AVARON

AVARON ASSET MANAGEMENT

RESPONSIBLE INVESTMENT REPORT
FOR THE YEAR 2022

AVARON

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MESSAGE FROM THE CEO

2022 was another challenging year for investors, especially in Emerging Europe. It began with hope for the end of the COVID-19 era, only to be disrupted by the Russia's invasion of Ukraine. Beyond the human tragedy, all aspects of our society have been affected by the following energy shortages and affordability issues, soaring inflation, and consequent aggressive monetary policy tightening. These events have not only challenged financial market participants but also raised questions about the pace of the net-zero transition. Although we have seen some carbon-intensive energy projects being reactivated, the shortages have also increased prompt efforts to adopt clean energies that should accelerate the transition in the medium to long-term.

Amid those challenges, Avaron Asset Management remains committed to responsible investing. How we act today, will define our future. We are happy to see that asset managers are more and more transitioning from simple environmental, social and governance (ESG) awareness to wanting the capital entrusted to make an impact on acute sustainability issues we currently face such as climate change, human rights, and workforce equity.

In 2022 we took an important step forward in our efforts to contribute to the mitigation of climate change by issuing a public climate change policy statement. It has been one of focal points of our responsible investment efforts for some time, though largely concentrating upon improvements in disclosure by Emerging Europe issuers. As the latter has seen significant improvement over the past year or two, we have now set an ambitious target of reaching net-zero emission investments in our core Emerging Europe listed equity strategy portfolios by 2050 and achieving a 50% portfolio footprint reduction by 2030 from 2020 baseline. This requires active engagement with the regional issuers as well as asset owners who have entrusted us to manage their money. As of end 2022 27% of our flagship Avaron Emerging Europe Fund's portfolio was invested into companies that had committed to carbon emission reduction initiatives aimed at aligning with the Paris Agreement.

Like in 2021, regulation around ESG has been a hot topic during 2022 with the ongoing implementation of the European Union's Sustainable Finance Disclosure Regulation (SFDR). In July the European Commission published the final Regulatory Technical Standards (RTS) under the SFDR, including Principal Adverse Impact (PAI) reporting template and indicators, and the mandatory pre-contractual and periodic templates for Article 8 and 9 products. The RTS applies from 1 January 2023. **Over the year, we have worked earnestly to meet the regulatory timeline, developing our in-house ESG data platform to enable product level PAI disclosure.** Under the SFDR Avaron Emerging Europe Fund is categorized Article 8 (light green) or a fund that promotes environmental and social characteristics and invests in companies that follow sound corporate governance principles.

Our internal ESG rating system that is used to assess the ESG performance of issuers in our portfolios, is the main tool in Avaron to conduct ESG due diligence. We implemented the rating system back in 2018 and are consistently striving to enhance it. Besides the PAI integration we also recalibrated the list of indicators used to that enables the use of raw ESG data from Refinitiv Eikon.

Furthermore, **we made a significant advancement in the ESG integration to investment decision-making process by linking ESG issuer ratings to issuer fair value estimates.** This approach brings sustainability factors into the heart of financial analysis, recognizing that a company's performance in ESG areas can have a material impact on its overall valuation. By incorporating ESG data and ratings into fair value estimation, investors gain a more comprehensive understanding of an issuer's risk and growth potential. This integration not only encourages responsible investing but also provides a more holistic view of a company's long-term sustainability and resilience in an increasingly ESG-focused world.

The steps we undertook in 2022 not only made our responsible investment approach more robust but also served as the foundation for the application for LuxFLAG ESG label of Avaron Emerging Europe Fund, which was granted to the Fund in April 2023. By diligently implementing sustainable practices and integrating ESG considerations into our operations, we have established a strong framework that aligns with the criteria of the label. This not only demonstrates our commitment to responsible investment practices but also signifies our readiness to be recognized and accredited for our efforts in promoting sustainability and positive ESG outcomes. Earning the ESG label is not only a testament to our dedication but would also serves as a benchmark for our stakeholders as Avaron Emerging Europe Fund is the first region specific listed equity fund to receive the label.

Looking forward, I want to express my confidence in the responsible investment approach we have implemented, reflecting our commitment to sustainability and long-term value creation. However, as we navigate the ever-evolving landscape of ESG considerations, it is imperative that we remain agile and proactive. I am convinced that our current approach is sound, but I also believe that we must continuously strive for improvement to successfully address the ESG challenges that lie ahead. By fostering a culture of innovation and adaptability, we can stay ahead of emerging trends and evolving stakeholder expectations. I would like to assure that our organization shall remain at the forefront of ESG excellence and continue to drive positive impact for both our investors and the world at large.

Kristel Kivinurm-Priisalm, CEO
Avaron Asset Management AS

AVARON OVERVIEW

GENERAL INFORMATION

Avaron Asset Management (hereafter: "Avaron" or "Company") is a fund management company established in 2007. Avaron holds a license from the Estonian Financial Supervision Authority to manage investment portfolios and funds and is also a registered Investment Advisor with the US Securities and Exchange Commission. Our core activity involves investing the assets of our mutual funds and institutional investor managed accounts into Emerging Europe listed equities. We create additional value to our clients by applying active value investing principles while also adhering to the UN Principles of Responsible Investment.

As of the end 2022 Avaron managed 145 million euros of investor assets, out of which the core long-only Emerging Europe listed equity strategy accounted for 123 million. Fixed income investments accounted for 5% of the total assets under management (AUM). The Company manages three mutual funds domiciled in Estonia. Avaron Emerging Europe Fund (AUM €37M) and Avaron Emerging Europe Smaller Companies Fund that was launched at the end of 2022 are focused solely on Emerging Europe ex-Russia listed equities (UCITS V). Avaron Flexible Strategies Fund (AUM €13M) is an asset allocation fund combining predominantly European listed equities and fixed income but based on the fund prospectus can invest globally (AIF).

