

Lupus alpha

Lupus alpha

**SUSTAINABILITY**

**REPORT 2018**



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Dear  
readers,

Transparency in the investment process is one of the most important criteria for institutional in-

vestors when selecting their asset manager. The growing interest in strategies that take sustainability aspects into account has also resulted in an ever-greater need for information about how and to what extent ESG criteria play a role in selecting individual stocks.

When we launched our Lupus alpha Sustainable Convertible Bonds fund in spring 2018, we also signed the European SRI Transparency Code for Sustainability Funds. This enables us to document what matters to us in our mandates when it comes to the convertible bond fund, namely that clients can understand how their capital is invested at all times – including with regard to the ecological, social and corporate governance-related aspects and impact of their investments.

Lupus alpha uses various tools to integrate ESG criteria into its fundamental investment process and in doing so incorporates client-specific ESG requirements into the portfolio construction process. After all, the strength of any investment process lies in the ability to replicate investors' various ESG guidelines, irrespective of what their standards focus on.

Lupus alpha Sustainable Convertible Bonds shows that we mean business when it comes to transparency and sustainability. Within a year of its launch, the Fund was presented with the Austrian Ecolabel and given two out of three stars by the Forum Nachhaltige Geldanlagen (the Forum on Sustainable Investment - FNG).

As a result, we are particularly committed to the challenge of achieving consistent alpha for our investors not only in specialised investment segments such as European small and mid caps but also in convertible bonds, despite the additional selection criteria expanded to incorporate ESG issues.

Yet asset management is only one aspect of sustainability at Lupus alpha – albeit an important one. As a company, we have a responsibility towards our business partners, employees, and society as a whole. This Sustainability Report outlines how we fulfil this responsibility by giving you an overview of our sustainability activities in 2018 and enabling you to form an impression of our commitment in this area.

Kind regards,

## 2 Lupus alpha – Who we are

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Lupus alpha was founded in October 2000 as one of Germany's first independent investment companies. Even then, our partnership-based corporate structure and independence from banks offered an alternative to the competitors dominating the market. With their unique corporate philosophy, the founding partners of Lupus alpha created an environment that provides optimum support for a focus on quality and performance and offers long-term prospects for the Company's top performers.

Since Lupus alpha was founded, we have focused on investment approaches in asset classes with particular return drivers, starting initially with European small and mid caps. Our active investment process has proven successful for many years. Our portfolio managers analyse small and mid-cap companies across Europe and identify assets where above-average performance is expected. With one of the largest and most experienced teams in Germany specialising solely in small and mid caps, combined with an active, fundamentally based bottom-up approach, Lupus alpha has succeeded from the beginning in generating steady, sustainable added value for investors.

As one of the first providers of absolute return concepts, Lupus alpha continued to specialise in 2003 and expanded its product range into the new area of Alternative Solutions. This development was triggered by growing demand for alternative investment approaches among institutional clients and a wider statutory framework. Today, Lupus alpha offers a variety of liquid alternative investment strategies based on different return drivers that can map a broad range of risk-return profiles. The product portfolio includes investment concepts in the equity, convertible bonds and collateralised loan obligations asset classes. Lupus alpha is also one of the leading providers of volatility strategies.

We will continue to serve as a specialist provider of asset management “made in Germany” in the future. With more than 80 employees, including 30 portfolio management specialists, we use specialised, innovative strategies to systematically uncover new alpha sources and sustainable risk premiums for our investors and create opportunities for them to further diversify their overall portfolio.

## 3 Corporate responsibility

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Our corporate responsibility involves tailoring our services to the needs of our clients and monitoring possible risks. We can only fulfil our responsibility and achieve long-term success by maintaining a close dialogue with our clients, business partners, shareholders and employees.

Our understanding of responsible conduct and adhering to ethical business standards is guided by our most important stakeholder groups: our clients, business partners, employees and shareholders. As a company, we also have a social responsibility to make a valuable contribution to both the economy and the common good.

In the following sections, we have identified the following key topics and provided a report on our involvement in different areas.

### 3.1 Responsibility towards clients and business partners

Lupus alpha takes comprehensive measures to ensure compliance with laws and regulatory requirements. Compliance means acting in accordance with all applicable legislation. Strictly speaking, this means working with clients, business partners and employees in a manner defined by fairness, solidarity and trust based on applicable laws and guidelines.

Lupus alpha expects its employees to behave with integrity towards its clients and business partners to avoid conflicts of interest and act consistently in the interests of the clients. Furthermore, all processes are constantly monitored in accordance with relevant rules. Employees receive regular training on issues such as preventing money laundering and insider trading in order to become aware of these issues. Individual departments are also subject to regular risk monitoring to ensure that operational and procedural risks are constantly monitored.

