FRANKLIN TEMPLETON

Templeton Emerging Markets Sustainability Strategy Outcomes

Investing for a sustainable future

- Assessing the sustainable investment opportunity in emerging markets
- Identifying companies delivering positive social and environmental outcomes
- Measuring and reporting the real-world contribution of our investments

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Contents

About us

Franklin Templeton in emerging markets

Having focused on identifying investment opportunities in emerging economies for over 30 years, Franklin Templeton is an emerging market (EM) pioneer.

Our footprint of more than 70 investment professionals across 13 countries enables us to identify investment opportunities beyond the mainstream, often before they are recognised by the broader market. We are also able to cover a wide range of companies across EMs, currently over 700, using our proprietary and rigorous bottom-up research approach.

Our scale and longstanding presence give us unparalleled on-the-ground access to business leaders, policymakers, and up-and-coming entrepreneurs across these fast-changing EM economies. We focus on independent research and active, high conviction investing. We build diversified portfolios and select companies across the capitalisation spectrum to meet each strategy's investment objectives.

By identifying structural market opportunities, investing in companies with sustainable earnings, and engaging in responsible stewardship as shareholders, we seek to capture the potential for long-term returns while encouraging the highest corporate standards in every market in which we invest.

ESG Investing
WINNER AWARDS 2022

The Templeton Emerging Markets Sustainability Strategy was the winner of the 2022 ESG Investing award for best ESG investment strategy, emerging market equities. The Strategy was selected from a shortlist of eight funds and was presented by ESG Investing, a division of Global Markets Media, a UK-based financial media company.

TOWARDS SUSTAINABILITY - TOWARDS SUSTAINABILITY

The Strategy has been awarded the 'Towards Sustainability' quality standard for 2022/23 by the Central Labelling Agency in Belgium. Based on thorough independent analysis, this indicates that a financial product is managed with sustainability in mind and has no exposure to highly unsustainable practices.

Our journey so far


Andrew Ness and Chetan Sehgal

Co-Managers
Templeton Emerging Markets Sustainability

Since our last report, which covered a period when Covid-19 had a firm grip on many economies, the pandemic has become less of a concern as populations get vaccinated and economies re-open. Clearly, there are some exceptions to this; in China, for example, a dynamic zero-Covid policy has a range of implications beyond its own borders. We have also witnessed the severe humanitarian, political and economic implications of Russia's invasion of Ukraine. At the same time, the world is grappling with inflationary pressures and investors are keeping a close eye on central bank interest rates and company earnings.

Set against the wide and differing drivers of emerging markets, we believe that our local presence and long-term investment strategy are as relevant as ever. Whether it's being positioned in some of the leading companies in the global semiconductor supply chain, leading local hospitals, or banks reaching underserved customers across emerging markets, we've continued to focus our research efforts on companies with a long-term focus. We've also made new investments in businesses using our holistic sustainability approach, which we further describe in this report.

> **"The direction for sustainable investment is a long-term, multi-stakeholder approach to value creation, with a focus on positive, real-world, social and environmental outcomes."**

Being part of the sustainable investment evolution

Over the past decade, sustainable investment has undergone a rapid transformation. Forty years ago, it was a niche practice to enable charities and religious organisations to screen out investments at odds with their purpose or ethics, such as tobacco or the arms industry, or to support the set-up of specialist green and environmental funds.

Figure 1: The sustainable investment evolution

Socially responsible investment, or SRI, was coined at the turn of the millennium. More recently, it's been recognised that the environmental, social and governance (ESG) practices of a company are material to both its downside financial risks and upside performance potential. The result is the widespread adoption of so-called ESG factors into investment analysis, stock selection and corporate engagement.

Issues such as climate change, poverty and social inequality have been climbing the global agenda, catalysed by the worldwide adoption of the United Nations' 17 Sustainable Development Goals (SDGs). Governments, intergovernmental organisations, and investors — from major institutional funds to individual private investors — are urgently asking how mainstream investments can do good in the real world (rather than just avoiding harm).

A focus on real-world outcomes

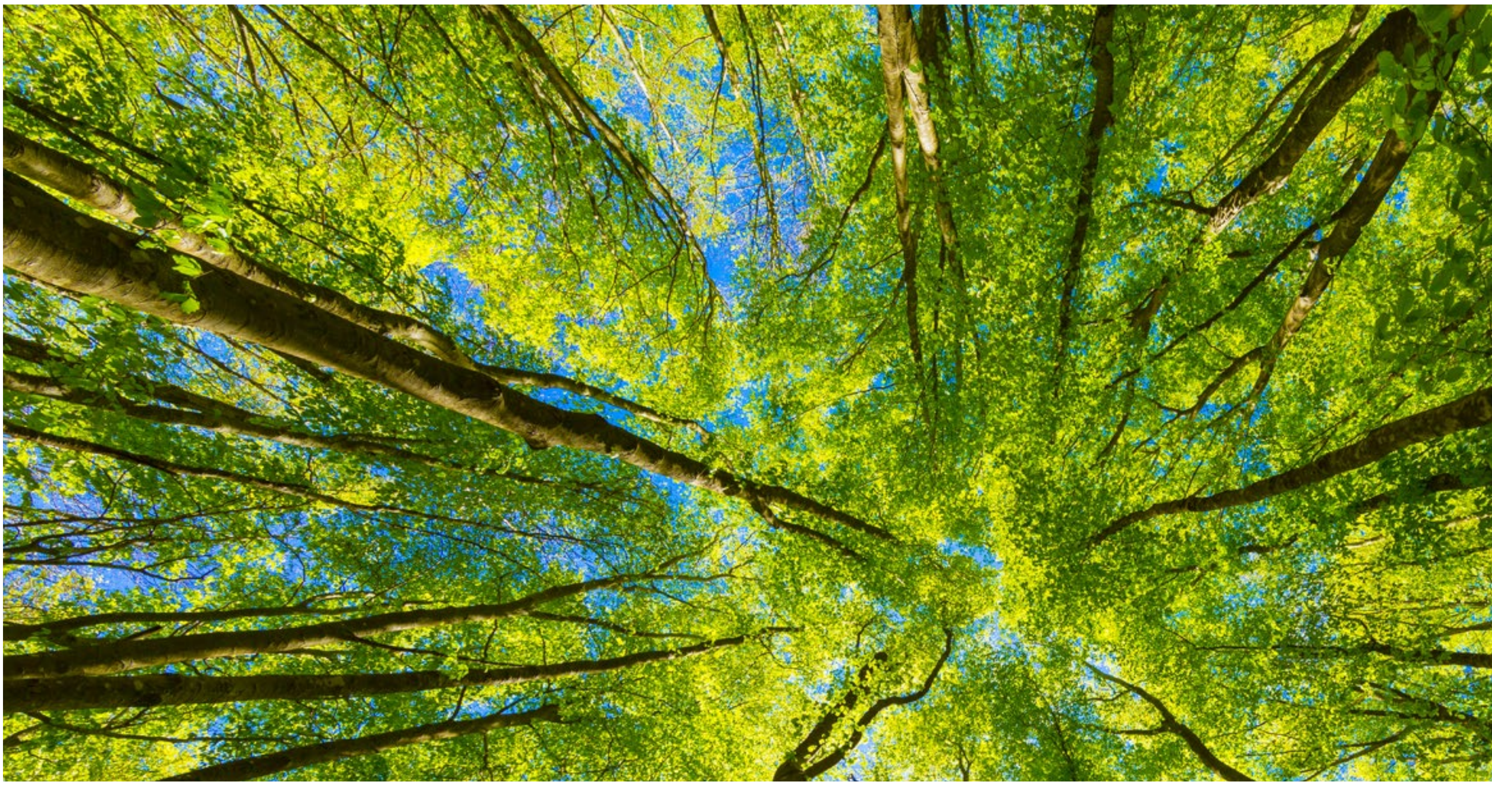
Sustainable investment — closely aligned to this global movement for sustainable development — is the result. It is a long-term, multi-stakeholder approach to value creation, with a focus on positive, real-world, social and environmental outcomes, delivering and quantifying them in an effective, accurate and repeatable way.

Templeton Emerging Markets Sustainability Strategy seeks to be at the heart of this evolution. Sustainable investment strategies with a focus on developed markets have proliferated in recent years. But this is one of the few strategies available to give investors pure EM equity exposure that's focused on sustainability.

Putting principles into practice

On the following pages, we explain the factors driving sustainability opportunities in EMs and the investment process used by the Templeton Emerging Markets Sustainability Strategy to harness and drive these opportunities. We then show how this process is being put into practice to deliver positive outcomes for all stakeholders, while targeting attractive risk-adjusted returns.

Managing the Templeton Emerging Markets Sustainability Strategy compels us to ask why we own a particular company and how it is quantifiably contributing to the creation of a better world. We hope this report will inspire many investors to ask the same questions of their portfolio.



Key highlights of the strategy

1. A dual objective to deliver attractive long-term investment returns, while contributing to six specified positive social and environmental outcomes areas, which are linked to the UN SDGs.
2. A unique, holistic three-pillar analysis and rating process, which identifies EM companies that are contributing to positive social and environmental outcomes and that have a strong operational ESG footprint or the potential to do so in the future.
3. A robust company activity analysis shows the portfolio measurably contributing to positive environmental and social outcomes linked to the UN SDGs — from supporting climate stability to enabling decent work.
4. A high-conviction portfolio with a long-term bottom-up approach and high active share.

Figure 2: A $1 million investment in the Templeton Emerging Markets Sustainability Strategy helped to...