Avaron also provides sub-investment management services to third party funds and managed accounts. Investment management services to professional investors in the form of third-party funds and managed accounts have been an important business line for the Company over the years and accounts now for around 61% of the AUM. The total size of institutional investors' mandates in the end of 2020 was 89 million euros. Besides that Avaron also manages 6 million euros worth of portfolios for high net worth individuals.

The firm employed 17 investment and finance specialists.

GOALS AND VALUES

Avaron's mission is to be the most suitable partner for institutional investors catering for their needs in investing into Emerging Europe listed equities. Avaron's main objective is to offer our investors positive risk weighted long-term return through value based and responsible investing. To achieve this, we adhere to our investment style and process, respectively value investing and fundamental analysis, which deliver bottom up stock picks to the portfolios. Avaron's investment team has a key role in achieving our objective and this is why the Investment Managers and key employees are also Avaron's shareholders. The Company's Investment Managers have worked at Avaron since its launch in 2007, while the two Senior Analysts joined in 2008 and 2011. Today our investment team consisting of 8 investment specialists (3 Investment Managers, 2 Senior Analysts, 3 Analysts) is one of the largest teams dedicated to Emerging Europe region stock analysis.

Avaron has a strong corporate culture where integrity, passion for investing, diligence, flexibility, and sustainability is highly valued.

Integrity is the foundation of long-lasting success in asset management industry. To build clients' trust we are honest, open, ethical and fair. People trust us to adhere to our word and we are accountable for our actions. Passion for investing is a key characteristic we look for during our employee selection process as we consider it to be essential for self-development and long-lasting job satisfaction. In order to keep excelling one has to have a strong drive. Without it we would lose our competitiveness. Success in investing relies on disciplined, careful and persistent work. Adhering to our well-defined investment process and strategy in long-term enables us to achieve our goals. As a boutique asset management house flexibility, both towards our clients and employees, is something that sets us apart from the competition. We offer tailor-made solutions to our clients and opportunities for personal growth for our employees.

At Avaron we recognise that our business and investment practices have an impact on the environment and society. We are committed to carry out our business activities in a sustainable manner to ensure diverse ecological environment and vibrant cultural, social and economic base for future generations. Our perception of sustainability is of something not being harmful to people, communities, environment or depleting natural resources, and thereby supporting long-term social and ecological balance. As asset managers we also believe that environmental, social and corporate governance (ESG) issues are important contributors to the long-term performance of investment portfolios. We believe that investing responsibly in quality companies reduces the risk associated with investing and improves our ability to meet the promises made to clients. That is why the concepts of active ownership and engagement, as well as assessing investment risk in all its forms, are fundamental to our investment approach.

INVESTMENT APPROACH

Avaron runs two different investment strategies across its asset base – long-only listed equity strategy, which accounts for over 91% of the AUM, and asset allocation strategy. Both strategies are managed in accordance to value-driven investment philosophy. It is based on a premise that superior long-term results can be achieved by exploiting the judgmental biases and behavioural weaknesses that influence the decisions of market participants. The market tends to overreact to short-term problems that from time to time emerge even for growing and established businesses causing the stocks or bonds of these companies temporarily to go out of favour. In such situations it becomes possible to acquire stocks or bonds at prices that ignore the intrinsic value of the instruments.

Portfolio construction is based on picking stand-alone investment ideas, thus fully bottom up. Idea generation is proprietary, driven by the in-house fundamental research. Our Emerging Europe investment universe includes around 170 issuers, which are under close observation of our investment team. Engaging with and monitoring investee companies is an essential element of our investment strategy. Not a single investment is made without prior direct contact with the management team. We regularly follow up with companies we are invested in via management conference calls and on-site meetings. We have integrated ESG analysis into our investment process as we recognise that companies must exhibit good corporate governance and address environmental and social factors in order to flourish and survive in the long-term.

