OUR TAKE ON ESG

> Hotchkis & Wiley's investment approach is predicated on several important pillars:
> - We are long-term, fundamental investors
> - Valuation is the beacon that guides us
> - All investment decisions weigh risk and return

A comprehensive understanding of ESG factors strengthens each of these pillars. As long-term fundamental investors, we must understand if an asset or business practice is sustainable because this can significantly influence our estimate of normal earnings power, intrinsic value, and risk. We value businesses based on sustainable cash flows and/or long-term economic asset values, and material ESG factors can impact both. Accordingly, ESG factors have always been considered during the normal course of our research process—even before the widespread use of the term "ESG".

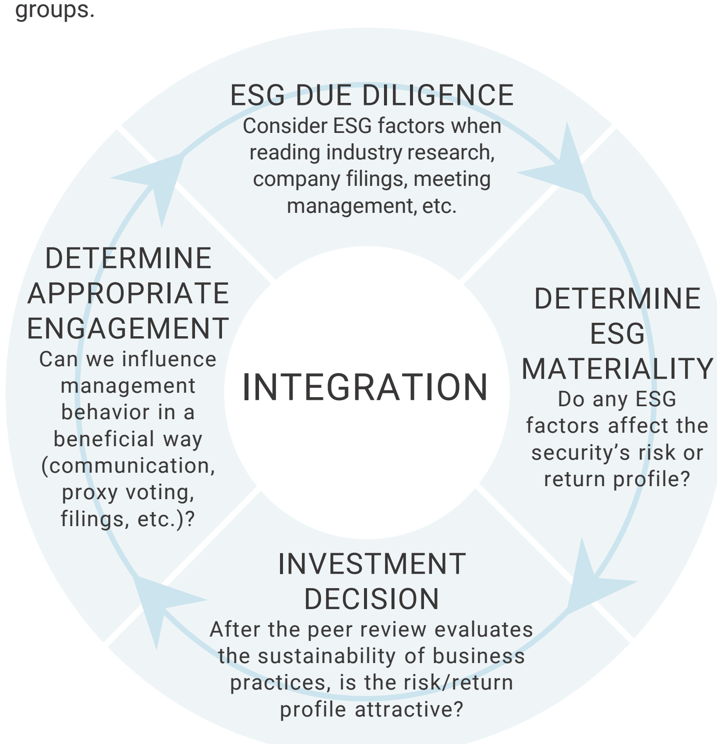
Our process for integrating ESG factors into our analysis has been progressively formalized/enhanced; however, the essence of our approach has been consistent throughout our firm's history. We recognize that material ESG factors can influence investment merits in many respects. To reflect this belief, we became signatories of the UN Principles for Responsible Investment ("PRI") in 2013.

In this paper, we will describe our philosophy and approach to integrating environmental, social, and governance issues into our investment process.

INTEGRATION

The PRI identifies three broad approaches to incorporating responsible investment into investment decision making: integration, thematic, and screening. Our approach is appropriately classified as integration because consideration of material ESG factors is incorporated into our bottom-up, fundamental research process. To help inform our investment decision, the ESG evaluation is combined with all other factors that can influence an investment's sustainability, valuation, and/or risk profile. Importantly, we are not precluded from investing in companies with ESG issues unless we determine that the issue impairs an investment's economic merit.

Effectively integrating ESG factors into our process requires a full team effort. We believe the analyst conducting fundamental research at the company level is best equipped to judge the materiality of ESG issues and potential ramifications, and also in determining if/how to engage management. In recent years, we have armed our analysts with third party ESG support, but we use these vendors as ancillary sources to support the analysts' independent judgement. Quarterly, we run two ESG reports on our portfolio holdings. One report gathers third party E, S, and G scores from four different vendors, which we average to compute a total third-party score. The other report is a proprietary scoring system that is derived using company reported ESG data. The report scores each company relative to peers in the same industry group. Both reports are used to inform our analysts and highlight any potential areas of concern; they are not used as a means of explicitly excluding select companies and/or industry groups.



We do not consider our ESG approach to be thematic, though our process may result in the appearance of themes, ESG or otherwise. However, this is a byproduct of our bottom-up process. For example, at similar valuations we are likely to prefer securities of utility companies that use cleaner fuel sources because they are less susceptible to EPA and other regulatory scrutiny, and thus represent more sustainable/less risky businesses. In this case, the portfolio would appear to have a clean energy theme, but this would be a result of company by company risk-return assessment rather than the manifestation of a top-down theme.

We also do not consider our ESG approach to be screening, although we have the ability to screen out so-called sin stocks at the request of individual clients. We have managed such accounts for long periods, and currently manage more than $3b billion in socially restricted assets. Outside of these client-directed initiatives, however, we do not explicitly exclude companies or entire industries from our investment universe. Often the investment hurdle is higher for companies that operate in controversial industries, however, because such companies are often subject to greater risks (punitive regulatory action, additional taxation, legal liabilities, etc.).