Save
36 tonnes
of CO_2 emissions

Provide
46 people
with mobile phone services

Deliver
1,095
basic needs products

Provide
249 people
with healthcare services

Provide growth services to
2 businesses

Give
85 people or micro, small and medium-sized enterprises
access to microfinance services

Provide
155 people
with access to retail banking services

Provide
636 people
with access to internet services/users*

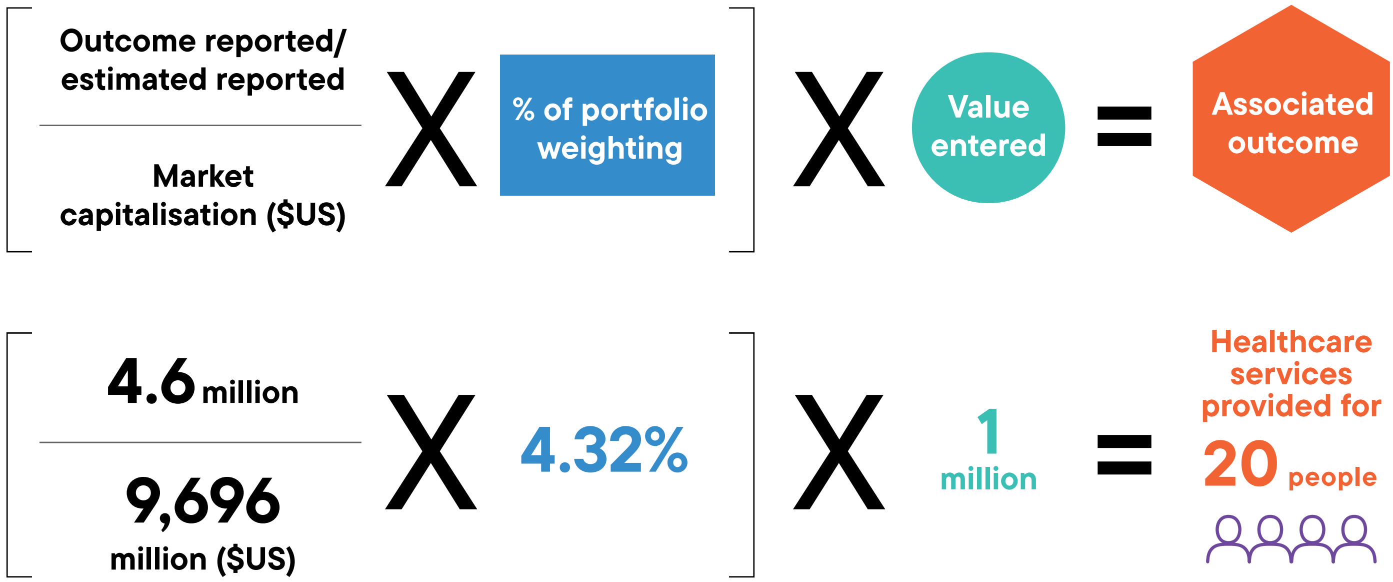
***May include daily, monthly or annual active users.**
Note these outcomes are estimates only and are not guaranteed.

Calculating our portfolio outcomes

Based on our ownership stakes in each company, we use a formula to calculate and quantify the outcomes achieved by each of our holdings.

Figure 3: Formula to calculate the positive contribution of a portfolio holding

Using a company's capitalisation, its reported or estimated outcome(s) and our portfolio weighting in that company, we can quantify the associated outcome to which our ownership stake contributes. As an example, the calculation below shows the outcome generated by a $1mn investment in the fund through our position in "Apollo Hospitals", which reports treating 4.6+ million in and outpatients in the latest reportig year.



In turn, we can then calculate the aggregated outcomes across our whole portfolio. We currently measure to these specific outcome indicators for 78% of the portfolio. A minority of companies are left out of this calculation where their activities fall outside these indicators.

This enables us to indicate to investors, based on the portfolio's total assets under management, how their holding may translate into a range of positive outcomes over a given period of time. Figure 2, for example, shows some of the key outcomes we estimate to be achieved by a $1 million investment in the strategy. The data collected for this calculator is based on latest available annual data, or a reasonable assumption otherwise, as at 30th April 2022.

Part one

The sustainable investment opportunity in emerging markets

To date, sustainable investment has focused heavily on opportunities within developed markets. But, at Franklin Templeton Emerging Markets Equity (FTEME), we believe the world's EMs also present compelling opportunities that require specialist and local knowledge to be identified and captured effectively.

Additionally, there are several macro factors at play, which should ensure that the EM sustainable investment opportunity is with us for the long term:

Opportunity 1: EM growth invites a rethink on global challenges

EMs are set to be the key beneficiaries of two global megatrends: urbanisation and demographics. Currently over 80% of global GDP is generated in cities and 93% of future urban population growth is expected to take place in emerging economies. At the same time, the world's population is projected to rise by more than 1 billion by 2030, with 97% of this population growth coming from emerging economies.[1]

These trends support economic growth and wealth creation in terms of consumption, connectivity, and innovation. But there is now a global appetite to see how this economic activity in emerging markets can address, rather than exacerbate, ongoing global challenges such as poor labour practices, pollution, resource scarcity and climate change.

Key points

- Urbanisation and population growth in EMs need to be managed in a sustainable way.
- The UN SDGs will require substantial private market investment if they are to be achieved within their targeted timeframe.
- EM corporates are starting to embrace more sustainable practices.

Opportunity 2: EMs face a huge sustainable development funding gap

A concerted global effort to tackle perennial challenges such as poverty, inequality, climate change, environmental pollution and resource scarcity was established in 2015, with the UN General Assembly's launch of its 17 SDGs and 169 underlying targets. Unanimously adopted by the 193 UN member states, the UN SDGs are the first truly global framework for action to achieve a better and more sustainable future for all.

The timetable for the UN SDGs is ambitious — it's hoped that all goals will be achieved by 2030, with progress subject to annual monitoring. But meeting the UN SDGs in this timeframe presents a significant funding gap, which can't be met by government spending alone — especially in lower-income economies (see Figure 4). This gives rise to a major financing role for private capital and, therefore, a significant opportunity for investors.

Figure 4: The UN SDG Funding Gap

The UN Sustainable Development Solutions Network (SDSN) estimates that the world's funding gap for achieving the UN SDGs is between $2 trillion to $4 trillion a year between now and 2030. This is as much as 4.5% of the world's $87 trillion gross output.

In 31 low-income countries and 51 lower-middle-income countries, the SDSN estimates that the UN SDG funding gap is between $1.4 trillion and $3 trillion per year.[2]

For low-income countries, the International Monetary Fund estimates that, if they increased their tax-to-GDP ratios by 5% within the next 10 years, they would only be able to finance one-third of the extra $500 billion required to fund the core work to achieve the UN SDGs. Private market participation will be central to make up this funding gap.

1. Consultancy.org
2. United Nations Association — UK

Opportunity 3: Societal/regulatory pressures are driving corporate stewardship

Across EMs, there has been a wave of interest in corporate stewardship. This has been led by local government policymakers, shareholders and other stakeholders.

Stock exchanges are asking for more disclosures from their corporate constituents, albeit on primarily voluntary basis at this stage. To attract inward investment, many countries are adopting global frameworks such as the World Bank's Ease of Doing Business indicators. Companies themselves are increasingly open to engagement. As an investor, FTEME has seen a strong improvement in ESG disclosure during recent years, if often from a low base.

Figure 5: Sustainability and corporate responsibility are growing in EMs

EM green bond issuance forecasted to reach $100bn a year by 2023[3]

China 14th five-year plan targets 1,300 gigawatts of wind and solar capacity by 2030[4]

The cost of starting a business in an emerging economy has fallen from 140% of income per capita in 2004 to <30% in 2020[5]

In Asia, almost 90% of companies now pay dividends[6]

> **"The timetable for the UN SDGs is ambitious — it's hoped that all goals will be achieved by 2030, with progress subject to annual monitoring. But meeting the UN SDGs in this timeframe presents a significant funding gap."**

But the right insight and process is essential

The combination of economic growth, the need for private capital to help fund the UN SDGs and rising corporate standards are providing a compelling sustainable investment opportunity for investors. But the move to better ESG standards in these markets is still very much a work in progress.

Given the diverse corporate practices and varying levels of policymaker engagement across markets, this is an area that requires first-hand corporate access, deep local knowledge of individual markets and a robust stock selection process. Our goal is to identify the most impactful sustainable opportunities, including those with the potential for future improvement.

On the following pages, we show how the Templeton Emerging Markets Sustainability Strategy is structured to realise this opportunity to its full potential.

3. Environmental Finance
4. Chinese Government
5. World Bank
6. FactSet – based on constituents of MSCI AC Asia ex Japan Index

Part two

Templeton Emerging Markets Sustainability Strategy — a dual purpose

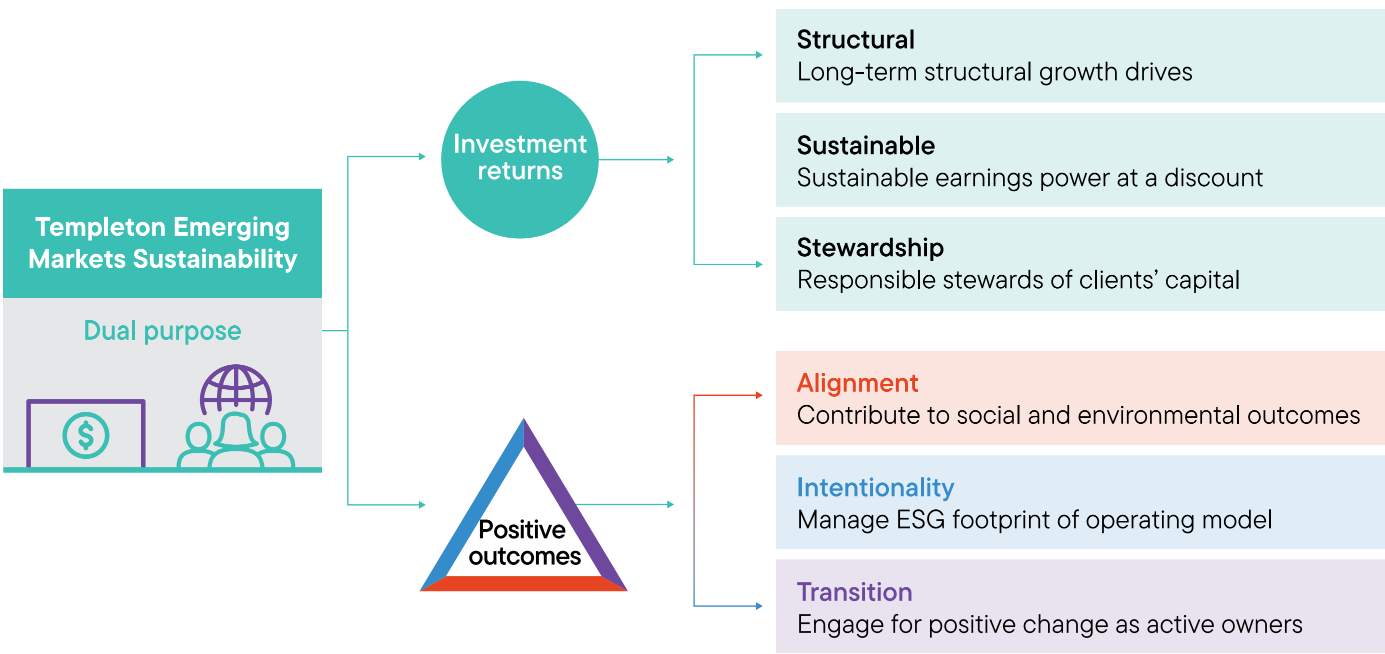
A Strategy focused on a dual purpose:

1. It aims to produce attractive long-term risk-adjusted returns, relative to the MSCI Emerging Markets Index.
2. It aims to deliver a range of positive social and environmental outcomes, which can benefit stakeholders across EMs and globally. This is done by investing in companies whose products or services contribute to one or more of six positive social and environmental outcomes linked to the UN SDGs (see Figure 6).

Key points

- Strategy managed to deliver financial, as well as social, and environmental outcomes.
- Transforms the UN SDGs into six investable themes.
- Unique three-pillar ESG process aims to identify the sustainable EM companies of today, and tomorrow.

Figure 6: The dual purpose of the Templeton Emerging Markets Sustainability Strategy



Through this approach, we aim to provide an investment strategy that can:

- Deliver on an investor's long-term financial and sustainability goals.
- Give investors targeted exposure to sustainability opportunities in EMs. This could complement complement their sustainability-driven equity exposure in developed markets.
- Enable us to act as active and engaged stewards to companies that are, or could be, able to help deliver positive social and environmental outcomes nationally, regionally, or globally.

As we'll show, the holistic approach we take to stock selection is designed to give investors a portfolio of companies with products and services that contribute to positive social and/or environmental outcomes. Equally, we look to identify corporate management teams who demonstrate a strong accountability for their own ESG operational footprint, or that present a significant potential to improve it.

In this way, we can identify EM companies that are making a strong positive contribution to the world today, and also those that could make a strong contribution in the future.

Our six positive outcome areas

Central to the Templeton Emerging Markets Sustainability Strategy investment scope are its six positive outcome areas, which are linked to the UN SDGs (see Figure 7).

The UN SDGs are a universally recognised set of 17 goals, which provide a comprehensive framework for action on the world's most urgent social and environmental challenges.

The UN SDGs were created as a framework for governments, not investors. Our six positive outcome areas, therefore, look to group the UN SDGs into "investable themes". Adapted from work by the Institute for Sustainability Leadership at the University of Cambridge, these are the key social and environmental outcomes that sustainability-focused investors might, reasonably, wish for their portfolio to achieve.

To be included in the Strategy, a company's products or services must align to at least one of these positive outcomes, and we rate companies on the strength of their alignment. By building a balance of companies that contribute to these different outcomes, we aim to help drive a range of sustained positive environmental and social contributions in EMs and globally.

Figure 7: Defining our six positive outcome areas

		Links to the Following UN SGDs	Examples of Investable Opportunity
Social Outcomes			
Basic needs	Focuses on goods and services known to contribute significantly to development including clothing, communications, education, energy, finance, food, healthcare, housing, sanitation, transport and water.	1 No poverty; 2 Zero hunger; 3 Good health and well-being; 6 Clean water and sanitation; 7; 10 Reduced inequalities	• Communications • Consumer finance • Consumer essentials
Wellbeing	Promotes enhanced health, education, justice and equality of opportunity for all. This may involve critical services including healthcare, education, justice, crime, welfare, culture, security and environmental protection.	3 Good health and well-being; 4 Quality education; 5; 10 Reduced inequalities; 11; 16 Peace, justice and strong institutions	• Healthcare • Education • Internet search
Decent work	Facilitates the creation of secure, socially inclusive jobs and working conditions for all, with a particular focus on alleviating poverty/supporting job creation in rural areas, and the use of formal employment contracts.	5; 8 Decent work and economic growth; 9	• E-commerce • Business finance
Environmental outcomes			
Healthy ecosystems	Looks to maintain ecologically sound landscapes and seas to benefit both people and nature—particularly in terms of the ability to supply or facilitate freshwater, clean air and abundant food.	14 Life below water; 15 Life on land	• Waste management • Agricultural
Climate stability	Focuses on global efforts to curb the Earth's temperature rise by supporting companies providing climate stability solutions, including green infrastructure, large-scale energy efficiency solutions, and zero emissions mobility.	9; 13 Climate action	• Green infrastructure • Low-emissions mobility • Semiconductors • Cloud computing
Resource security	Refers to the preservation of natural resources through efficient and circular use. Focuses on a company's progress from linear to circular operation and those facilitating this transition.	12 Responsible consumption and production	• Sustainable materials • Circular economy enablers

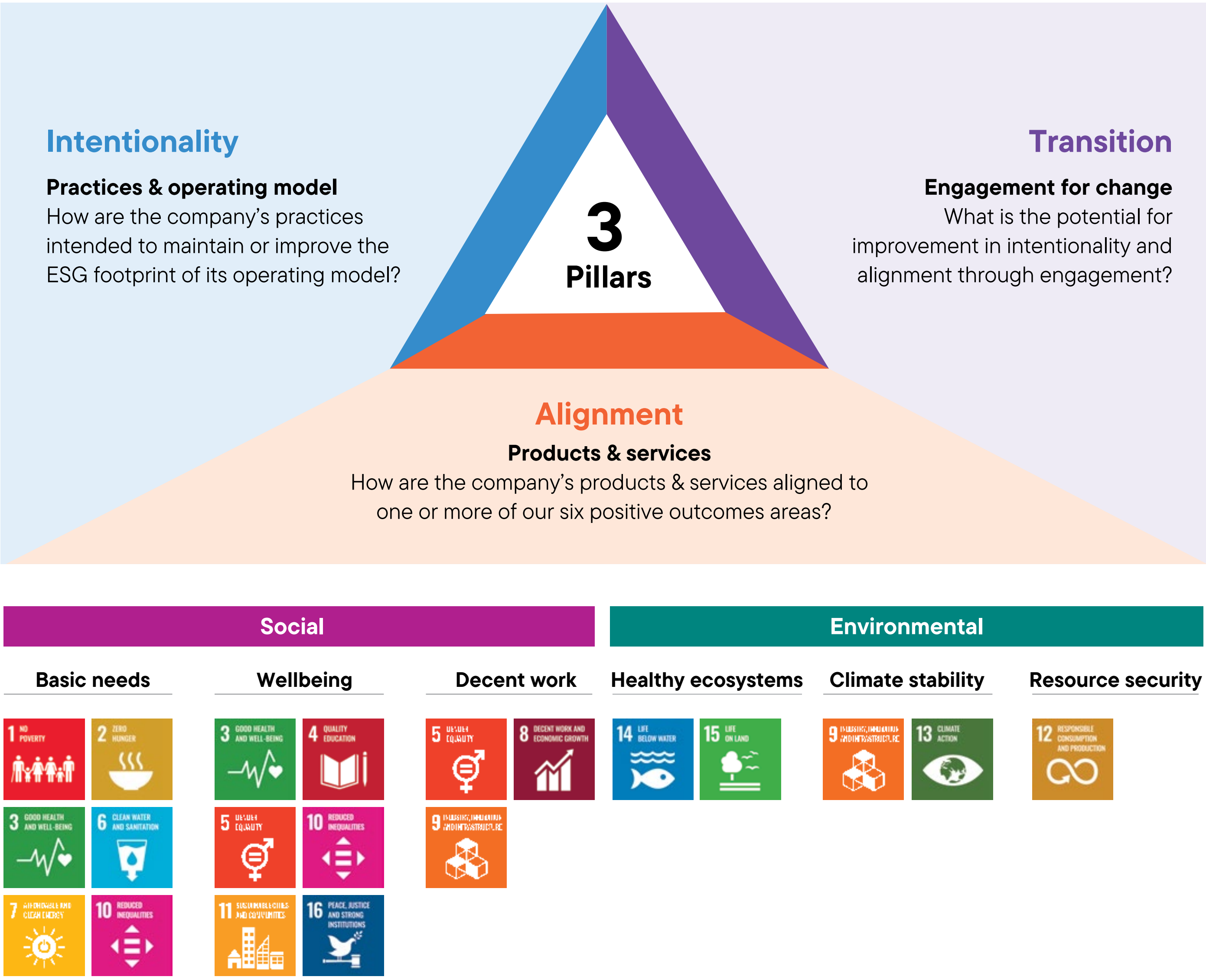
Source: Franklin Templeton/Cambridge Institute for Sustainability Leadership.

Our three-pillar ESG assessment

Templeton Emerging Markets Sustainability Strategy is a concentrated high-conviction strategy, where all our active ideas are made at the individual stock level. To identify potential equity holdings for the portfolio, we conduct an intensive, holistic three-pillar ESG assessment on each company (see Figure 8).

This approach aims to identify companies whose products and services, supported by their operational model, that are making a real and significant contribution to our six targeted social and environmental outcomes. Equally, and especially important for EMs, we can identify promising companies that offer scope for improvement and where our engagement can help drive progress. In the following section, we'll look at our three ESG pillars in more detail and how they are translating into real-world outcomes.