OWNERSHIP AND MANAGEMENT STRUCTURE

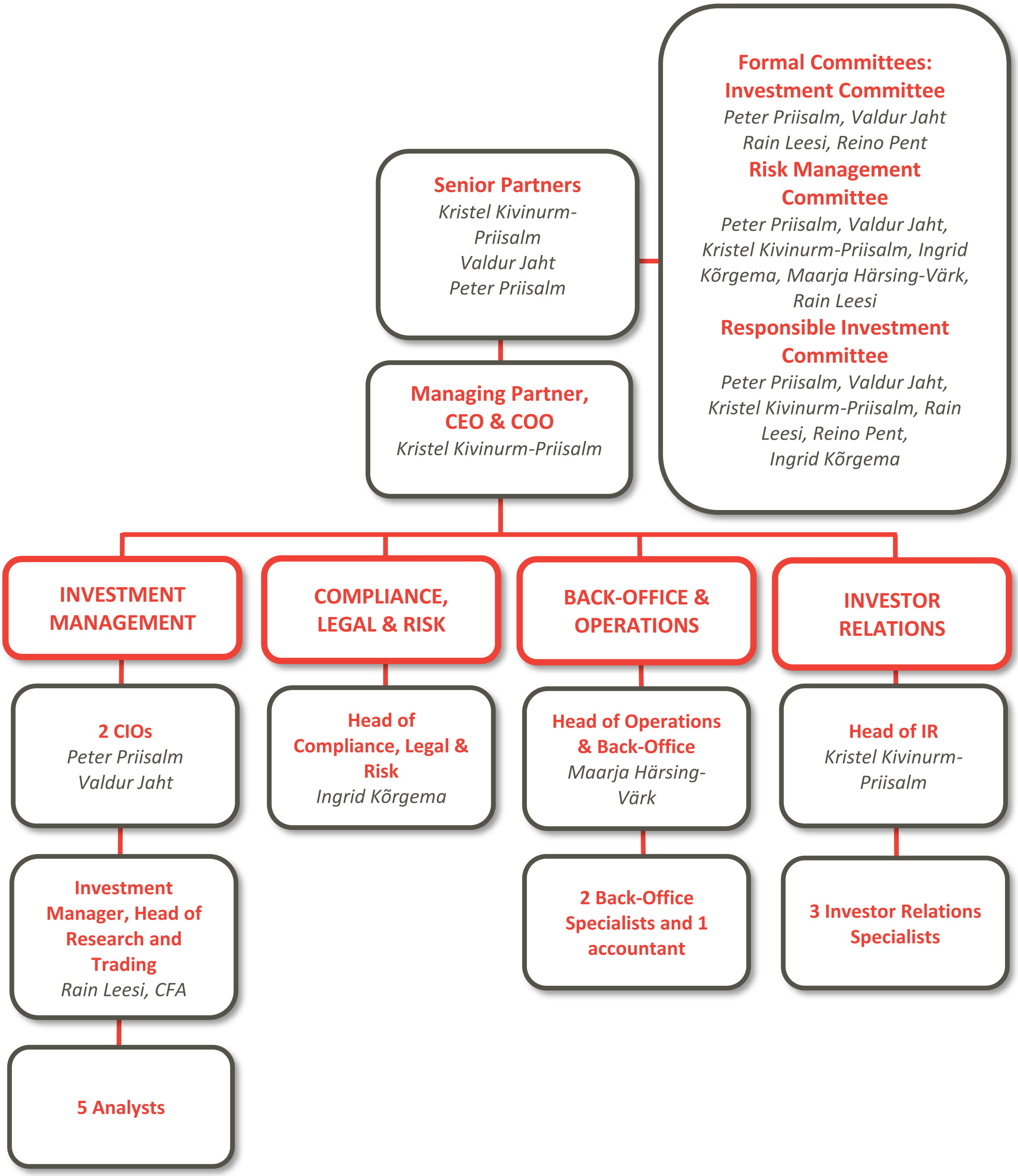
Avaron is fully owned by its employees and the Company has no institutional or outside investors. Beneficial owners of the Company are its founding partners Kristel Kivinurm-Priisalm (CEO), Valdur Jaht (co-CIO & Chair of Responsible Investment Committee) and Peter Priisalm (co-CIO) which each own via their holding companies one third of OÜ Avaron Partners that is with 82.41% shareholding the core owner of the Company. The rest of the Company is owned by its long-term senior research team – Rain Leesi (Investment Manager & Head of Research and Trading, 6.85%), Piotr Jurga (Senior Analyst, 5.86%) and Reino Pent (Senior Analyst 4.88%).

The Company's Supervisory Board consists of Peter Priisalm (Chairman), Maris Jaht and Rain Leesi. Mrs. Jaht, the wife of Valdur Jaht, is not on daily basis active at Avaron. The Management Board consists of Kristel Kivinurm-Priisalm and Valdur Jaht. The Company and its Estonia domiciled funds are audited by KPMG. Internal audit of the Company and its Estonia domiciled funds is carried out by PwC. Compliance and risk control functions are internalised and are being carried out by an independent employee, the Company's Chief Compliance Officer.

The Company functions as a partnership, which is being managed by the three founding partners: Kristel Kivinurm-Priisalm, Valdur Jaht and Peter Priisalm. Kristel Kivinurm-Priisalm is the Managing Partner of the Company and acts as CEO. She is responsible for general management, investor relations management and operations management. Valdur Jaht and Peter Priisalm are Partners and act as the Company's Investment Managers, who are responsible for the investments made by the funds and managed accounts as well as the smooth running of the investment team's work.

Avaron has established three committees to guide its business activities and risk management. Investment Committee is the main body to manage and oversee Avaron's investment funds' and managed accounts' investment decision-making and portfolios' risk management. Risk Management Committee performs an oversight function of the risk management, determines the Company's risk appetite and tolerance as well as ensures that risk assessments are performed regularly. Responsible Investment Committee steers the implementation of the Responsible Investment Policy framework within the Company.

Figure 1. Organizational structure



RESPONSIBLE INVESTING

At Avaron, we see responsible investment as a key element in aligning the objectives of asset owners and managers with the ones of the broader society. We believe it is in our clients' best interests for the companies in which we invest to adopt sound environmental, social and governance (ESG) practices. Such companies are in our view better positioned to mitigate ESG risks and seize the related opportunities in today's rapidly changing world. This also provides a framework for each company to be managed according to the long-term interests of its shareholders and helps to create an environment of higher standards of business conduct, increased market efficiency, sustainable management, and thus ultimately a more cohesive and fairer society. Mindful of our responsibilities to our clients, we act as good, long-term stewards of the investments which we manage on their behalf, as expressed in our responsible investment policy.

Responsible investment principles have been an integral part of our investment process since 2011. As a signatory of UN PRI, CDP and formal supporter of the Financial Stability Board Task Force on Climate-related Financial Disclosures (TCFD), we recognize the value in being transparent about our responsible investment strategy and sharing publicly what we are doing.

Our mission is to be the most suitable asset manager for institutional investors within the Emerging Europe listed equity asset class. We seek to offer positive risk-adjusted long-term returns to our clients through value based and responsible investing. To achieve this, we adhere to our bottom-up value focused investment process. Given our main aim of generating alpha to our clients via stock picking it is important to have ESG considerations integrated into our investment process.

