



What do we mean by integration?

Sawan Wadhwa, Head of Stewardship

2024



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The term integration is widely used in the investment industry. For us, integration within our investment process means considering both traditional financial risks and non-financial risks when evaluating a company. This includes assessing management and cultural quality, emission intensity, historical controversies related to litigation and human rights, misalignment between pay and performance, and the mix of skills on the board – alongside conventional risks such as debt levels, pricing power, and economic and operational sensitivity.

As stewards of our clients' capital, we proactively assess and manage all risks a company may face throughout its lifecycle. Active risk management is fundamental to ensuring long-term investment returns. While Evenlode strategies are not restricted by sector or geography (beyond the stated mandate), additional risk management is applied at the portfolio level to ensure diversification and resilience. This includes fundamental risk management, which focuses on the idiosyncratic risks specific to each company.

Risk scores

Evenlode operates within a defined risk framework centred on 10 key risk factors that influence a company's ability to withstand uncertainty. Among these, ESG risk is independently overseen by the Stewardship team, reinforcing our commitment to a comprehensive, risk-aware investment approach.

The purpose of the risk scores is to provide a framework for discussion of the risks that businesses face. All risks are scored on a range from A to E, with A being highest quality, C being the average company (considering all

companies, not just those in the investable universes), and E being the lowest quality. They are deliberately non-numerical to de-emphasise the idea of exactly measuring or diversifying away risk. The ESG risk assesses the impact of potential disruption of related factors and is not an ethical judgement on the company's activities. If a company scores an E on ESG risk, because there are severe ESG concerns that the company is not managing adequately, it will be excluded from the portfolio/universe.

Inclusion of a company into our investable universe is based on the outcomes of the quantitative and qualitative research. The purpose of the qualitative research is to assess the ability of a company to maintain high returns on invested capital into the future. Materiality is the key driver of qualitative research and determines the level of resources that should be invested. Quantitative research provides analysis of the historic fundamental performance of a business and gives insight into the success (or otherwise) of past capital allocation decisions.

New ideas

When conducting research on potential new ideas, analysts undertake a qualitative analysis on the company being proposed. This initial analysis results in four outputs; the initiation note; the summary profile; the investment thesis, and the initial risk scores.

1. Initiation note: The purpose of the initiation note is to explain the current position of a company and drivers of future performance.
2. Summary profile: This includes sector exposure, geographic exposure, any major ongoing risk and/or market dynamic.



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- Investment thesis: The purpose of the thesis is to explain why the company will be able to maintain and/or improve returns on capital over a period of 5 to 10 years (or longer).
- Initial risk scores: mentioned above.

Case study – Airbnb

We initially started looking at Airbnb as a new idea for the Evenlode Global Equity fund in September 2023. The business can be described as a platform for vacation rentals with a network of over 5m hosts. Additionally, it provides hosts with listings, marketing services, insurance and education to improve occupancy. The investment thesis was that the global vacation rental market is expected to grow by 10% p.a. to meet rising demand for lodging (4% p.a.). Airbnb will maintain its take rate while taking market share from offline vacation rentals and subsequently generate low double digit organic revenue growth over the long term.

We continued the qualitative research of the business by completing our ESG risk score matrix which highlighted the following:

- Airbnb provide good disclosure on environmental-related indicators. Although they do not operate in the most emission intensive industry, they report on scope 1, 2 and 3 emissions via the Carbon Disclosure Project (CDP) platform. They have also set both absolute and intensity emissions reductions targets including a net zero target across scope 1 and 2 by 2030.
- Airbnb impacts certain communities and traveller hot spots. Often locals feel they are priced out of certain areas or pushed out of rental properties so that landlords can place properties on the platform. This means that many countries and cities have

put in place – or are thinking about putting in place – regulation to contain the issue. For example, exposure to increased regulation further impacting the moat, industry and/or pricing power was high, especially in large cities like New York. Also, the company seem to get dragged into various lawsuits relating to incidents inside rental units (illegal listings, accidents etc).

- Airbnb’s co-founder Brian Chesky is the CEO and Chairman which is not uncommon in the US, but means the company needs a lead independent director and a robust succession plan. Remuneration policy was less than satisfactory. Brian Chesky’s compensation consists entirely of 10-year restricted stock units (RSUs), which vest only if Airbnb’s stock price hits specific targets over the next decade. To fully vest, the stock must reach over 7x its IPO price and 13x its grant price. Chesky receives a \$1 base salary and does not participate in the short-term cash incentive plan (STIP). For other executives, the STIP focuses primarily on non-GAAP, non-financial metrics, which was not ideal.

Airbnb has disproportionate voting rights. It consists of four share classes: A, B, C, and H. Class C and H shares have no voting rights, while class A and B do. Founders and early investors hold class B shares, which carry 20 votes per share, compared to class A’s single vote. At the time of the analysis, the founders alone held 73.9% of the voting rights making it difficult for minority shareholders to have an active voice and effecting change at company level.



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The next step was an expert call with an industry specialist, which identified three key areas for further exploration.

1. The rise of property management software (PMS) posed the biggest threat, as cross-listings have become increasingly simple and inexpensive. To counter this, Airbnb is securing an exclusive share of available nights by enhancing its host tools, making it easier to find a co-host, and offering features that would typically require a paid PMS subscription for free.
2. Long-term growth will be driven by expansion into the hotel market, while short-term growth will be influenced by consumer trends, particularly the spending habits of Gen Z and Millennials.
3. We downgraded the management and cultural quality score, as Airbnb's internal culture has undergone significant changes since its IPO. Before Covid, individual team managers had greater autonomy which encouraged independent thinking. Post-Covid, CEO Brian Chesky has adopted a far more hands-on approach, centralising decision-making. The company now operates with a top-down leadership structure, reducing creative input from the broader team.

Finally, after the quarterly earnings statement at the end of 2023, we concluded that there was positive upside on the long-term industry outlook and ESG risks. Active listings were up by 19% which was equivalent to 1m new listings. They also experienced double-digit growth in all regions. The call highlighted that New York City only represents 1% of revenues, limiting the impact of new regulations. In fact, 80% of the top 100 Airbnb markets (by revenue) have some form of regulation.

As highlighted above, integration for us means embedding both traditional financial risks and non-financial risks – such as ESG factors – into our investment process from idea generation through to ongoing ownership. This is not a separate, standalone exercise but a fundamental part of how we assess a company's ability to sustain long-term returns. Our approach combines quantitative and qualitative research, risk scoring, and active stewardship to ensure we fully understand the risks and opportunities a business presents. The Airbnb case study is a good example of this process in action: ESG risks such as governance structures, regulatory pressures, and litigation risks were assessed alongside fundamental financial metrics. Ultimately, integration at Evenlode is about recognising that financial and non-financial risks are interconnected, and by proactively managing them, we can better preserve and enhance our clients' assets over the long term.

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