Figure 8: Our three-pillar ESG company assessment



> **“This approach aims to identify companies with products and services, supported by their operational model, that are making a real and significant contribution to our six targeted social and environmental outcomes.”**

Figure 9: Features of the strategy

As a result of our investment approach, the Templeton Emerging Markets Sustainability Strategy typically displays the four characteristics below. Together, these position the strategy to deliver on its dual goals of attractive long-term risk-adjusted returns and positive social and environmental outcomes.

Investing in sustainability-focused equities

Focuses on companies whose products or services may contribute to one or more positive social or environmental outcome areas (see Figure 7) linked to the UN SDGs.

High-quality growth at attractive valuations

Invests in businesses with sustainable earnings power, that are trading at a discount to intrinsic worth. This typically leads to a portfolio with higher quality, lower debt, demonstrable growth, and attractive valuation levels.

High-conviction portfolio with a high active share

A high-conviction portfolio holding 30-50 of our best stock ideas. Active share is typically over 75%, featuring holdings and weightings that may differ widely from both competitor strategies and the benchmark index.

Low turnover and long-term view

Our bottom-up, high-conviction and long-term view on companies means that, typically, our portfolio turnover is less than 20% a year. Our average stock holding period is over five years.

Figure 10: Portfolio exclusions

Alongside selecting companies that contribute positively to our six positive outcomes, certain activities may automatically exclude a company from our investment universe.

UN Global Compact violations

Companies in violation of the UN GC principles on human rights, the environment, labour and anti-corruption.*

Weapons

Companies involved in manufacture of nuclear weapons, anti-personnel mines, biological/chemical weaponry, depleted uranium, or cluster munitions. Also excludes companies deriving >5% revenue from other weapons.

Tobacco, gambling & adult entertainment

Companies that manufacture tobacco or tobacco products, or derive >5% revenue from such products. Companies deriving >5% of revenue from gambling or adult entertainment.

Coal & unconventional oil & gas

Companies deriving >5% of revenue from thermal coal extraction or unconventional oil and gas extraction (i.e. shale oil, shale gas, oil share and tar sand)

Conventional oil & gas

Companies either deriving:
1. >5% revenue from oil & gas,
2. >15% of capital expenditure dedicated to oil & gas with no increase in revenue,
3. or those that do not have science based targets set at well-below 2°C or 1.5°C, or don’t have a science based target ‘Business Ambition for 1.5°C’ commitment.

*Exceptions can only be made where our analysts conduct a formal review and can refute that a company is complicit in violation of UN GC principles, or can demonstrate that the company has made a positive change.

Part three

Our three-pillar ESG process in action

Key points

- Invests in EM companies with goods or services that contribute to the six targeted positive outcome areas.
- We also look to determine that a company has (or could have) strong ESG practices across all its operations.
- Process also identifies EM companies where active engagement can help create the sustainability names of the future.

Our proprietary three-pillar ESG inclusion framework goes beyond simple screens, ratings, and standardised metrics. Instead, it provides a rigorous and holistic fundamental approach to assess each company within our global EM universe.

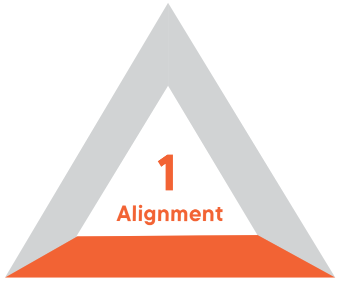
As we've shown, the positive environmental or social outcomes to which a company's products or services are aligned are at the forefront of our investment focus. This is combined with an analysis of the material ESG factors of a company's operating model and practices to find companies that demonstrate a strong accountability for their own operational footprint. Finally, as pragmatic, long-term investors, our focus on companies in transition allows us to invest in businesses at an earlier stage of their sustainability journey, where we believe that active owner engagement can help deliver measurable improvement.

> **"Our focus on companies in transition allows us to invest in businesses at an earlier stage of their sustainability journey, where we believe that active owner engagement can help deliver measurable improvement."**

Our three ESG pillars in practice

How do we go about measuring the effectiveness of our approach and the outcomes it generates? In this section, we show how we're applying our three ESG pillars — alignment, intentionality and transition — to stock analysis, selection and how we assess the impact firms are having.

1. Alignment: investing in products and services that can deliver positive outcomes



Principally, we look to achieve sustainable outcomes by investing in companies with core products or services that contribute significantly to one or more of the of the six social or environmental positive outcome areas detailed in Figure 7.

This requires a wide-ranging assessment through a bottom-up analysis of the potential direct and indirect benefits different sectors and industries can provide. For example, the wellbeing outcome which looks to promote enhanced health, justice, and equality for all, may include companies that operate in healthcare and education. But, less obviously, it can include internet search companies because of their ability to equalise access to knowledge and services, regardless of geography or physical ability. Using metrics like revenues, each company receives an alignment score based on the proportion of their business that is aligned to one or more of the six positive outcome areas.

Figure 11: Alignment — How we score companies

Alignment score		
10–24% of a company's business by our metrics is net positively aligned to one or more of our six Positive Outcome Areas.	**25–49%** of a company's business by our metrics is net positively aligned to one or more of our six Positive Outcome Areas.	**> =50%** of a company's business by our metrics is net positively aligned to one or more of our six Positive Outcome Areas.

Once in the portfolio, the real-world outcomes for each company are tracked and measured using an agreed "sustainability indicator". This indicator can range from the number of people accessing mobile data, thanks to a telecom company, to the quantity of CO_2 emissions avoided by an energy-efficient district cooling company. By identifying a clear and quantifiable sustainability indicator for each company, we aim to be able to track if, and to what degree, its contribution to an outcome area improves over time. We also aim to be able to show to investors what measurable outcomes their investment is helping to deliver.

Alignment in action

On the following pages, we profile three companies that have scored highly in our alignment analysis. We detail the social and environmental outcomes and identify the UN SDGs these companies address, the significance of their contribution, and the potential for further contribution in the future.

Case study

Safaricom

Safaricom is the largest mobile telecom operator and leading broadband provider in Kenya.

Positive Outcome Area (% of Revenue)*	Basic needs: 100%
Positive Outcome Summary	A leading telecom business in Africa that connects people and reduces inequalities, particularly with its financially inclusive M-Pesa mobile money transfer service.
Sustainability Indicator	1) Number of total customers 2) Number of M-Pesa customers
Primary UN SDG	
Underlying SDG Target	10.2 - Facilitates inclusive, sustainable economic development and innovation to transform lives and reduce inequalities by providing essential communications.
Secondary UN SDG	
Underlying UN SDG Target	1.4 – Helps the poor and vulnerable gain equal rights to economic resources through its microfinance products and services on M-Pesa.

What problem is Safaricom addressing?

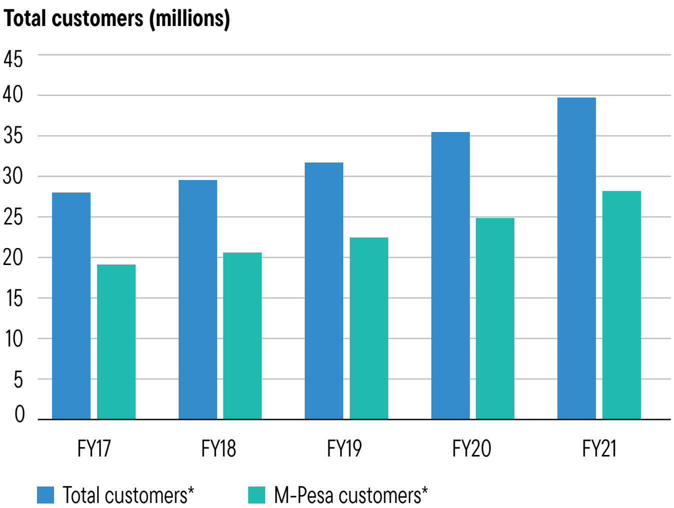
Kenya's landline infrastructure is largely lacking, with less than one fixed line subscription per 100 inhabitants. Although mobile penetration in the country is much higher, at almost 109%, only 40% of Kenyans have internet access. Smartphone costs and data pricing remain some of the key barriers to internet access, especially for low-income households. Covid-19 has accelerated demand for affordable data amidst growing internet traffic seeking government and health information, education, and other forms of content.

Kenya's low banking penetration and small network of bank branches has also restricted access to conventional financial services. The lack of infrastructure has led to high costs and inefficiencies when transferring money over long distances.

Case studies are used for illustrative purposes only and should not be construed as a recommendation to purchase a particular security or as an indication of trading intent for any Franklin Templeton strategy. It should not be assumed that securities discussed here were or will prove to be profitable.

*See page 11 for detail on how we classify our six positive outcome area

Figure 12: Safaricom in numbers



Source: Safaricom 2021 Sustainable Business Report.

247,869 Agents

64.4% Market share

10,800km Fibre optic footprint

39.9 million customers.

Safaricom 2021 sustainability business report.

What positive contribution is Safaricom making?

Safaricom has become central to the daily lives of nearly 40 million customers.[7] Its mobile voice, messaging and data offerings have enabled essential communications in a country with little landline infrastructure. Some of its offerings have brought health and educational services to low-income consumers who may otherwise not have any access to them.

Notably, M-Pesa has widened financial inclusion in Kenya's underbanked market. On top of transferring funds, M-Pesa users can borrow money, pay merchants, and receive global remittances more cost-effectively and efficiently. By some estimates, mobile money's rapid growth has lifted 2% of Kenyan households out of extreme poverty. At the same time, the company has helped some 185,000 women shift from subsistence farming into business or sales occupations.[8]

Safaricom has also directly created work for more than 240,000 agents who act as a distribution network for customers wishing to withdraw cash, purchase airtime and data, or access other services. The agents earn commissions from such transactions.