We offer our clients a personalised service. We place particular emphasis on maintaining a cooperative relationship with our clients to ensure that we can recognise their requirements as accurately as possible at all times. Our Clients & Markets team regularly analyses whether client and service requests are comprehensively covered. Our clients also receive regular reports and up-to-date information on our investment strategies to ensure maximum transparency with regard to the investment process, performance and relevant ESG indicators.

Clients are promptly informed of any changes or adjustments on the product side or to processes and kept up to date with the latest developments.

As part of our outsourcing partner's risk analysis, we assess the implementation of ESG criteria by our business partners. If the pre-defined criteria are not met, we reserve the right to take further action and terminate existing business relationships in cases of doubt.

## 3.2 Responsibility towards employees

Lupus alpha's corporate culture is defined by open, constructive communication, a high degree of personal responsibility and the satisfaction of our employees. A positive working environment is as crucial as professional development and wellbeing. We help our employees to continually develop their professional and social skills and open up their professional prospects. After all, only highly motivated staff can deliver the best performance for our clients.

Dedicated, skilled employees make a decisive contribution to the long-term success of the Company and help us to gain an important competitive advantage in the asset management sector. This means not only attracting the best talent but also motivating them to be top performers and keeping them at the Company in the long term. We treat each other as equals and invest systematically in young talent and leaders who actively take responsibility and drive Lupus alpha forward.

Lupus alpha's mission statement sets out the Company's aspiration to bring a new level of quality to asset management. We strive for quality in everything we think and do. Our primary objective is to help Lupus alpha's clients to achieve their investment goals by delivering above-average product performance and exceptional service. Our clients can rest assured that Lupus alpha only offers products and services that provide a realistic opportunity to place them among the market leaders in their class. As a result, our employees are our most important asset, as their commitment and ongoing support for innovative products and services ensure the long-term success of Lupus alpha.

The annual Open Forum employee survey was introduced back in 2000 to promote an open critical exchange of views between employees, management and partners. This communication platform contributes to the internal discussion and helps us to form opinions about issues that are important to our employees, which in turn enables us to respond with specific measures where appropriate.

### 3.2.1 Professional development

When it comes to professional development, Lupus alpha offers various programmes tailored to our employees' individual roles. In addition to the Introduction Course, which

provides an overview of all of the Company's divisions, additional opportunities are also available to new employees. Every new joiner is assigned an experienced senior manager as part of Lupus alpha's mentoring programme. This programme promotes the systematic integration of new colleagues and introduces them to the Company's unique corporate culture. New Lupus alpha employees can also sit in on other departments at any time in order to gain a holistic view of the Company and its staff. Internal 'lunch & learn' events, where portfolio managers present products to their colleagues in detail, are also held at regular intervals.

A special advanced training programme is also available to employees promoted into leadership roles. Combined with professional external training seminars, the Leadership Programme provides new leaders with the best possible preparation for their new role within the Company and their team.

Employees also have the opportunity to make use of professional development options such as the part-time CFA programme or MBA degree courses. The aim is to provide the best possible personalised training for our employees that takes their personal wishes and needs into account while also meeting professional requirements.

### 3.2.2 Wellbeing

Actively promoting the health and wellbeing of our employees plays an important role at Lupus alpha. Staff have access to a fitness studio where they can develop and prepare an individual training plan with a personal trainer. Several employee-organised sports groups also meet regularly to prepare for in-house competitions or the J.P. Morgan Corporate Challenge race.

In addition to nutrition and sport, healthcare is also a top priority at Lupus alpha. The healthcare programme has been running for many years. The programme is open to all employees aged 35 and over and includes a complete diagnosis day at the Helios DKD Clinic in Wiesbaden every three years, where a comprehensive check-up and specialist care modules are provided. Throughout the year, staff can also make use of a wide range of services provided by the Occupational Health Service (BAD), including eye and hearing tests, ergonomic sitting workshops and flu vaccinations.

## 3.3 Responsibility towards society

Since Lupus alpha was founded, we have regularly supported non-profit organisations such as Aktion Mensch, Schritt für Schritt – Hilfe mit System e.V., Oxfam and other regional institutions. In addition to making annual donations to nationwide organisations,

we also support local causes close to our heart such as cancer charity Krebshilfe Frankfurt e.V.

Since 2006, we have provided financial support and participated in the Frankfurter Kinderbüro Christmas campaign to make the wishes of children living in precarious circumstances come true. Our employees gave a great deal of commitment to this campaign, once again enabling around 50 children to receive their own personal presents shortly before Christmas in 2018. Overall, this special initiative benefits around 4,000 children in Frankfurt.

We also encourage and support any voluntary work carried out by our employees.

