QUARTERLY SHAREHOLDER LETTER

30 September 2019

To Shareholders of Genesis Emerging Markets Fund (the "Fund"),

As long-term investors we consider the sustainability of the Fund's companies' business practices. Our analysis includes not just the stability of near-term cashflows but also the broader benefits and costs to stakeholders, which affect cashflows in the longer term. These stakeholders include internal groups such as employees as well as external groups such as society, shareholders and customers. Stakeholder analysis has been integral to our quality assessment, predating the mid-2000s popularisation of Environmental, Social & Governance ("ESG") considerations, for the simple reason that long-term cashflow generation depends on business sustainability. We evaluate governance in our companies from perspectives including minority shareholder rights, because alignment is a common banana skin for EM investors. However, we view environmental and social ("E&S") factors as nothing less than existential.

Existential because the E&S impact of a company contributes to its long-term license to operate. If a business behaves unsustainably, shareholders will eventually pay a price. If nothing else, its cashflow is less secure and the company is less attractive as an investment. Increasingly a company's E&S practices may form a competitive advantage, and that can affect sales and margins. We welcome the increasing effort our companies are making to communicate their policies and assess their impact on the world around them. Many EM companies are tightening their business practices as we watch, feeling the global wind and becoming more aware of the issues. As investors we tread a delicate line. Some of our companies are not E&S angels, and whether we should invest in one with low awareness, but an improving trajectory needs thought and subjective evaluation. It is particularly encouraging that our interaction with a company can itself become part of the solution.

This topic is timely. At the end of June, the carbon intensity of the Fund, as calculated by Sustainalytics, increased significantly. This is largely due to the increase in our cement positions, notably that of Semen ("cement") Indonesia, now 1.5% of the Fund. We take this seriously. We have been a signatory to the United Nations-supported Principles for Responsible Investment since 2007, we support the UK Stewardship Code and we intend to issue our first annual ESG report early next year.

This letter takes three companies from the Fund and explores the complex questions regarding their E&S impacts. ESG analysis is usually applied as a negative filter, but to come to an overall judgement on the companies it is also important to consider the positive impacts. Taking E&S complexities as the topic of this letter is more like offering an invitation to a journey than describing the destination; it is less about the end point than engaging with the companies and trying to help them raise their game.

Semen Indonesia

Despite its polluting emissions and our related misgivings, we see our cement investments as compelling in a broad stakeholder analysis. Unfortunately, making cement generates greenhouse gases ("GHG"), especially carbon dioxide (CO_2). Cement generates about 8% of the global CO_2 total, not far behind the largest emitter, agriculture (12%). GHG emissions are unavoidable in the production process; limestone and clay are fed into huge kilns and heated to over 1,400 degrees Celsius, causing the calcination reaction that splits the material into carbon dioxide and the dark grey balls of clinker that are then ground into cement. Aside from GHG emissions, cement production also has other negative environmental impacts including water consumption and particulate air pollution.

On the other hand, concrete, which is made from cement by blending in aggregates, is crucial for construction. It was used by the Romans over 2,000 years ago and is now the most widely used man-made material. It is a key input for modern infrastructure and housing; indeed, it is hard to imagine a country developing without cement. If we accept economic development as a good thing for lower-income countries and that people should have access to better fundamental facilities such as hospitals, clean water and modern housing, we are forced to embrace cement. As investors we believe the way to deal with this necessary environmental evil is to look for, and encourage, best-in-class corporate behaviour to minimise the negative effects. We also focus our cement investments in lower-income countries, where the need for basic housing and infrastructure is more pressing.

Semen Indonesia is the largest cement producer in Indonesia with over 50% market share after buying the third player, Holcim Indonesia, earlier this year. Its dominant position is supportive of profits but in return the company is expected to be a good corporate citizen, supplying a region after, say, a natural disaster without profiteering. Cement consumption in Indonesia is unusually low at only 260 kg of cement per capita, which is half the level in Egypt, where incomes are lower, and a third of the per capita usage in Vietnam, where incomes are similar. If consumption rises, as we expect, it implies more emissions, but we cannot argue with the societal benefit of building infrastructure in a poor country. According to the UN, more than 1/5th of Indonesia's urban population lives in slums. Slums and other informal housing are vulnerable to Indonesia's frequent natural disasters, including earthquakes, flooding and drought. Proper housing, which will require cement, could help unleash the human potential of millions of Indonesians.