Potential to increase positive outcomes

- **Support small businesses:** Micro, small and medium enterprises (MSMEs) are the lifeblood of Kenya's economy but have been among the worst hit by Covid-19, and Safaricom has been developing solutions to support them. For instance, it launched Pochi la Biashara, a product that enables MSMEs such as food vendors and kiosk owners to separate their business and personal funds on M-Pesa. Safaricom also introduced M-Pesa Till, a one-stop solution for MSMEs to receive and make payments.
- **Develop purpose-led technology:** In FY2021, Safaricom adopted a new strategic positioning that would drive its evolution from a telecoms business into a purpose-led technology company. This strategy would see it focus on new business areas such as agriculture, education, healthcare and next-generation financial services.
- **Expand financial services:** Safaricom has been growing M-Pesa into a global payment platform, while expanding in new areas such as insurance. The company sees opportunities to extend and digitise its financial services for select industries such as healthcare and agriculture.

7. *Safaricom Annual Report FY2021
8. CNBC Africa, https://www.cnbcafrica.com/2017/mpesa-economic-impact-on-kenya/

Case study

National Central Cooling Co. (Tabreed)

Tabreed, operating across the GCC, is the only publicly listed district cooling company in the world. District cooling applies industrial scale to the cooling process, chilling water at a central plant and distributing it to buildings through a network of underground insulated pipes.

Positive Outcome Area (% of Revenue)	Climate stability: 96%
Positive Outcome Summary	A regional leader in district cooling. The company harnesses technology to lower capital expenditure and maintenance costs while consuming less electricity; this results in a smaller carbon footprint.
Sustainability Indicator	CO_2 emissions avoided by using lower-emission district cooling.
Primary UN SDG	
Underlying UN SDG Target	13.1 – Provides innovative technology solutions to support energy consumption and reduction, and the prevention of emissions.

What problem is Tabreed addressing?

2020 was tied with 2016 as the warmest year on record, signalling climate change's increasing impact on the planet.[9] Cities house over half the world's population, consume over two-thirds of the world's energy and account for more than 70% of CO_2 emissions.[10] With heating, cooling and hot water making up 60% of energy demand in buildings, most of which is supplied by fossil fuels, there is a pressing need to generate sustainable cooling at speed and on a large scale.[11]

Over the next decades, population growth, economic development and continued industrialisation will intensify demand for sustainable cooling.

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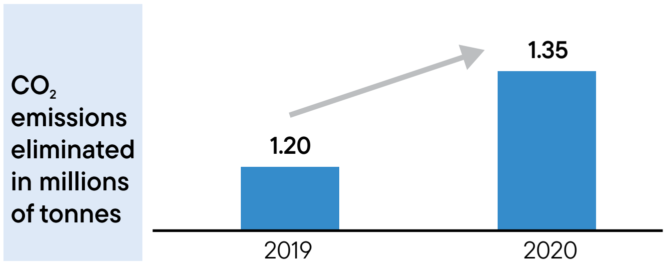
9. Financial Times, https://www.ft.com/content/379b8938-3834-4d1a-b673-c367a0075152
10. UN Environment Program, https://www.unep.org/news-and-stories/story/district-energy-secret-weapon-climate-action-and-human-health
11. Ibid

What positive contribution is Tabreed making?

Figure 13: Tabreed in numbers

2020 Sustainability Indicator:



86 plants across the GCC (>1mn RT)

221k RT new customer connections

1.35 million tonnes of CO_2 eliminated

Switch to sea water in Bahrain plant saves 150mn gallons of water

Sources: Tabreed 2019–2020 Annual ESG Report.
Note: RT - refrigerated ton

Tabreed's district cooling technology consumes 50% less energy than conventional cooling methods[12] It also incurs lower capital expenditure per refrigerated ton (RT) of cooling capacity and lower maintenance costs. These benefits have made district cooling a favoured option for environmentally and financially conscious governments and businesses.

Across the Gulf Cooperation Council (GCC) in 2020, Tabreed delivered over 1.4 million RTs of cooling to its clients. The energy saved by its services prevented the release of 1.35 million tons of CO2 emissions a year, equivalent to removing more than 293,000 petrol cars from the roads annually.[13]

Tabreed also uses thermal energy storage (TES) systems to manage peaks in district cooling demand. TES systems store chilled water in large tanks, making it available for use when cooling demand climbs. This helps to pare the total amount of energy that its plants would otherwise have used. Tabreed has adopted the TES technology in many of its plants for larger electricity savings, which is also positive for the plants' performance.

Potential to increase positive outcomes

- **Limiting carbon emissions:** Increased demand for cooling will impact emission levels, underscoring the importance of Tabreed's role in developing sustainable cooling projects to mitigate that impact. For example, in the UAE, cooling accounts for up to 70% of peak energy consumption, making it a major source of the country's CO_2 emissions.

- **Sustainable growth beyond the GCC:** Tabreed is focused on expanding into India and Egypt, which are seen as major opportunities for growth. The confluence of population growth, urbanisation and energy transition in these markets should drive their demand for district cooling.

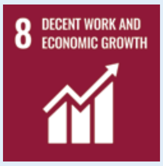
- **Shareholder support:** Tabreed has significant support from Mubadala, a shareholder and Abu Dhabi government entity. Tabreed is also supported by ENGIE, one of the world's largest international power and utilities companies. ENGIE has deep operating experience in the utilities sector. Both entities have continued to support Tabreed as it expands its footprint.

12. Tabreed 2019–2020 Annual ESG Report
13. Ibid

Case study

Itaú Unibanco (Itaú)

Itaú Unibanco (Itaú) is one of Brazil's largest financial conglomerates, providing a full range of banking and financial services.

Positive Outcome Area (% of Loan Book)	Decent work: 62% Basic needs: 32%
Positive Outcome Summary	A leading financial conglomerate in Brazil, which provides individuals and businesses, with financial services that support decent work, economic growth (e.g., consumer loans and credit cards) and basic needs (e.g., real estate and vehicle loans).
Sustainability Indicator	1) Number of corporate customers 2) Number of retail customers
Primary UN SDG	
Underlying SDG Target	8.3 – Promotes the formalisation and growth of SMEs including through the access to financial services.
Secondary UN SDG	
Underlying UN SDG Target	10.2 - Promotes social and economic inclusion through financial services aimed at significant development.

What problem is Itaú addressing?

Micro, small and medium enterprises (MSME) form a critical part of Brazil's economy. They make up 98.5% of all legally constituted companies, 27% of GDP and 41% of total payroll.[14] Despite their importance to Brazil's economic development, they often face challenges in securing credit to stay afloat. Credit in Brazil has traditionally been expensive, reflecting the high interest rates that are a legacy of the country's long-running battles with inflation.

In Brazil, financial literacy is generally low, which contributes to consumers' financial vulnerability. Household default rates hit an all-time high of 26.7% in August 2020, with Covid-19 contributing to the indebtedness.[15]

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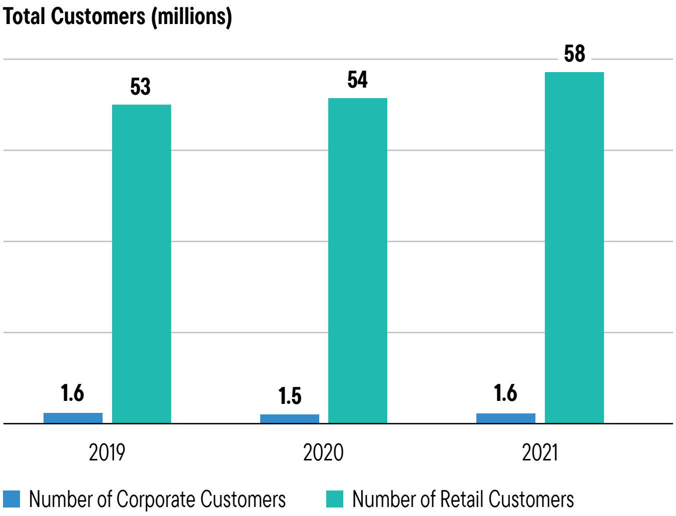
14. https://www.oecd-ilibrary.org/sites/8153da8d-en/index.html?itemId=/content/component/8153da8d-en
15. Ultau Unibanco Positive Impacts Commitment Report 2020

What positive contribution is Itaú making?

Figure 14: Itaú in numbers

Sustainability indicators:



Over 4,000 branches	Over 24 million digital clients	Over 1,600 suppliers in Brazil	Present in 18 countries

Itaú's microcredit programme offers small businesses low-cost credit lines ranging from R$400 to R$20,000, with a repayment term of up to 15 months.[16] This microcredit is available to both formal and informal entrepreneurs and aims to encourage investment in small businesses, which could boost job creation and incomes. Increased economic formalisation and development could also drive higher tax revenues for Brazil.

The bank has been expanding individuals' access to financial services and offering tools to help them make better financial decisions. In 2020, through preventive monitoring, it contacted around 1.2 million credit clients per month to offer financial guidance and kept most of them from falling into critical indebtedness.[17] Itaú has encouraged the use of its financial management tool, Minhas Financas (My Finances). The app had 800,000 users as of December 2020 and aims to reach 2 million users by the end of 2021.[18]

Potential to increase positive outcomes

- **Inclusion and entrepreneurship:** Itaú has several initiatives underway to further improve financial inclusion for MSMEs. For example, it has been extending more credit to women-led small and medium-sized businesses and aims to lend R$11 billion by 2024 (the figure crossed R$9 billion as of December 2020).[19] It has also provided entrepreneurs with specialised learning programmes and solutions.
- **Positive-impact sectors:** Itaú has committed to stepping up its funding and services in positive-impact sectors such as healthcare, education, and renewable energy. The company aims to allocate R$100 billion to such sectors by 2025.[20]
- **Digital expansion:** Itaú has been expanding its digital offerings for small business owners. Amongst them is Iti, a platform that enables business owners to access cash at accessible rates through an app, without even having a bank account. The bank has also launched a platform to help entrepreneurs in the running of their businesses by offering services such as sales and service order management, financial management, automatic invoice issue and accounting integration.

16. Ibid
17. Ibid
18. Ibid
19. Itau Unibanco Integrated Annual Report, December 31, 2020
20. Ibid

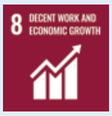
Spotlight on internet companies

Principally, we look to achieve sustainable outcomes by investing in companies with core products or services that contribute significantly to one or more of our six targeted positive outcome areas.