## 4 Responsibility in asset management

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### 4.1 ESG issues an integral part of the Lupus alpha investment process

Lupus alpha's specialist Small & Mid Caps team covers the entire spectrum of listed second-line equities in Europe - from micro caps and small caps all the way to mid caps. Around 60 to 80 stocks are selected from a universe of more than 1,000 investable companies to form a portfolio. As part of the analysis process, the responsible portfolio manager addresses relevant ESG issues that form part of the qualitative analysis as non-financial information, partly by taking specialised external research into account. Depending on the investment strategy, tools such as exclusion lists or best-in-class approaches can also be used.

### 4.2 Fundamental investment process

Lupus alpha pursues a fundamental investment process in the small and mid-cap segment. This process focuses on analysing individual companies based on their business model. The process involves an intensive dialogue with companies usually represented by top management (CEO and CFO) and other company representatives such as those responsible for product development, marketing, sales or controlling. After valuing the company based on a close dialogue with its management, we make an investment decision depending on our findings. The portfolio manager also regularly communicates with company management after the initial analysis. The aim is to track the company's strategy and the consistency of development as well as establishing a sustainable relationship with the investee company.

Among the most important issues to us are those relating to corporate governance, particularly with regard to management structures and monitoring. In this area, we focus on the individuals acting on behalf of the company, its leadership structures, the independence of its supervisory bodies and how the company avoids conflicts of interest. Issues concerning the configuration of incentive-based remuneration systems for management are equally important when it comes to aligning the interests of management with those of shareholders and other legitimate stakeholders. Questions concerning the environmental sustainability of production, occupational safety and working conditions and compliance with legal standards – including along the supply chain – also play a significant role. These issues can give rise to reputational risks that could considerably damage the company's brand and pose a significant threat to its business model.

Our portfolio managers' ESG questions focus on management incentive systems and corruption prevention (corporate governance), resource consumption, production processes, growth plans and energy efficiency (environmental), and the configuration of outsourcing relationships and employee participation (social).

### 4.3 Collaboration with Vigeo Eiris

Lupus alpha has been working with Vigeo Eiris to analyse companies for more than ten years. EIRIS was founded by church and charitable organisations in 1983 to incorporate its investment principles into the company selection process. In 2016, EIRIS joined forces with French ESG research firm Vigeo. The company is represented by the Institute for Market, Environment and Society (imug) in Germany. The Vigeo Eiris database provides access to more than 4,000 issuers analysed according to 250 criteria in six areas of interest. An ex-ante examination of individual stocks is conducted where this has been separately agreed with an investor and the stocks excluded where appropriate based on Vigeo Eiris analysis.

The exclusion criteria used include:

- the development, manufacture and distribution of controversial weapons (company-wide exclusion),
- violations of the UN Global Compact (inhumane working conditions, violation of the ILO's core labour standards, flagrant environmental pollution, etc.)
- the development, manufacture and distribution of weapons or armaments making up a significant percentage of company revenue,
- the genetic modification of food and seeds,
- intensive farming inappropriate to the species in question, performing animal testing for non-medicinal purposes
- the manufacture of tobacco or spirits making up a significant proportion of company revenue
- the operation of games of chance or the marketing of sexuality making up a significant proportion of company revenue

Lupus alpha works with the SimCorp Dimension software during the portfolio implementation process. Excluded companies can be consistently blocked with the help of this software, meaning that portfolio managers and implementers can be reliably stopped from acquiring shares in blocked companies.

## 4.4 Summary

There are a number of ways to take ESG criteria into account during the portfolio construction process for European small and mid caps. With the approaches outlined above (integration in the fundamental investment process, exclusion lists, best-in-class), Lupus alpha has various tools at its disposal for incorporating ESG criteria into the portfolio construction process as necessary to achieve a positive and informed outcome.

# 5 Active corporate governance

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## 5.1 BWT – water technology from Austria

Operating across Europe, this company is one of the leading providers of water treatment systems to the home, building and industrial technology sectors. In addition to offering water treatment technology for public baths, swimming pools and thermal baths, BWT also sells fixed water filtration systems to consumers and for professional use in cafés and restaurants.

The company, which is no longer listed on the stock exchange, carried out a squeeze-out of its remaining shareholders, including Lupus alpha, in 2017. This development was preceded by a dispute with the major shareholder, who is also CEO of the company, about his buyout offer. The major shareholder wanted to merge the company with an unlisted subsidiary without submitting a suitable valuation report. Lupus alpha participated in a lawsuit against the major shareholder to take legal action against the delisting.

After various court proceedings, Lupus alpha accepted an improved takeover offer presented in 2017 that was more than 40% higher than the original offer. However, this offer was only for half of the shares in our portfolio. As a result, there was still a chance of a further improved offer for the remaining shares. In addition, Lupus alpha was keen to continue actively exercising its shareholder rights to take action against poor governance at BWT Austria.