Avaron investment team has been following vast majority of our current listed equity universe for over 15 years, which serves as an important strength in assessing the companies' future potential. At Avaron, we believe that the stock returns in the long run are driven by the underlying fundamental potential of companies with ESG practices being an inseparable part of company fundamentals. To have an extensive knowledge base of the companies in our investment universe we have taken a strategic decision not to outsource ESG analysis to third party providers but rather build ESG know-how in-house.

Our responsible investment approach is underpinned by two fundamental pillars, each of which plays an important role in achieving sustainability investment objectives: (1) ESG integration; and (2) stewardship activities.

The foundation of our responsible investment approach lies in the thorough and systematic analysis of ESG factors across our investment portfolios. This involves a deep dive into the sustainability practices, risk exposure, and overall ESG performance of the companies we invest in. This comprehensive assessment helps us identify both the opportunities and risks associated with ESG factors, allowing to make informed investment decisions. By integrating ESG considerations into our investment process, we not only align with responsible investment principles but also enhance our ability to deliver long-term value for our clients.

Active ownership is of high importance because it not only aligns with their fiduciary duty to act in the best interests of their clients but also contributes significantly to long-term investment success. By actively engaging with the companies in which we invest, we can promote positive change, encourage responsible business practices, and mitigate risks associated with ESG issues. This allows us to influence corporate behaviour, enhance shareholder value, and protect clients' investments from potential ESG-related setbacks.

Our commitment to active ownership extends to our participation in the corporate governance process through proxy voting. We take an active stance in voting on all resolutions and initiatives proposed by the companies in our portfolio. This includes voting on matters related to executive compensation, board composition, environmental policies, and social responsibility efforts. Our proxy voting activity is guided by our Voting Policy, and it serves as a powerful tool for reinforcing the importance of responsible and sustainable practices among the companies we invest in.

Together, these two pillars not only define our responsible investment approach but also reflect our dedication to integrating sustainability considerations into our investment strategies. By conducting comprehensive ESG security analysis, actively engaging with companies, and proactively participating in proxy voting, we strive to generate financial returns while advancing the broader goals of responsible investing.

INTEGRATION

In Avaron we seek to integrate the consideration and thoughtful management of ESG issues into the investment process by undertaking ESG analysis on all prospective and existing investments. Within our investment process the ESG analysis is carried out as part of the qualitative company analysis. Our ESG integration strategy involves a two-tiered approach to ensure the continuous consideration of pertinent factors in our investment decision-making process:

1. To avoid financing companies that are engaged in activities with clear negative impact on people and environment we apply exclusion principles.
2. Norms-based screening is used to identify companies in our investment portfolios that are allegedly involved in breaches of international law and norms on environmental protection, human rights, labour standards and anticorruption such as United Nations Global Compact, Universal Declaration of Human Rights, and ILO's International Labour Standards.
3. Comprehensive analysis of ESG criteria, facilitated by our internally developed issuer ESG rating system. This rating forms an integral part of our company quality analysis and enables us to thoroughly evaluate the

ESG performance of companies within our investment universe.

Exclusions

Exclusion is used as a tool to ensure no investments are made into activities that have a clear negative impact on people or the environment. It is applied outright for involvement in certain sectors (e.g. adult content, alcohol, armaments, gambling, tobacco) or after non-successful engagement process to address discovered infringements of international laws and norms.

As of end 2022 our internal Emerging Europe coverage list included 171 issuers. **Based on exclusion principles we had 25 companies in our restricted list in 2022** reflecting the direct impact of Responsible Investment Policy implementation. This figure does not include companies that are restricted due applicable international or national sanctions but includes sector-based exclusions alongside with exclusions based on poor ESG practices.

Exclusions based on type	
Environmental	8
Social	6
Governance	11

Excluded companies by country	
Turkey	12
Poland	7
Greece	3
Hungary	2
Czech Republic	1

Full exclusion list of companies valid for 2022 is given in Appendix 1.

Norms-based screening

Norms-based screening is used to identify companies that are allegedly involved in breaches of international law and norms on environmental protection, human rights, labour standards and anticorruption such as United Nations Global Compact, Universal Declaration of Human Rights, and ILO's International Labour Standards. This Companies where our ESG analysis detects violations of the mentioned standards or principles are subject to engagement, quarantine, or exclusion. Internal assessment of the incident is conducted by the investment team, which provides a recommendation to the Investment Committee that decides on actions to be taken.

In 2022 we did not discover any breaches by the companies in our Emerging Europe listed equity strategy portfolios.

ESG ratings

Our proprietary ESG rating system was introduced back in 2018 with an aim to get a quantifiable outcome for measuring the ESG performance of companies in our portfolios and coverage universe. It comprises a list of environmental (E), social (S) and governance (G) indicators that are individually assessed and assigned a score on a 1 to 5 scale, higher score indicating better performance. For each group of indicators (E, S, and G) an aggregated rating is calculated in accordance with the weights assigned to the indicators. The weights of indicators are not equal but reflect our understanding of the materiality of different indicators. In the final ESG rating though the three subgroups (E, S and G) have equal weights. As a final step the rating is adjusted for ESG related controversies (negative) and other specific issues (positive or negative), which are not reflected in the rating system but are deemed important to be considered when assessing the overall profile of the company. These adjustments are considered when having occurred over the past 5 years. To exemplify, the aggregate ESG rating (weighted sum of issuer ratings ex-cash) of Avaron Emerging European Fund at the end of 2022 stood at 3.44 with the controversy adjustment factor accounting for 0.04 reduction in the rating. Without it the portfolio's rating would have been 1.0% higher.