Internet companies are included in our investment universe given their ability to democratise access to knowledge and services, regardless of whether a user is based in a rural or urban area, is old or young, or a white or blue collar; all that is required is an internet connection. Their positive outcome areas are SDG 8: decent work and SDG 10: wellbeing.

Case study — Alibaba

Alibaba's China retail marketplace empowers millions of SMEs to sell products online, offering jobs and income opportunities (and helping some of those live in under-developed areas move out of poverty). They charge payment processing/commission/advertising revenue in return.[21]

Positive Outcome Area (% of Revenue)	Decent work: 65%
Sustainability Indicator	Annual active customers China Retail Marketplaces **2020**: 779 million **2021**: 882 million
Primary UN SDG	
Underlying UN SDG Target	SDG 8.3 – Promotes employment and growth opportunities through the access to internet services.
	Digital and platform economies have become the new driver for entrepreneurship and employment, while also playing an important role in facilitating employment and boosting incomes. Alibaba runs numerous e-commerce platforms, including Alibaba.com, Taobao Marketplace, and TMall. As one of the world's largest online B2B marketplaces, Alibaba.com has international B2B as well as domestic B2B trading within China. Alibaba's retail marketplace enables millions of SMEs, both domestically and internationally, to sell products online. This brings jobs and income opportunities. A report by Renmin University of China showed that Alibaba created 41 million jobs in 2018. As long as Alibaba's ecommerce GMV grows, it will continue to create jobs[23]. With 10 million merchants on Taobao and Tmall, and tens of thousands of merchants its potential as a catalyst for job creation is significant.

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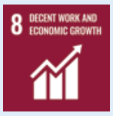
21. Source: Bloomberg
22. https://www.statista.com/statistics/226927/alibaba-cumulative-active-online-buyers-taobao-tmall/
23. http://www.aliresearch.com/en/Reports/Reportsdetails?articleCode=21831

Case study

Tencent

The Company, via its subsidiaries, provides social networking, music, web portals, e-commerce, mobile games, Internet services and payment systems.[24]

Positive Outcome Area (% of Revenue)	Decent work: 27%
Sustainability Indicator	Annual active customers China Retail Marketplaces **2020** **2021** 1.23 billion 1.23 billion
Primary UN SDG	
Underlying UN SDG Target	SDG 8.3 – Promotes employment and growth opportunities through the access to internet services.
	Tencent is a leading Chinese online platform. The company empowers SMEs by allowing them to do business with its WeChat userbase and receive payments via its digital wallet WeChat Pay. WeChat (and Weixin for mainland Chinese users) has 1.23 billion active monthly users and penetrates every aspect of Chinese society. The service provides a vast customer base with which SMEs can do business. Over the last decade, Tencent's WeChat has sought to simplify daily life for its users and has become a 'one-stop shop for the social and transactional needs of Chinese consumers. The service provides numerous functions that interact with people's daily lives. For SMEs looking to enter Chinese markets, WeChat can provide them with a competitive edge. WeChat Pay is a digital wallet connected to the app. This service has also become a vital payment method for businesses wanting to reach Chinese shoppers, both internationally and in China. Tencent's FinTech and Business Services revenue is mostly from WeChat Pay and related financial services. Recently, we have seen Tencent reducing transaction fees for SMEs on WeChat Pay to tide pandemic-hit merchants over and assist with the country's economic recovery.

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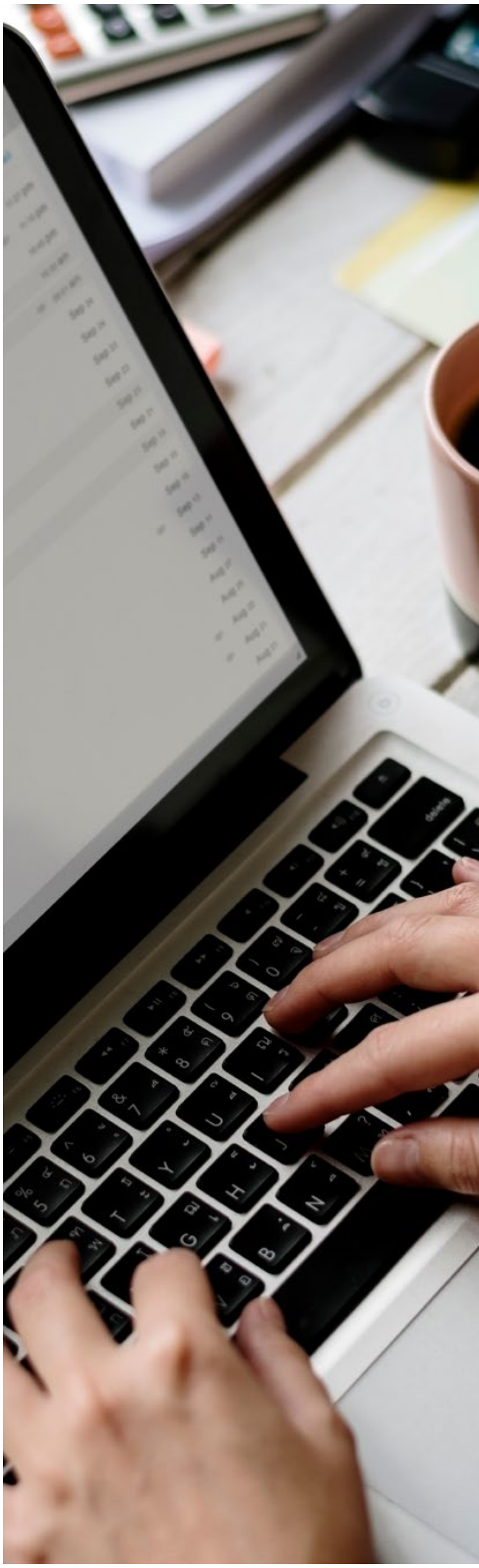
24. Source: Bloomberg
25. https://www.statista.com/statistics/255778/number-of-active-wechat-messenger-accounts/

Case study

Baidu

Baidu operates internet search and software services. The Company offers enterprise, online storage, navigation services, and news and image searches.[26]

Positive Outcome Area (% of Revenue)	Wellbeing: 65%
Sustainability Indicator	Annual active customers China Retail Marketplaces[22] **2020** **2021** 545 million 622 million
Primary UN SDG	
Underlying UN SDG Target	10.2 – Promotes social and economic inclusion through access to information.
	Baidu's search engine enables opportunities and access to knowledge, thus reducing inequalities. The service enables SMEs to be discovered by users, hence supporting economic growth in connecting businesses with potential customers. The search engine also enables advertisers to reach a large pool of potential customers and increase brand influence at a relatively low cost. The word "Baidu" literally translates as "100s of times". It is taken from a poem called The Green Jade Table in the Lantern Festival, written by Xin Qiji (1140–1207), and refers to a persistent search for the ideal. Now, in its 20th year, Beijing-based Baidu is not just a search engine; the company also provides maps, an encyclopaedia, forums and cloud storage services. Baidu is also a developer of the world's largest open-source autonomous driving platform: Apollo. Search enables users to[27]: • Covert information to action. • Understand and educate ourselves on a particular topic. • Fulfil the need to connect and socialise with others. • Experience moments in real-time. • Progress personal growth with long-term rewards. • Self-discover and develop a sense of identity.



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26. Source: Bloomberg
27. https://www.thinkwithgoogle.com/intl/en-gb/marketing-strategies/search/meaning-of-search/

2. Intentionality: Backing companies with a strong or improving operational ESG footprint

A company's products and services are the most important factor in whether it merits consideration for the Templeton Emerging Markets Sustainability Strategy. But, for inclusion in the portfolio, evidence of the appropriate management of a company's entire ESG footprint is key.

Focusing on 'Intentionality' allows us to identify companies in EMs, which are well managed and fundamentally committed to sustainability (or those whose sustainability profile could be improved through engagement). It also helps us flag and minimise any unintended ESG impacts that are generated by our portfolio companies and conflict with our six positive outcome areas.

How we measure intentionality

Guided by Franklin Templeton's ESG Sector Framework Guides and informed by the Sustainability Accountings Standards Board (SASB), we identify a minimum set of ESG issues, which are most likely to materially impact the operating performance or financial condition of a typical company in its industry group. These include:

- **Environmental issues:** resource efficiency, carbon emissions management, waste prevention, recycling, and pollution prevention and control.
- **Social issues:** labour standards, fair wages, diversity and gender balance, health and safety practices, and product safety.
- **Governance issues:** appropriate accounting practices, alignment of interests, board effectiveness, capital allocation, shareholder rights, and quality of disclosures.

Using our proprietary rating system, we assess and score companies on how they are taking action to achieve and maintain a strong operational ESG footprint. This will contribute to a company's overall Internal ESG Rating (see Figure 15).

> **"Focusing on 'Intentionality' allows us to identify companies in EMs, which are well managed and fundamentally committed to sustainability."**

Figure 15: Intentionality – How we score companies

Intentionality score

Some acknowledgement or management of key ESG concerns that we have identified.	Significant efforts are being made to manage key ESG issues in the company.	All key ESG issues are well managed and management demonstrates strong accountability.

Intentionality in action

Below we outline how we assess some aspects of the ESG operational considerations of our portfolio companies. Wherever possible, we also look to extend this assessment to our overall portfolio to monitor, manage and report on our own ESG footprint.

i. Carbon emissions/carbon intensity

We look to measure the level and intensity of carbon emissions where they are material to a company's operations. We also look to assess our whole portfolio's overall carbon footprint, and what is driving it, to determine how it compares to the market and how it could be improved.