There are two things here: first, the necessary evil of producing GHG while making cement; and second, a much simpler question of communication. The reporting on ESG issues by EM companies is in its infancy. There is also significant variance among the ESG data providers that are monitoring them. This is not necessarily their fault: some EM companies are not sure why they should respond to requests for information from organisations they have never heard of asking questions few have emphasized in their home market.

While Semen Indonesia's own sustainability report is good quality, there are more things we would like to see in it, including targets to reduce GHG emissions. A lack of disclosure is not unusual in EM and in our experience may not accurately reflect how seriously a company approaches climate change. Only 27% of MSCI EM benchmark constituents report Scope 1 and 2 emissions and the ESG ratings services often end up basing their assessments on estimates, downgrading companies when they don't make public filings. We are engaging with Semen Indonesia to provide better climate-related disclosures that conform to international norms and the company has welcomed our input. In addition, we would like Semen Indonesia to consider the recommendations of the Task Force on Climate-related Financial Disclosures and to participate in assessment questionnaires from external groups such as CDP (formerly known as the Carbon Disclosure Project). We are encouraged by what the company is doing to reduce its environmental impact, including using POS data to optimise road haulage, lowering the clinker factor and switching to local renewable energy sources like sawdust, rice husks and coconut powder. The next stage is to communicate more effectively what they are doing and set targets. Targets we would like to see include those for: reducing Scope 1 emissions, cutting particulate air pollution, lowering non-renewable energy consumption, improving wastewater management and setting the bar higher for health and safety. It is a great help when companies, such as Semen Indonesia, have an ESG team to facilitate the dialogue.

Alibaba

Alibaba's license to operate rests on the huge benefits it has brought to consumers and small businesses in China since its founding. If we think back to the early 2000s, prior to the rise of e-commerce, Chinese consumers faced a perplexing problem: increasingly wealthy, they wanted to upgrade to higher-end apparel and accessories but didn't know what to buy. Popular global brands had limited presence in China at the time, and, to fill the void, consumers tended to use price as a proxy for quality: the higher the price, the higher the perceived quality. Some local brands took advantage and marketed their products at high price points. The high prices allowed multiple layers of distributors to enter the supply chain, but the middlemen typically added little value, seeking only relationship-based economic rents.

China's inefficient distribution provided fertile ground for the rise of Alibaba's Taobao platform, today the world's largest online retail marketplace with over 400 million active users and over 1 billion products available. Taobao's value proposition was to offer suppliers a direct route to consumers, cut out the middlemen and also reduce the scope for corruption. Looking back through our company meeting notes at that time, the CFO of a large Chinese department store company told us in 2012 that e-commerce was reducing the retail mark-ups from the factory to the consumer from the typical 10x to closer to the 4-5x found in Europe.

As e-commerce developed, a smaller cut for middlemen led to lower prices, and soon being on-trend became an affordable mass market aspiration. Alibaba's investment in IT systems also dramatically improved logistics efficiency: the average cost of a parcel delivered in China has fallen 10-15% a year for the last five years. The combination of competitive prices (an Alibaba survey showed average online prices were 20% lower than offline prices in rural areas) and better logistics allowed e-commerce in the countryside to blossom. By one estimate rural e-commerce transactions grew from US$30 billion in 2014 to US$196 billion in 2017. We shouldn't underestimate Alibaba's contribution to this growth: in the early days, the company created village stations in rural convenience stores to serve as drop-off and pick-up points. The village station operators were supplied with internet access so rural residents could browse online products. Fast forward to today, people in lower tier cities can dress as fashionably as their peers in Shanghai. Whether fashion is a public good is debatable, but access to products at fair prices is not.

As Alibaba grew, it facilitated the emergence of a raft of entrepreneurial online businesses. Alibaba's platform transforms the fixed costs of consumer companies into variable costs, allowing SME businesses to compete effectively against larger rivals. Alibaba aggregates demand, provides low cost delivery, serves sellers with effective cloud IT solutions and facilitates financing for smaller companies. These small businesses are an engine of economic growth, employment and dispersed wealth creation.

Reducing the cost of consumer goods and democratising the corporate landscape are the positive outcomes of Alibaba's self-interested business decisions. But the effects are not all positive. We monitor two potentially negative impacts of Alibaba's business, both of which are difficult for ESG data providers to analyse.