Since introduction the ESG ratings system has been a key tool in conducting ESG research for investment decision-making process. **In 2022 we made significant changes to the rating system. Namely, we recalibrated the list of indicators to (1) include Principle Adverse Impact (PAI) indicators that were introduced as part of the European Union's Sustainable Finance Disclosure Regulation; and (2) enable the use of raw ESG data from Refinitiv Eikon.** As a result, the amount and structure of indictors changed. Supply chain related indicators that previously were a stand-alone subsection under social indicators and included both environmental and social topics, were split into specific environmental and social supply chain indicator groups under E and S sections, respectively. Also, the number of indicators increased from around 90 to 120.

The E rating now comprises different environmental aspects with a focus on climate change including carbon footprint and emissions reduction policy, renewable energy usage, water consumption and reduction, waste generation and recycling initiatives, biodiversity and ecosystem preservation practices, and supply chain management from environmental perspective.

The S rating comprises social aspects including human rights, labour rights, employee health and safety, career development and training, diversity, pay equality, employee satisfaction, treatment of customers and community, data privacy and cyber security, business ethics and corruption, and supply chain management from social aspect.

The G rating evaluates corporate governance related aspects including board composition, independence and structure, shareholder rights, financial communication and accounting risks, and governance related to sustainable management.

Another important change we introduced last year concerns how the issuer ESG ratings are integrated to the investment decision-making process. Until then when making an investment the rating was assessed against the potential upside to the fair value target of the issuer and compared to the aggregate upside and ESG rating of the portfolio. Higher perceived ESG risk of the issuer (i.e. lower rating) needed to be compensated by additional upside compared to the portfolio average. Also, in case of lower ESG risk (i.e. higher rating) were willing to tolerate lower potential return. **In 2022, we took a step further in the integration and linked ESG ratings to the issuer fair value estimates.** Issuers with a rating below 2 are automatically excluded from our investment universe, while

ESG rating integration: Epsilon Net (Greece)

In January 2022 we initiated a position in Greek small-cap software company Epsilon Net with a market cap of €260mil at the time of our entry. Epsilon specializes in software targeting primarily small and medium-sized businesses providing a wide offering of solutions (ERP, accounting, payroll, HR, CRM etc.) with an aim to be a one-stop shop for all SMEs irrespective of their industry. The company is founder owned and operated, and was listed in July 2020.

A key strength of Epsilon lies in its market leading position in payroll and human resources systems (80% market share), and among local accounting offices (75% market share). This enables Epsilon to grow more easily as accountants usually recommend end users the software they are used to. Given that Epsilon controls most of the value chain of software offerings for SMEs including cloud and different market verticals, which it has been adding via acquisitive growth, the opportunity to upsell their solutions is sizable. Over the past 5 years the company has been growing close to 40% CAGR.

Considering Epsilon's relatively brief tenure as a publicly traded entity, ESG considerations have only very recently garnered increased attention of the management. Therefore, the ESG rating stood at a rather low level of 2.77 at the time of our entry. Especially poor was the environmental performance rating (2.24), although the environmental issues for an IT company are of less importance compared to social and governance topics. However, there is a discernible shift in this regard. Throughout our tenure as shareholders, we have conducted multiple visits to the company and actively broached ESG matters during discussions with the management. Additionally, we have undertaken written engagement with the company, specifically addressing gender pay gap disclosure as part of our themed engagement initiative. Consequently, the ESG rating witnessed an improvement to 3.02 in 2022, and we anticipate further enhancements following the release of the 2022 sustainability report, as the management has pledged substantial improvements in disclosure practices.

Upon our initial investment, Epsilon's stock traded at approximately €4.5, juxtaposed against our calculated fair value of €6.42 per share. This valuation incorporated an ESG rating adjustment factor of -5%, aligning with our methodology of integrating ratings into our assessment, reflecting the aforementioned lower rating level.

for companies with a rating between 2-5 a fair value adjustment factor is added as the final step in company valuation process to reflect the ESG performance. The adjustment factor ranges from -10% to +10% and is linearly correlated to the ESG rating. For example, to the valuation of a company with an ESG rating of 2 additional 10% discount is applied, while the valuation of a company with a rating of 3.5 remains unaffected.

To illustrate how the ESG quality of our portfolios has changed over since the implementation of the ESG rating system in 2018, we can give the example of Avaron Emerging Europe Fund. The aggregate ESG score of the Fund has improved over the years by 11% to 3.44. Most of the positive change can be attributed to the improved ESG performance and disclosure among regional issuers that has been especially visible in the past 2-3 years.

Looking at the indicator subgroup level the aggregate ratings of Avaron Emerging Europe fund have improved across all three letters but most notably of E and S. Aggregate E rating of the Fund has improved 16% since end-2018 to 3.29, while S rating is up 14% at 3.54. G rating e has been more stable but also gradually improved. We are especially happy to see the improvement regarding environmental issues since Emerging Europe issuers lagged in this area as most lacked climate change and resource efficiency driven corporate policies and related practices. This is a topic on which we have been engaging with our portfolio companies for several years already, raising their awareness and requesting improvements, which is now bearing fruit.

Controversy monitoring

Controversy monitoring is carried out for all issuers in our portfolios that are in scope of Avaron Responsible Investment Policy and forms and integral part of issuer ESG rating assessment process. **In 2022 we detected ESG controversies in relation to four companies that we owned at the time – bank Santander Polska, Polish e-commerce giant Allegro, and Romanian banks BRD-GSG and Banca Transilvania.**

Poland's Office of Competition and Consumer Protection (UOKiK) filed charges against 5 banks, including Santander Polska, accusing them of unfair customer treatment. Namely, charging interest on credit card debt of unaware clients that had fallen victims of phone or internet fraud.