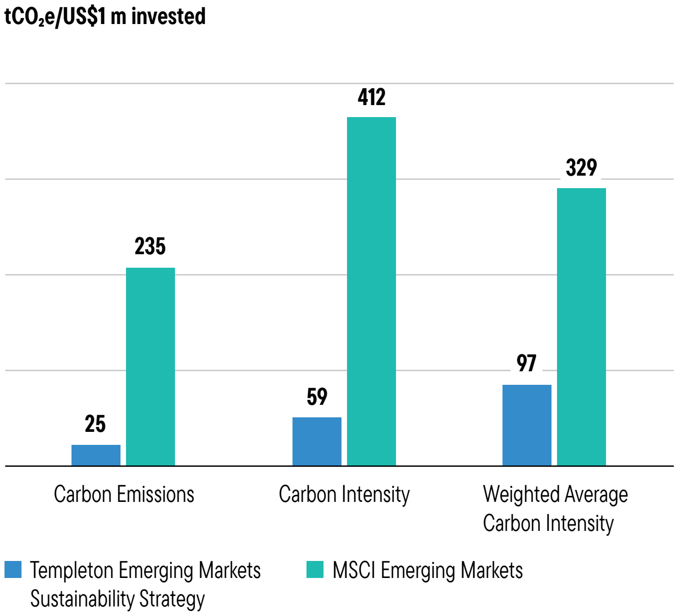
We assess carbon at a company and overall portfolio level on three metrics using emissions data provided by MSCI (see Figure 15). We gather additional reported carbon data from companies to determine their intentionality score.

Figure 16: Calculating the carbon footprint of our portfolio vs the MSCI Emerging Markets Index

i. Carbon emissions tonnes CO_2e/ US$1 m invested	Measures the portfolio's normalised carbon footprint per US$1 million invested.
ii. Carbon intensity tonnes CO_2e/ US$1 m sales	Measures the portfolio's efficiency in terms of the level of carbon emissions per US$1 million of sales of sales generated by a company.
iii. Weighted average carbon intensity tonnes CO_2e/ US$1 m sales	Measures the portfolio's exposure to carbon-intensive companies.

Our focus both on low carbon intensive investments and companies managing their emissions profile has helped us achieve a portfolio whose carbon profile is much lower than the MSCI Emerging Markets Index on all three measures—see Figure 17.

Figure 17: Carbon profile of Templeton Emerging Markets Sustainability Strategy vs MSCI Emerging Markets Index



Source: MSCI ESG. Carbon emissions include scope 1 and 2.

We emphasise that the carbon data does not always fully represent the actual carbon risk of the portfolio. Some of this data is estimated where carbon emissions are not disclosed by portfolio companies. The weighted average carbon intensity (WACI) is measured against sales; in production orientated industries this is not always an accurate measure. Importantly, the reported data is a snapshot at a single point in time and does not represent the forward-looking nature of our approach to analysing investee companies.

Case study

Tabreed: Reducing carbon emissions

Tabreed a district cooling company. District cooling applies industrial scale to the cooling process, chilling water at a central plant for onward distribution.[28]

ESG issue: Tabreed has ramped up its efforts to save energy and reduce its carbon footprint over the years. Given the scale of its operations, even small improvements in its efficiency can make a considerable difference.

Company action: One measure it tracks is electrical efficiency, or the amount of electricity used in kilowatt hours per unit of sold cooling. From 2017 to 2019, its electrical efficiency improved by around 4%.[29]

Tabreed has also been cutting its vehicle fuel consumption to lower its carbon emissions. By its estimates, every litre of gasoline that a vehicle uses generates about 2.3 kilograms of CO_2. From 2016 to 2019, the company's vehicle fuel consumption declined by 41%.[30]

The company has focused its R&D and innovation strategy to foster mid to long-term capital expenditure projects. Their goal is to significantly reduce the power consumption, CO_2 emissions and lifecycle costs of its existing and future cooling plants.

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ii. ESG controversies, UN Global Compact, human rights and labour norms violations—

Data to appraise all these operational ESG aspects at the company level is drawn from engagement with management, financial statement analysis, corporate reports, and third-party ESG research from companies, including MSCI and Sustainalytics. As explained in Part Two of this report, we exclude companies in violation of the UN Global Compact Principles on human rights, the environment, labour, and anti-corruption unless our analysts can put a strong case otherwise.

Filtering out companies with concerns in these areas has enabled the Templeton Emerging Markets Sustainability Strategy to have zero exposure to very severe controversies and norms violations—see Figure 18.

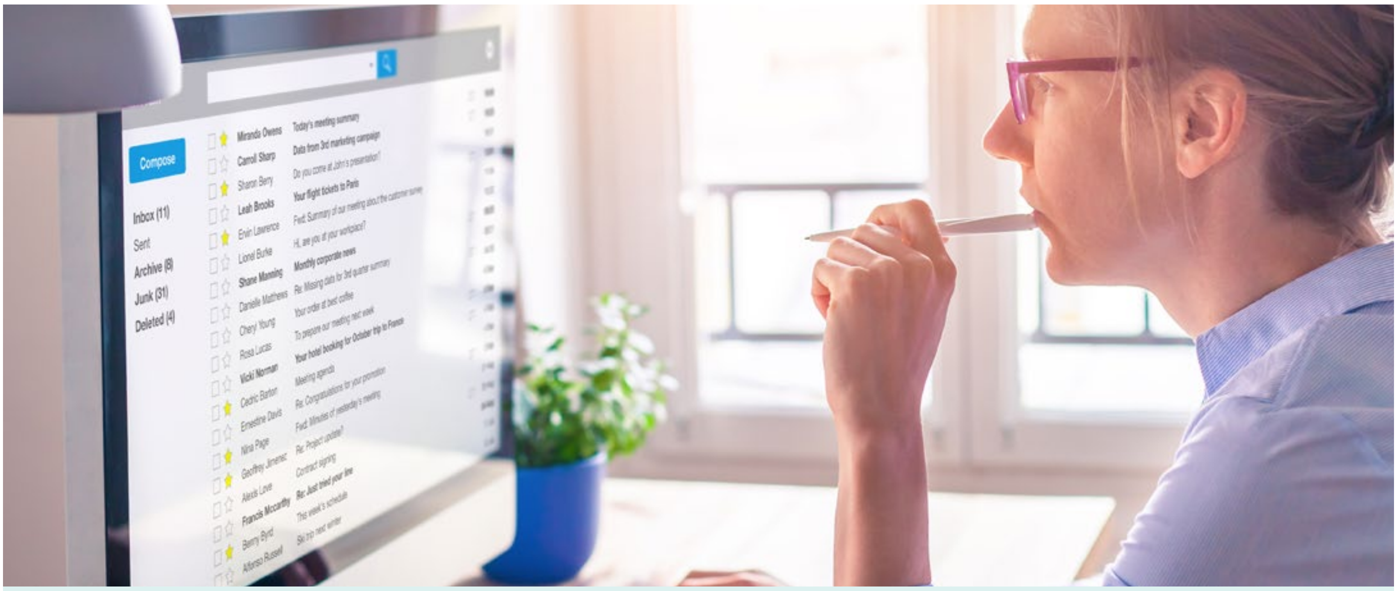
Figure 18: Exposure to international norms violations

% of portfolio by value	Templeton Emerging Markets Sustainability Strategy	MSCI EM Index
Very Severe Controversies	0%	2%
UN Global Compact Violations	0%	2%
Human Rights Norms Violations	0%	1%
Labour Norms Violations	0%	1%

Source: MSCI.

28. Bloomberg
29. Tabreed 2019–2020 Annual ESG Report
30. Ibid

Case study | Safaricom: Protecting customer data



Safaricom is the largest mobile telecom operator and leading broadband provider in Kenya.[31]

ESG issue: Protecting customers' personal data is key to being a trusted service provider, as is providing enterprise clients with managed security services to safeguard their business operations.

Company action: The European Union's General Data Protection Regulation (GDPR) and Kenya's personal data management legislation have further raised the bar on data security. Safaricom has designed its data protection policies with these rules in mind.

Notably, the company set up fraud management squads specialising in analytics, machine learning and other technologies to enhance customer safety, fraud awareness and process reviews.

Safaricom also launched a customer awareness campaign known as Jichanue and Take Control to highlight issues of identity theft and social engineering fraud through radio, television, and digital channels.

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iii. Governance

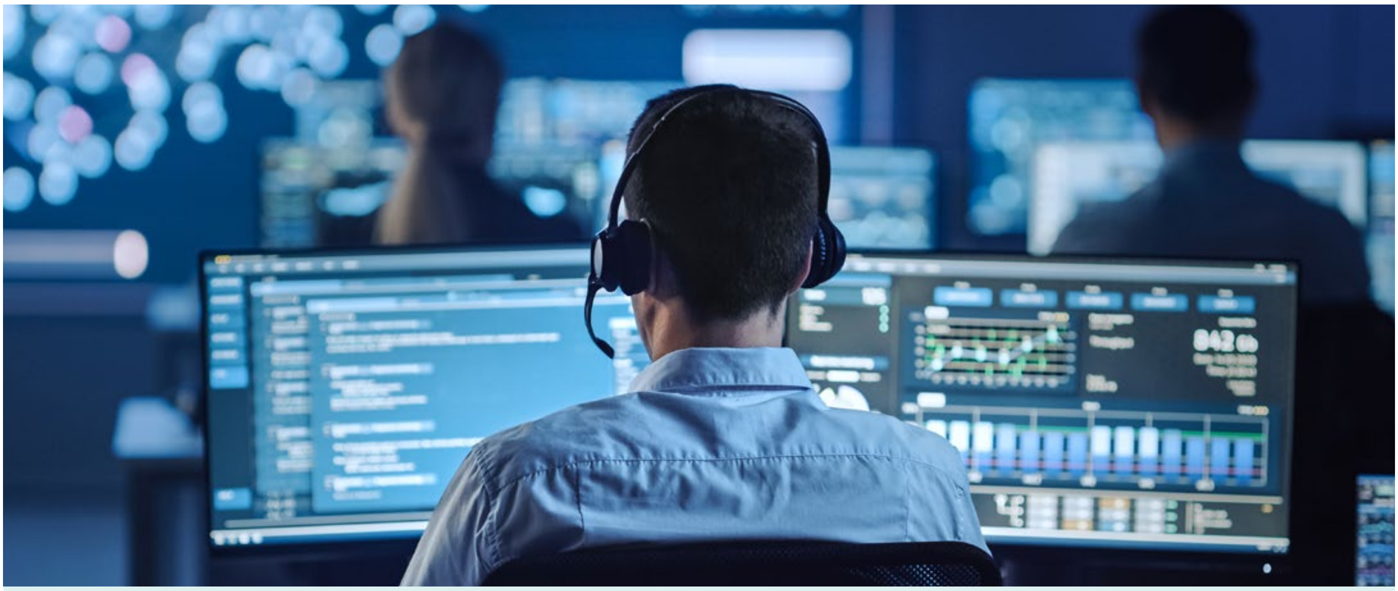
Highly divergent standards and differing regulation of corporate governance are a feature of global EMs. Assessing companies for strong or improving governance practices requires a highly active, first-hand assessment of companies and cannot rely on third-party data.