At the start of October 2017, the company managed to complete its squeeze-out of the remaining shareholders, including Lupus alpha. The compensation of EUR 16.51 per share was based on an assessment carried out by auditing firm Deloitte and was not only well below the previously paid compensation of EUR 23 per share but was also significantly lower than what we believed to be fair value at that point. Lupus alpha then pushed for a cash compensation review procedure questioning the independence of the auditor used. Lupus alpha also doubts the basic legitimacy of the squeeze-out. This issue

is currently being clarified before the Austrian Constitutional Court. As a result, Lupus alpha has broken new ground when it comes to shareholder rights, as the consequences of a possible decision in favour of the shareholders are still completely open at present.

## 5.2 Frauenthal – Conglomerate and supplier to the European commercial vehicle industry

Through its Frauenthal Automotive division, the Austrian company supplies most of the European commercial vehicle industry and selected automobile customers. The group's products include connecting rods, balance shafts and distributor boards in the automotive sector. Frauenthal also produces quality components primarily made from steel for customers in the non-automotive sector.

The Frauenthal Trade division is the number one wholesaler of sanitary, heating and installation technology and offers a wide range of products for municipal infrastructure (gas, water, sewers, etc.) as well as for large industrial plants. The Austrian company operates across Europe and has more than 3,200 employees.

In 2016, the largest shareholder presented the Chairman of the Executive Board with a takeover offer valued at EUR 11.06 per share. As we believed this takeover offer was not adequate because it was below the appropriate enterprise value, we rejected the offer. In an ad-hoc announcement dated 14 November 2017, shareholders learned that two production sites acquired from Stuttgart-based automotive supplier Mahle at the start of 2017 had already been depreciated by EUR 21.7 million in September 2017. This caused investors to suspect that Frauenthal wanted to depress its own share price to enable it to pay off its floating shareholders for the lowest possible amount.

Lupus alpha, together with other small shareholders, interrupted the Annual General Meeting and demanded an explanation from the Executive Board. Lupus alpha initially refrained from taking legal action to initiate a special audit in return for the promise to provide more detailed future information about this transaction. The major shareholder also promised to make a dividend payment in accordance with the business situation for the 2018 financial year and agreed not to pursue the squeeze-out further for the time being. However, the discharge of the Executive Board has been postponed until the issue has been clarified. The company is performing well, with a share price of around EUR 25 at the end of the year. It therefore remains important for Lupus alpha to actively exercise its shareholder rights and seek a dialogue with the Group.

## 6 Sustainability targets and progress in 2018

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Our 2018 sustainability targets included the further integration of ESG issues into our investment processes, our shareholder policy, the establishment of company-wide sustainability targets, and the development of a Lupus alpha corporate social responsibility concept by the Lupus alpha Sustainability team.

Lupus alpha has been one of the signatories of the European SRI Transparency Code for Sustainability Funds since spring 2018. In March of that year, we launched Lupus alpha Sustainable Convertible Bonds, our first mutual fund with a proven ESG strategy. The Fund focuses on investing in companies that make a positive contribution to achieving the Sustainable Development Goals of the United Nations. Exclusion criteria are also used. The Fund was presented with the Austrian Ecolabel and the FNG Label with two out of three stars in the year of its launch.

An active corporate governance policy is an integral part of our sustainability targets. At Lupus alpha, we believe that responsible corporate governance is the key to achieving sustained growth in the value of our investments. We focus on representing and safeguarding investors' interests and voting rights vis-à-vis stock corporations. Voting rights are among a shareholder's most valuable rights and should be handled responsibly. Lupus alpha acts exclusively in the interests of the relevant investment fund.

The Company exercises its shareholder voting rights on behalf of its investors using the clearly defined criteria set out in its 'Principles for Exercising Voting Rights'. We exercise our shareholder and creditor rights irrespective of third-party interests and exclusively in the interests of investors in the relevant investment fund.

Lupus alpha stays in close contact with the respective company. If company analysis shows that involvement is essential as part of active corporate governance, the engagement process begins and Lupus alpha exercises its voting rights.

In 2018, the Company voted at 75 shareholder meetings in the European small and mid-cap sector. Lupus alpha attended one shareholder meeting in person to observe proceedings and carry out personal assessments. The Company actively made ESG decisions in the following cases: BWT and Frauenthal. Our involvement as active shareholders and the implementation of ESG criteria in our shareholder policy are the primary focus of our sustainability targets. In 2018 we actively exercised our shareholder voting rights at the aforementioned shareholder meetings based on our ESG criteria and in accordance with our voting rights policy.

## 7 Outlook for 2019

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In 2018, Lupus alpha developed a company-side corporate social responsibility concept that was adopted at the start of 2019. The various subprojects deal with the issues of corporate governance, organisation and communication, social participation, investment processes and portfolio management, clients and sales, and employees as well as climate and the environment and are being implemented this year and over the next few years.

We are planning to systematically expand our ESG reporting and increasingly integrate ESG criteria into our risk management systems in 2019.

## Contacts

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