourably by Teviot.

Board Composition

Teviot recognises that a well-balanced and effective board of directors can make a significant difference to the outcome for investors. Accordingly we pay close attention to the effectiveness and experience of the directors. This is particularly important in smaller companies where they are often younger and more entrepreneurially founded. Occasionally it can be difficult for a founder director to recognise the value of independent directors and the challenge this brings. However this is the underpinning of good corporate governance and is not negotiable.

The role of Chairman is critical to the effective operation of the Board. Attracting a Chairman with a proven track record is a key priority as, in our experience, this leads to a sound strategy and effective decision-making. A good Chairman often attracts higher calibre non-executive and executive directors and so their value can not be over-emphasised. Of course, where a Chairman is considered to be under-performing, it is important that the Senior Non-Executive Director shows sufficient independence and judgement to deal with the situation.

Teviot expects the board of directors to be fully accountable for its actions. To this end, we favour smaller rather than larger boards, with a balance in favour of independent directors. In our experience, smaller boards lead to more effective decision making, with the board taking ownership of the consequences.

Teviot welcomes the progress towards greater diversity on boards both in terms of gender and ethnicity. Further progress needs to be made and the pool of available candidates needs to be broader and deeper. Despite these considerations, Teviot's priority is that appointments to the board should be based on merit and we would prefer non-compliance rather than tokenism.

Sustainable Investing

Teviot believes it is the responsibility of all investors to promote ethical and sustainable investment. We see our job as identifying potential risks that could undermine the long term value of a company. This evaluation should consider a broad range of non-financial metrics that point to the sustainability of a company's business model. All companies present a different set of risks; some extract natural resources, some have large global workforces, some are power and resource intensive, some provide services to vulnerable segments of the community. Teviot is not pursuing some over-arching political agenda. We work to identify the risks on a case by case basis and understand how they will impact the long term value proposition of an investment. Where we identify issues of concern then we will engage to understand more and change practice where we see it in the best long term interests of investors.

No sectors or companies are excluded from our coverage or as potential investments. It is quite possible that risks have depressed a valuation and yet management are taking steps to mitigate the risks or are proactively changing to more acceptable practices. As such, these may be interesting investment opportunities providing the change of approach culminates in a sustainable investment case.

Other Considerations:

-Return of Excess Capital: Teviot expects investee companies to run with an efficient capital structure over the long term in order to maximise the returns to investors. What constitutes an efficient balance sheet will vary on a case by case basis depending on the characteristics of the underlying business and its ability to service debt over the economic cycle.

The mechanism for returning excess capital will also be judged on a case by case basis. Above all, we expect every investee company to prioritise the payment of a regular and sustainable dividend stream. Returning capital by way of special dividends is the most efficient way of delivering capital back to shareholders. However Teviot will actively encourage share buybacks where the investee company shares are trading at a pronounced discount to their intrinsic value and there is sufficient liquidity in the shares to allow capital to be deployed in this manner.

-Pre-Emption: All companies should seek to defend the interests of existing shareholders by upholding the principle of pre-emption when raising additional capital. In the case of rights issues and open offers, the right of pre-emption is enshrined in the fund raising mechanism. Where companies place shares or use a cash box mechanism, it is at the discretion of the company and their advisers as whether existing shareholders are able to participate. In these situations, Teviot would expect to be consulted as an existing shareholder. In the event that we were not consulted then the company should not rely on our support to renew the powers to raise capital on a non pre-emptive basis.

UK Stewardship Code

The UK Stewardship Code is founded on seven principles and was published by the Financial Reporting Council in September 2012.

Principle 1

Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

- Stewardship responsibilities will be handled directly by the investment manager responsible for the investment.
- Oversight of stewardship matters will be dealt with by Andy Bamford who is a partner of the firm.
- At the heart of decision-making is our duty to our client, and the underlying investors in the Fund. Our decisions will be informed by what represents the best long term interests of our client.
- A key priority is to try to engage with key individuals in a company on a one to one basis. When-ever possible we will engage with the chairman, non-executive directors and advisors. We are active managers so we take a keen interest in accumulating as much knowledge about the company prior to investment and as part of on-going investment monitoring.
- We actively encourage companies to engage directly with us if it is helpful to them. This may be feedback in relation to strategy and execution. It may be in relation to references regarding potential appointments or using our network of contacts to identify potential candidates.
- As appropriate, we are prepared to be made insiders where the company values our feedback.
- Teviot votes all shares under its discretionary management. Any negatively cast votes will be discussed with the company to reinforce the message we intend to deliver.
- Circumstances where we would engage include:

-Issues surrounding governance: leadership, board composition, remuneration and independence.

-Issues surrounding the corporate strategy and how this is being executed. This will be assessed in a long term context and reflect the historic and prospective returns delivered to shareholders.

-Whether the company have been good steward's of client's capital. Has the appropriate capital structure been applied? Has capital been applied in a manner that maximises the long term returns of investors? Are acquisitions accretive to the long term value proposition?