The first issue is whether Alibaba, having destroyed one set of inefficiencies, is creating its own potentially unsustainable monopoly, extracting overly high economic rents. We watch this closely, looking at Alibaba's take from the retail market, the profitability of its suppliers, the value the platform provides, and how the company uses its cash flows to invest. Currently we think the platform fees are sustainable, kept in line by the level of competitive pressure, but Alibaba's attempts over the last few years to block suppliers from selling on competing platforms is a sign of the company's market power that needs watching.

The second issue is something that plagues e-commerce businesses generally, and where none of us is off the hook: each order generates GHG emissions from transport and packaging, and worse, we tend to order smaller packages online than offline. We recently learnt that the average basket size at China's leading offline hypermarket is US$15, compared to the average ticket for an online grocery order of only US$10. This is the dark side of the highly efficient e-commerce logistics industry, which brings cheap goods to customers all over China. Although Alibaba's business model relies on delivery, the actual logistics is carried out by "ecosystem partners" that are not on Alibaba's balance sheet, so any narrowly focused ESG analysis misses out this important negative externality. We would like the company to place more emphasis on the environmental impact of its delivery partners, building on its focus on reducing the amount of packaging materials used by its ecosystem, whether or not it is something that impacts its official ESG assessments.

New Oriental Education

New Oriental, founded in 1993, is one of China's best-known brands in private education. Until the late 2000s, New Oriental focused on overseas test prep (i.e. LSAT, GRE, GMAT, etc.), building a strong brand through high-quality teaching. We have some first-hand experience of this at Genesis: Yiyong, one of our Partners and Portfolio Managers, was a New Oriental student in 2001 prior to attending London Business School. From the late 2000s, the company shifted its focus to after-school tutoring for primary and high school (K-12) students. K-12 is a larger market than overseas test prep, with much longer class duration, i.e. many years versus a one-off exam.

New Oriental's K-12 business has a significant social impact mainly through giving students access to higher-quality teachers. It achieves this by addressing two structural issues in the Chinese education sector. The first issue is that top students typically don't study to become teachers; they pursue jobs in engineering, economics, science etc. Therefore, most students are taught by people who themselves weren't top students. New Oriental resolves this problem by hiring high achievers directly from China's top universities, putting them through a very selective training and then offering strong financial incentives and a career trajectory (all top management at New Oriental started as teachers). This results in superior teaching quality compared with most private after-school tutoring.

The second issue New Oriental addresses is that high-quality teachers tend to be in Tier 1 and 2 cities. Students in lower-tier cities often travel to larger cities during school holidays to study, but there are many kids who can't do this. New Oriental's solution is technology; it created two innovative formats to reach the more distant students. The first is online small classrooms, where teachers livestream simultaneously to 20-30 students, with student-teacher interaction like a traditional classroom. Keeping class sizes small preserves the learning experience. The second format is dual-teacher classrooms. This involves a physical classroom, where a lead teacher livestreams remotely while a local tutor works with the kids to answer questions and mark homework. Both formats help to close the gap in service quality between what is offered in a top tier city and what is offered elsewhere.

We have several concerns about the Social impacts from New Oriental's education business. It is not ideal that a private company is profiting from what is a basic right, the services widen the education gap between those who can afford it and those who can't, and young kids are sometimes pushed overmuch into studying instead of playing. These are tough structural issues, but we are at least encouraged to see New Oriental offering a reasonable service and a pragmatic solution that goes some way towards broader access to the services available in the best postcodes.

While New Oriental has improved the quality of after-school tutoring in China, it has also consistently raised tuition costs above the level of inflation. The company's approach may contribute to parents feeling pressure to pay for ever more expensive tutoring to keep up with their peers. For businesses to be sustainable, and therefore attractive to long-term investors, the balance of stakeholder impact must be positive. We are encouraged by what we see at New Oriental, while watching the counterbalance.

Concluding Thoughts

At Genesis we are focused on long-term investments in good quality businesses with sustainable competitive advantages at attractive valuations. The sustainability of business practices is often not a simple question, and we are committed to thinking carefully about the impact on all stakeholders. For each of the Fund's companies, the issues must be re-evaluated as the facts change, and these changes may be more rapid in

EMs. Through extensive research and internal debate, we hope to gain a deeper understanding of a company's risks and opportunities and to engage meaningfully to improve outcomes.

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