UOKiK also had an ongoing investigation related to Allegro that had allegedly abused its dominant market position by favouring its own retail sales (1P) to the sales activities of external sellers (3P) on its allegro.pl platform, which resulted in imposing a fine of PLN 206 million (€43.9mil) at the end of 2022. During the investigation Allegro commented that they have cooperated with UOKiK and presented a third-party analysis that the economic impact on 3P merchants was not negative. The company noted that 99% of sales on the platform are generated by independent sellers, while own retail accounts only for around 1%. However, UOKiK issued a decision stating that Allegro infringed its dominant market position and imposed a fine on the company. Allegro has challenged the decision in court.

At the same time, UOKiK imposed a PLN 4 million (€852thou) fine for abusive rules and conditions for Allegro's "Allegro Smart!" service that offers free shipping of goods purchased to the consumer. As of December 22, 2022, the company decided to no longer include the contested provisions in template contracts.

In the above cases we did not see the need to launch engagements with companies as the processes to rectify the mentioned issues were in the process or already have been implemented, or the decisions challenged in court. We recorded these controversies in issuers' ESG rating system, resulting in negative adjustments to the ratings.

Two controversies related Romanian bank BRD-GSG were the following. Firstly, it was reported that at the end of June, the former general manager of BRD Pensii Private (49% owned private pension management arm) came under investigation for embezzling RON 23.5mil (€4.75mil) from the company. BRD-GSG claimed that it had notified the authorities about the irregularities in May and had filed a complaint against the company's former general manager, who was dismissed. Prior to that in May, the Financial Supervisory Authority (FSA) fined the former general manager of BRD Pensii Private, RON 100,000 (€20,000) and suspended their authorization for holding this position after a control revealed breaches of corporate governance rules and irregularities in the pension fund manager's financial reports. The three non-executive members of the company's Board were also fined and resigned following the sanctions. In relation to this, we engaged with the company in writing to further understand the details of the incident, its potential financial implications on the banking group and remedies taken to eliminate the corporate governance deficiencies.

BRD-GSG confirmed to us that the holdings of participants in the Pillar 2 and 3 pension funds, as well as their assets, which are held, according to the law, with a custodian bank and are segregated by law from the management company's own funds, were not affected in any way by this situation. BRD-GSG, as a minority shareholder with 49%, had fully covered the amount at stake, by adjusting the net asset value of BRD Pensii Private in H1 financial statements to reflect the share of BRD-GSG in the loss of ca. RON 10mil (€2mil). In August the FSA also applied sanctions to BRD Pensii Private, which was fined with RON 553,900 (€112.4thou) and written warning for not applying adequate and effective internal verification mechanisms according to its activity size, nature and complexity. Following the incident BRD Pensii Private took the following corrective measures: (1) capital increase of RON 20mil (€4mil) to ensure the liquidity and capitalization of the company; (2) RON 4mil (€810,000) credit line from the shareholders that was recently reimbursed; and (3) a 3-month remediation plan that was carried out from July to September 2022, implementing new controls, redefining operational processes within departments and reorganizing teams to ensure better governance.

In our assessment the financial implications of the incident were immaterial to BRD-GSG and proper remedies were taken. We concluded the engagement, and the controversy was recorded in the ESG rating system.

Secondly, in November the Romanian Competition Council opened an investigation into the possible fixing of local interbank rate ROBOR between 10 banks, including BRD-GSG and Banca Transilvania. To get more colour on this investigation we asked comments from the banks on the status of the investigation and potential fines that could emerge. Similar investigation was conducted during 2008-13 resulting no sanctions to the banks. Regarding potential financial repercussions the banks indicated these could include: (1) administrative fines of up to 10% of the bank's turnover obtained in the previous year to the sanctioning decision (the fine is computed taking into consideration the type of the infringement as well as any applicable mitigating and aggravating factors); (2) reputational risks; and even (3) private damages actions from concerned parties. We assume it is going to be a rather timely process and continue to monitor the situation. The controversy has been recorded in the ESG rating system of both banks.

ACTIVE OWNERSHIP

Engagement

One way Avaron manages and protects the value of its clients' investments is via being an active owner, exercising the shareholder rights and engaging with managements of the listed companies. We take an active approach in communicating our ESG views to companies and seek improvements where deficiencies in disclosure or performance are identified, or a company has infringed appropriate standards. Engagements may be reactive or proactive. Reactive engagements are company specific and are triggered by a negative ESG event (e.g. norm infringements, controversies), while proactive engagements are preventive in nature and target improvement of ESG practices. Proactive engagements can be also theme specific and undertaken across a group of companies.

Should our ESG analysis with the ESG Score uncover undesirable practices, or in reaction to a specific ESG related events, reactive engagement actions are undertaken to obtain within a predetermined timeframe specific and measurable changes on the part of the issuers. Engagement is always the preferable option over exclusion in order to thrive towards better ESG awareness and policies. A dialogue with the company is maintained over an extended period if necessary. Escalation and means of the engagement activities are decided upon by the investment team and depend on the specifics of the issue at hand and the company. Actions may include communications through the company's brokers, direct engagement with the management board or joint intervention with other shareholders, and where appropriate, voting against board proposals.

Our ESG rating system also provides a basis for proactive engagements enabling to detect areas where companies could improve existing practices. Based on the ratings data for our portfolio companies over the past 3 years we have detected that integrating climate change issues into corporate strategy and related disclosure is one major area where improvements should be sought. In this respect we are glad to report that the situation has improved in an accelerated manner. At the end of 2022 78% of Avaron Emerging Europe Fund holdings reported Scope 1 and 2 emissions data, while in 2020 that proportion stood below 50%.

In 2022 we continued to engage with selective portfolio companies on environmental topics within the scope of CDP Non-Disclosure Campaign. In addition, we conducted a broader themed engagement effort on gender pay gap and CEO excessive pay across all our portfolio companies. Three reactive engagements were launched related to controversies discovered, which were covered in the controversy monitoring section of this report.