-Is the company being positioned to grow organically? Is the company generating the expected level of cash profitability so that it can produce a sustainable dividend stream?

Principle 2

Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.

- Teviot retains a conflicts of interest policy and register which are kept under regular review by the Compliance and Risk Committee. The policy is available to clients and investors on request. The partners judge it far better to produce a policy that shows a real appreciation of the conflicts faced by the business at its current stage and size rather than a “high level” document with general observations. For this reason, the partners elect not to publish the policy.
- The nature of Teviot’s business as a small focused investment manager means there is a low risk of conflicts regarding stewardship. The partners are significant co-investors in the fund and wholly own the partnership. This should provide comfort that decision making is aligned with investors.
- Teviot manages money with a single strategy. This avoids potential conflicts where liquidity is preferentially allocated to clients with favourable fee structures.
- Teviot only acts as agent on behalf of its client and does not take any principle positions on behalf of the firm.
- Gifts and entertainment are strictly controlled and recorded in a register in line with best practice set by the regulatory body.

Principle 3

Institutional investors should monitor their investee companies.

- We believe this is a key competitive strength of Teviot. In particular, Teviot has the ability to invest in the smaller end of the quoted universe where independent research is unavailable. This means the vast majority of our research is internally generated.
- By not proliferating products, we believe we are able to maximise the amount of time spent developing our knowledge of the companies.
- Teviot seeks regular meetings with executive management and site visits on a periodic basis. We take any opportunity to build contacts with non-executive directors and chairmen.
- A core part of our process is the rigorous analysis of the annual financial report and every results announcement and trading update. In the majority of cases we will build detailed financial models on the companies so that we can understand historic performance and use this to predict the future performance of a company.
- Emphasis is placed on sourcing independent data to understand the industry and competitive dynamics in order to calibrate the strength of the business franchise. The digital world has evolved at such a pace that there are rich and abundant sources of free information available to us that help formulate our understanding of the companies.

Principle 4

Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities.

- The decision to escalate a stewardship matter will be made on a case by case basis by the partner responsible for the investment.
- We take every opportunity to speak to our investee companies and describe our approach as being “constructively engaged”. It is one of the peculiarities of our chosen asset class that we have the opportunity to engage to the level we do, with larger companies often much less responsive. This naturally leads us to challenge assumptions and decisions. There will be times when we fundamentally disagree with a position that a company is taking and at this stage we would escalate our engagement.
- Teviot is a small organisation and the lines of communication are short which we believe is a strength. If an issue arises within an investee company, it will be covered at the weekly investment meeting. A decision will be taken whether to escalate concerns. If appropriate a second partner will become involved in the process.
- Escalating our concerns may include writing to the Board, engaging with other shareholders or advisors or voting negatively at the AGM.
- Areas where we would escalate our engagement would include topics such as: business under performance, shortcomings in the board’s stewardship, remuneration, strategic decision-making, capital structure and sustainability issues.
- Teviot will be discreet in its dealings with companies. Publicising your argument is counterproductive in our experience as it damages any prospect of developing a constructive long term dialogue with the company.
- As noted in our introduction, Teviot will only effect change through the quality of its arguments but we will not hold back in contacting the board and advisors if our investor’s capital is not being looked after properly.

Principle 5

Institutional investors should be willing to act collectively with other investors where appropriate.

- The extensive experience within the firm means that we have several contacts in the UK small company sector. We will consider working alongside other institutions to leverage our argument. We are mindful of concert party issues and would seek appropriate assurances before working collectively.
- We prefer to express our views directly and would attend general meetings if appropriate.
- If any party wishes to contact us regarding an issue of collective concern then the partner responsible is Andy Bamford.

Principle 6

Institutional investors should have a clear policy on voting and disclosure of voting activity.

- For shares under our discretionary control, Teviot casts votes at every shareholder meeting. The voting decision is taken by the investment manager directly responsible for the investment.

- Teviot does not engage with governance consultants for voting guidance.
- Every meeting is voted after due consideration of each and every resolution. Teviot does not automatically support the Board.
- We will endeavour to notify the company of any resolutions where we are not prepared to vote in favour.
- Teviot does not engage in stock lending so there is no issue of whether shares are available to be voted.
- A record of voting activity is available on request.

Principle 7

Institutional investors should report periodically on their stewardship and voting activities.

- Teviot aims to provide transparent reporting to the underlying investors and is committed to an open dialogue regarding issues in the investee companies. This will extend to issues of stewardship and how we have engaged.
- A weekly investment meeting covers all pertinent aspects of the portfolio and a record will be kept of how engagement activities are progressing.
- Teviot does not seek independent assurance of the process. At this stage, we believe this would be disproportionate to the size of the firm.
- Teviot does not seek to disclose engagement activities beyond its underlying investors. Our experience suggests institutional investors frequently over-state the extent of their influence. Furthermore, we believe this type of disclosure probably detracts from the chances of future success. Engagement should be for the benefit of companies and their underlying stakeholders; not to promote the investment manager.

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