MATERIALITY

Determining whether an ESG issue is material to a company is a critical element of effective ESG integration. Some ESG factors, like capital allocation policies, executive compensation, and board composition are material to most, if not all companies. Other ESG factors are material to all/most companies in one industry but may be immaterial to all/most companies in a different industry. For example, greenhouse gas emissions is likely to be a material factor for utility companies but likely to be immaterial for banks. Conversely, cyber security practices are more likely to be material for banks. Beyond these straightforward examples, many ESG factors are idiosyncratic and require tailored research to determine what is important and what is not—as illustrated in the passage “The importance of employee relations – Alcoa” at the end of this paper.

Examples of materially positive ESG factors would include companies that:

- make products that reduce greenhouse gas emissions
- provide equal pay for women
- have an independent board of directors

Examples of materially negative ESG factors would include companies that:

- pollute excessively
- exhibit poor employee relations
- have dual class shares that restrict shareholder voting rights

ENGAGEMENT

We meet with management teams across the globe, in our offices, at conferences, and over the phone. We do not take a uniform approach to interviewing company management because each company and each management team is unique. During these meetings, we focus on the most influential drivers of our investment thesis. If during the course of our due diligence, we determine an ESG factor is likely to influence future cash flows or the company’s risk profile, we will address the issue with management. This does not indicate, however, that we are activist investors. We do not make an investment with the intent of obtaining a board seat, starting a proxy fight, or altering the strategic direction of the business. Instead, we take more cooperative approach by working with management and encouraging action that is in the best interest of shareholders, which when material, involve improvements to their approach to environmental, social, and/or corporate governance issues.

PROXY VOTING

As part of our discretion over managing client accounts, we vote proxies on our clients’ behalf unless explicitly directed otherwise. We have a formal proxy voting policy that outlines voting guidelines and procedures. The essence of our guidelines state that we shall vote in a manner that is in the best interest of shareholders and that each proxy should be considered individually. As it relates to ESG items, our approach to proxy voting replicates our approach to integrating factors into our research process—if the ESG item up for vote has a material effect on the sustainability of the business, we will vote accordingly. To facilitate consistency, our proxy voting procedures dictate that voting responsibility resides with the research analyst responsible for covering the company. To assist in this effort, we have engaged third party research from Institutional Shareholder Services (“ISS”). The research analyst responsible will consider the recommendations of both the board and ISS before independently submitting the proxy vote.

Proxy voting allows us to demonstrate our opinion as it relates to management actions, including ESG related items. We will vote against management's recommendation if we believe the proposed items are not in shareholders' best interests. ESG related factors are among the most common items where we express our opinions that oppose management—voting against excessive/misaligned executive compensation and the (re)election of ineffective directors are among the most frequent. We have also voted in favor of shareholder proposals that encourage ESG related improvements, including items related to employment diversity, global warming, etc.

CONCLUSION

We have long acknowledged that a company's approach to environmental, social, and corporate governance issues can affect its investment prospects. We integrate an assessment of ESG factors into the core of our research process, and when material, such factors influence our investment decisions. To implement effectively, our entire research team is responsible for integrating such factors into research process on a case by case basis. While we constantly strive for new and more efficient methods to support ESG integration, following nearly four decades of bottom-up fundamental risk evaluation our current process is robust.

THE IMPORTANCE OF EMPLOYEE RELATIONS – ALCOA

In the late 1990s, Hotchkis & Wiley analyst JP Flagler flew to Pittsburgh, PA to meet with Alcoa's CEO, Paul O'Neill. O'Neill was unique in that his top priority was to improve upon and ensure the ongoing safety of his workers. At the time he was appointed CEO, the company's safety record was generally viewed as adequate by the standards of the time. They were in no way satisfactory to O'Neill, however, and his policies to address the issues stretched well beyond what was considered normal for the time. From JP's perspective, O'Neill demonstrated his commitment by starting every one of his meetings with a review of safety-related procedures for meeting participants (JP's own meeting with Mr. O'Neill began with a compulsory review of the emergency evacuation plan), and every one of Alcoa's performance presentations began with a review of the company's safety statistics. O'Neill firmly entrenched this philosophy in the firm's culture, emphasizing the value that he and the rest of Alcoa's leadership placed on its workforce including, of course, those represented by unions. This, in turn, fostered improvements in employee morale, collaboration, and productivity.

Shortly thereafter, JP traveled to meet with one of Alcoa's direct competitors. As he was shuttled to the meeting, he was greeted by an angry group of striking union workers. The shuttle bus had protective metal screening installed in order to prevent injuries caused by thrown objects. Upon arrival, the company's CEO apologized for the scene in front of the plant and made comments that reinforced his combative stance with the workforce. The contrast with Alcoa was stark. Years later, that company filed for bankruptcy, and its inability to resolve its labor disputes was considered a key driver of that outcome.

Meanwhile, Alcoa thrived, as both its financial results and its share price rose. The primary takeaway, which was well understood by O'Neill, is that a safe, respected, and motivated workforce is essential to the success of a business and therefore its shareholders. We also understand and appreciate this distinction, which is one of the many important factors that we consider when evaluating an investment opportunity. It is part of our well-established and thorough due diligence process, developed long before the ESG acronym was coined.

The use of a historical company example is for illustration purposes only and should not be considered an investment recommendation. The example is based on a past investment in the company and does not reflect H&W's current view of the company. This information should not be indicative of the company's current situation, nor indicative of the company's future situation or performance. There is no assurance that the investment in the company was profitable. The company example does not represent all investments made for H&W's advisory clients.