Gender pay gap and CEO excessive pay themed engagements were launched in Q4 as the unadjusted gender pay gap is one of the mandatory PAI indicators to be reported under the Sustainable Finance Disclosure regulation and CEO excessive pay is a voluntary PAI indicator.

On CEO excessive pay we screened our portfolios to establish the availability of data and engaged with companies that do not provide proper disclosure in individual remuneration of board members. Regarding gender pay gap we followed up on our last year's effort re-engaging with companies that still have not yet started to publish the data. Altogether we got in contact with 23 companies out of the 44 we held in our Emerging Europe listed equity strategy portfolios with an objective to discuss the possibilities of improving their disclosure on these topics. 12 companies promptly provided necessary data 1:1 or indicated on their disclosure plans, while the rest have been earmarked for re-engagement in 2023.

As of year-end we had data to calculate excessive pay indicator for 33 companies out of 44. The indicator is calculated by dividing the annual total compensation for the highest remunerated individual to the average annual total remuneration of all employees excluding the highest paid individual. For the companies we have data it ranged from 2.3 to 122.5 with the median of 21.4. The lowest difference was reported by Warsaw Stock Exchange and the highest by Coca-Cola Hellenic Bottling Company.

Regarding the gender pay gap we managed to gather data for 28 companies with pay difference ranging from -14% to 38% and a median of 5%. The highest gap was reported by Polish bank Pekao, which very prudently included the whole management remuneration package in the calculation, and this elevated the gap to 38%. On the other end of the spectrum is Romanian integrated oil & gas company OMV Petrom with a negative gap of 14%. This to some extent is due to the combination of less than 25% female employees and high weight of women in managerial positions. Just to remind, the year before we managed to gather data for only 14 companies. We plan to follow up with the non-reporting issuers in 2023.

Leading collaborative engagements: 2022 CDP Non-Discloser Campaign

In 2022 for the 5th consecutive year we took part in the CDP Non-Discloser Campaign to encourage companies in our investment universe to improve their sustainability disclosure via CDP platform. As it has become a tradition, we took the lead investor role in engaging with our portfolio companies. The 2022 campaign targeted 4 issuers on climate change and water security topics – Estonian cruise operator Tallink, Greek refinery Motor Oil, Hungarian pharmaceuticals producer Gedeon Richter and Turkish refinery Tupras. We sent out official letters to the company management and investor relations and followed up via 1:1 communication.

As result Gedeon Richter and Motor Oil started to disclose on climate change and water security, while in case of Tupras and Tallink the engagement did not yield positive outcome. Unrelated to that we exited Tupras from our portfolios in 2022. Tallink remains our portfolio holding and will be targeted again within the scope of 2023 Non-Discloser Campaign.

Our engagement objectives for 2023 are the following. Firstly, we shall continue the climate change related efforts, but the focal point shall shift from disclosure enhancement to setting emission reduction targets. This relates to our own climate change ambitions, which were published in 2022. We have set an ambitious target of reaching net-zero emission investments in our core Emerging Europe listed equity strategy portfolios by 2050 and achieving a 50% portfolio footprint reduction by 2030 from 2020 baseline. This requires active engagement with the regional issuers as it largely depends on the emission reduction actions taken by the companies we invest in.

Secondly, we will focus on the necessary data availability stemming from the SFDR requirements. Although, the main set of mandatory indicators is also climate change heavy, there are other environmental and social indicators where the disclosure needs improvement.

Voting

A key part of being an active owner of listed equities is using voting rights in an informed way at company meetings, including but not limited to shareholder resolutions on ESG performance issues. Key principles of how we exercise our voting rights have been set in Avaron's Voting Policy.

Starting from 2018 we have committed to systematically exercise our voting rights on all shareholder meetings. Voting rights in Avaron are exercised internally i.e. our investment team reviews the agendas of shareholder meetings of the companies we are invested in. Voting proposals are put forth by the Analysts that cover the companies, approved by Investment Managers, and then forwarded to our global custodian or directly sent to the companies.

In 2022 we voted in 89% shareholders' meetings of the companies we own in all portfolios for which we hold the discretion to exercise voting rights. This compares to 88% and 92% participation rate in 2021 and 2020, respectively. On 1.6% of agenda points we voted against the management proposals and on 1.6% we abstained. According to our Voting Policy we communicate the reasoning behind "Against" votes to the companies. Starting from 2019 we are disclosing all our voting details for our publicly sellable funds, which are available in the Responsible Investment section on our website.

Voting against management proposals: Magyar Telekom (Hungary)

As part of our proactive stance, we exercise our voting rights against management proposals during shareholder meetings whenever we perceive shortcomings in various business practices that, from our perspective, do not contribute to shareholder value creation. During the Annual General Meeting (AGM) of Magyar Telekom on April 12, 2022, we voted against agenda items related to profit distribution, board election, and the approval of the board remuneration policy.

Consistent with our Voting Policy, we conveyed our rationale to the company before the meeting. Our objective was to underscore concerns regarding the company's capital management practices over the preceding year, which we believed had led to a decline in shareholder value. Specifically, we highlighted that Magyar Telekom's dividend policy remained unchanged post the 5G frequency auction in early 2021, despite the removal of uncertainties related to pricing and the determination of cash outlay. During this period, the company de-leveraged while maintaining a robust mid-term cash generation outlook. Consequently, we found it unjustified that the dividend policy was not updated to align with the anticipated cash generation and the actual leverage, especially in comparison to the targeted level.

Voting activity	2014	2015	2016	2017	2018	2019	2020	2021	2022
Meetings voted	8	20	13	16	67	69	60	80	70
Resolutions	65	210	94	158	656	641	665	903	810
For	54	183	91	119	578	598	593	877	784
Against	11	17	2	19	55	12	7	4	13
Abstained	0	10	1	20	23	31	35	22	13

COLLABORATION AND INDUSTRY INVOLVEMENT

Since 2011 Avaron is a signatory of UN Principles for Responsible Investment (UNPRI) that enables us to stay up to date on industry developments, offers a chance to implement new best practices in the industry and collaborate with other institutional investors and asset owners. We recognize that in many instances joint action by institutional investors has the potential to be more effective than acting alone. Thus, every year we participate or support select collaborative initiatives that overlap with our beliefs or needs.

In 2022 we supported the following initiatives:

i. 2022 Global Investor Statement to Governments on the Climate Crisis;

ii. 2022 CDP Science-Based Targets Campaign.

We continue as a signatory of the CDP as it is one of the largest investor collaborations globally with combined $136 trillion in assets from 746 capital market signatories, aiming to improve climate change, water usage and deforestation related disclosure, and related risk management of publicly traded companies.

Also, we continued our participation in Climate Action 100+ that is an investor initiative launched in December 2017 to engage with 170 global companies that have significant greenhouse gas emissions or are critical to the net-zero emissions transition and to meeting the objectives of the Paris Agreement. As of 2022 signatory assets under management totalled $68 trillion. Since 2018 we hold a supporting role in the collaboration.

Besides climate change related collaborations we remain supporters of the Tobacco-Free Finance Pledge, which we signed in 2018 as it aligns our long-term approach of limited financing of tobacco companies.

Since 2017 Avaron is a member of the Responsible Business Forum in Estonia, a non-profit organization with an aim to inspire and support furthering corporate social responsibility (CSR) in Estonian society through being the centre of competence building and communication on CSR. In 2021 we participated for the third time in the Estonian Responsible Business Index and managed to retain the highest gold level quality label that is valid for two years, including 2022. The Index aims at assisting Estonian companies to define, evaluate and monitor their economic, social and environmental impact. The quality label is given to organizations that show high performance and systematic approach in responsible activities towards local community, environment, workplace and marketplace.

GOVERNANCE AND REPORTING

Avaron Responsible Investment Committee has oversight of, and responsibility for, all responsible investment related issues including but not limited to development of relevant policies and steering policy implementation. The Committee is made up of senior staff members and is chaired by Executive Board Member and co-CIO Valdur Jaht. The Committee and its Chair have ultimate responsibility to ensure efficiency, compliance and ownership of responsible investment practices in Avaron. Current list of Committee members is:

Name	Role
Valdur Jaht	Co-CIO, Chair of the Committee
Peter Priisalm	Co-CIO
Kristel Kivinurm-Priisalm	CEO
Rain Leesi	Investment Manager, Head of Research
Reino Pent	Senior Analyst
Ingrid Kõrgema	Compliance Officer

Avaron discloses annually on responsible investment issues via UNPRI Reporting Framework and a stand-alone Responsible Investment Report. On quarterly basis we disclose on responsible investment related activities to our clients via our newsletter.

UNPRI Reporting Framework provides Transparency and Assessment Reports. Transparency Report shows signatory's responses to the Reporting Framework and is made publicly available on the PRI website. Assessment Report demonstrates how a signatory has progressed in its implementation of the principles year-on-year and relative to peers, and is not by default public. However, at Avaron we have decided to make our Assessment reports public on our webpage.

In August 2022, after a long delay, UNPRI published 2021 Assessment Reports. Avaron was rated under 3 modules: Strategy & Stewardship Policy, and asset class specifically Incorporation and Voting in Direct Listed Equity Active Fundamental. **In the Strategy module we scored 69 out of 100 (median 60), in Incorporation module 70 (median 71) and in Voting module 83 (median 54)**. Both UNPRI 2021 Transparency and Assessment Reports are available on our webpage.

CONTACT INFORMATION

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APPENDIX 1

Exclusion list

Name	Country	Reason
4IG	Hungary	Governance
ANADOLU EFES BIRACILIK VE	Turkey	Social – alcohol
ASELSAN ELEKTRONIK SANAYI	Turkey	Social – weapons & defence systems
BORYSZEW SA	Poland	Governance
EGE ENDUSTRI VE TICARET AS	Turkey	Governance
EGE PROFIL VE SANAYI AS	Turkey	Governance
ENEA SA	Poland	Environment – coal-based energy
ATHENS WATER SUPPLY & SEWAGE	Greece	Governance
FAMUR SA	Poland	Environment – indirect exposure to coal mining
GUBRE FABRIKALARI TAS	Turkey	Social – significant business interests in Iran
TURKIYE HALK BANKASI AS	Turkey	Governance
JASTRZEBSKA SPOLKA WEGLOWA S	Poland	Environment – coal mining
KOZA ANADOLU METAL MADENCILI	Turkey	Governance
KOZA ALTIN ISLETMELERI AS	Turkey	Governance
LUBELSKI WEGIEL BOGDANKA SA	Poland	Environment – coal mining
ODAS ELEKTRIK URETIM VE SANA	Turkey	Environment – coal mining & coal-based energy
OPAP SA	Greece	Social – lottery & gambling
OPUS GLOBAL NYILVANOSAN MU	Hungary	Governance
OTOKAR OTOMOTIV VE SAVUNMA	Turkey	Social – weapons & defence systems
PARSAN MAKINA PARCALARI SANA	Turkey	Governance
PGE SA	Poland	Environment – coal mining & coal-based energy
PUBLIC POWER CORP	Greece	Environment – coal mining & coal-based energy
PHILIP MORRIS CR AS	Czech Republic	Social – tobacco
TAURON POLSKA ENERGIA SA	Poland	Environment – coal mining
VAKKO TEKSTIL VE HAZIR GIYIM	Turkey	Governance