To assess companies' intentionality in terms of governance, we look at factors like accounting practices, alignment of interests with shareholders, board independence and diversity, capital allocation, remuneration practices, and quality of disclosures.

31. Bloomberg

Case study

Itaú Unibanco: Enforcing business ethics



Itaú Unibanco (Itaú) is one of Brazil's largest financial conglomerates, providing a full range of banking and financial services.[32]

ESG issue: Financial institutions play a key role in stemming illegal activities, with a focus on monitoring suspicious transactions and promoting ethical behaviour internally. That role is especially critical where corruption concerns exist. In Transparency International's 2019 Corruption Perceptions Index, Brazil ranked 106th; this was its worst position since 2012.

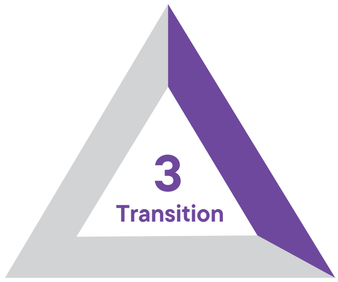
Company action: Itaú recognises its responsibility in promoting business ethics and has put policies in place to prevent and combat different forms of corruption, including transnational corruption. Apart from complying with local laws, it has also sought to build an ethical culture by providing its employees with training and reporting channels.

Some specific initiatives include Pró-Ética, which encourages companies to voluntarily adopt ethical measures. The programme publicly recognises companies that are committed to preventing, detecting, and rectifying corruption and fraud.

Itaú also has an internal ombudsman's office, an independent department that operates with full autonomy and reports directly to the chief executive officer. The office aims to help employees resolve conflicts of interest and other potential areas of misconduct in the workplace.

32. Bloomberg

3. Transition: Engaging with companies for future positive change



In an ideal world, all our companies would be achieving a perfect score on our first two ESG pillars, alignment and intentionality. However, many companies, especially in EMs, are at a relatively early stage of their sustainability journey. Yet they may often present compelling potential for progress, especially with the right engagement from active investors like Franklin Templeton.

Our third ESG pillar, therefore, looks to rate such companies on their potential to transition into leading sustainability names. In this way, we can fairly assess their credentials for inclusion in our portfolio.

How we measure transition

Where there is scope for improvement in a company's intentionality rating (or, in rarer cases, in its alignment rating) through engagement, we identify the key issues to be addressed. We then assess the actions and metrics on which we could engage with company management to begin to resolve these issues.

Where we see there is good potential for change through engagement, we will give a company a positive transition score. Note that where a company has scored highly on our intentionality pillar, no, or little, shareholder engagement may be required, so a company may receive a Transition score of zero.

"We have identified over 40 individual ESG issues across 24 portfolio companies on which we plan to engage, and where, given available time and resources, we are confident our involvement can have a constructive impact."

Figure 19: Transition - How we score companies

Transition score		
The company has strong ESG operational practices so no engagement is needed or there is scope for improvement but it is unlikely to be achieved through our engagement.	We have identified one or more areas of the company's ESG practices or activities that could be improved through targeted engagement by us.	We have identified numerous areas of the company's ESG practices or activities that could be improved through targeted engagement by us.

Transition identified

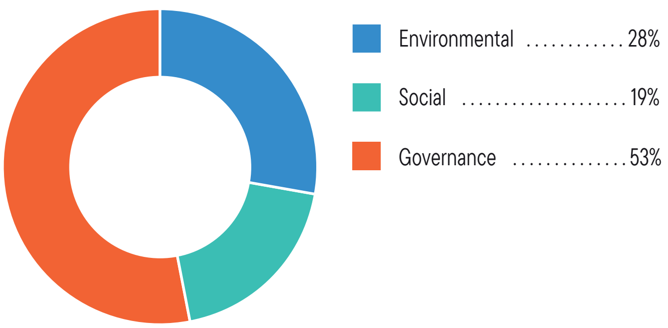
We have identified over 40 individual ESG issues across 24 portfolio companies on which we plan to engage, and where, given available time and resources, we are confident our involvement can have a constructive impact.

The majority of these engagement issues focus on governance (e.g., board independence, shareholder protection and rights, and executive remuneration), followed by social concerns (e.g., data privacy and community engagement), then the environment (e.g., pollution and waste management.)

Figure 20: Engagement issues identified in portfolio companies

Engagement issue	No of identified issues
E – Carbon Risk and Climate Change	**5**
Climate Disclosures	4
Other	1
E - Environmental	**7**
Other	3
Pollution and Waste Management	3
Water	1
S – Human and Social Capital	**8**
Community Engagement	2
Data Privacy	2
Bribery and Corruption	1
Cyber Security	1
Human Rights	1
Other	1
G - Governance	**22**
Board Independence	7
Shareholder Protection and Rights	6
Board Diversity, Skills and Experience	4
Executive Remuneration	3
Other	2
G – Strategic Risk and Communication	**1**
Business Strategy	1
Total	**43**

Figure 21: Identified company engagements by theme



Source: Franklin Templeton.

Active ownership

As investors with significant scale across EMs, our active ownership efforts are a key part of our overall approach to stewardship.

Our approach to active ownership and engagement focuses on material issues that affect the sustainability of earnings, including strategy, material governance and sustainability factors. Given our long-term outlook, we build strong relationships with our investee companies as co-owners on our clients' behalf. As active owners, we seek to engage with companies on material issues via several approaches, including management and board meetings, letter writing, proxy voting, and shareholder-resolution filings.

Engagement statistics in 2021

Our analysts are in a continual dialogue with companies on a range of topics, including governance and sustainability. We have also identified companies where a more detailed discussion on ESG topics are necessary, and we report the nature and outcome of these meetings.

ESG issue
Identify material ESG issues and rationale for engagement

Objectives and process
Set goal and/or rationale for the engagement and approach

Outcome
Review outcomes, next steps and investment thesis

Figure 22

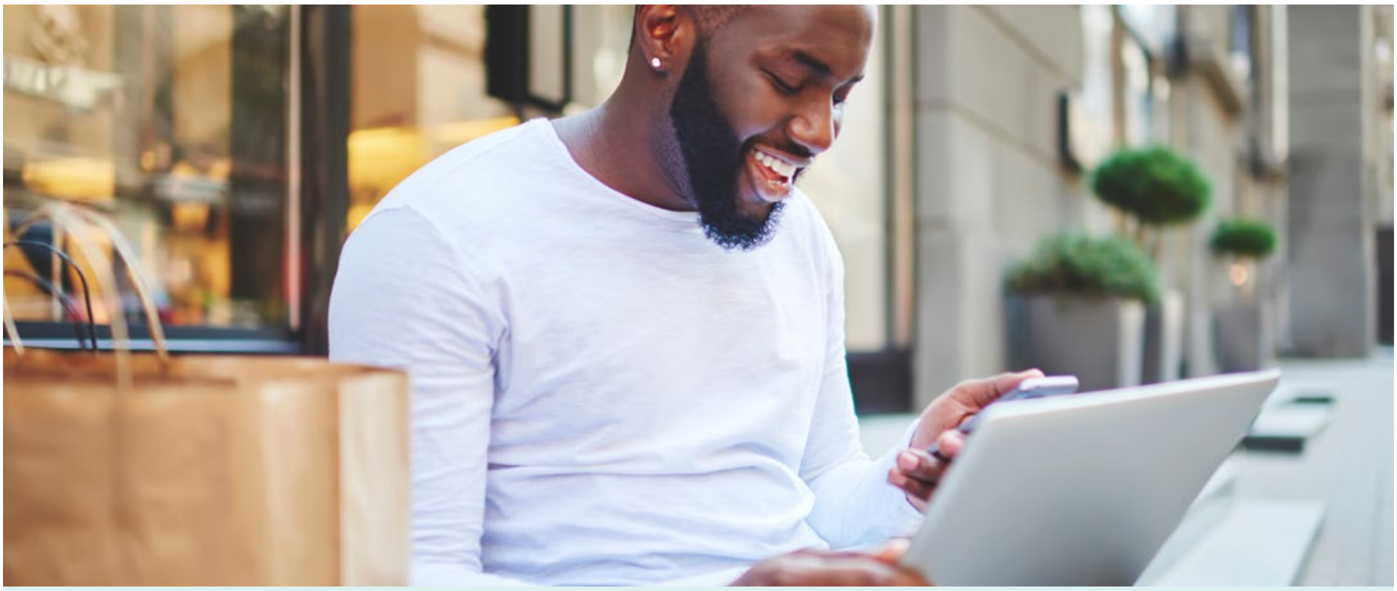
Interactions by theme 2021	Number	Percentage
Environmental Interactions	11	46%
Social Interactions	4	17%
Governance Interactions	3	13%
Combination of Interactions	6	25%
Total	**24**	
# of Individual Issues Engaged in 2021	**30**	

Engagement undertaken in 2021

As active owners, we engage with companies not only on issues that we have explicitly identified for improvement, but also on other areas that help us to better understand their strategy and direction. Many of these areas will be related to sustainability and governance. The following pages feature examples where we have identified engagement issues formally through our three-pillar framework, as well as through other conversations with the companies.

Case study

Safaricom



Safaricom is the largest mobile telecom operator and leading broadband provider in Kenya.[33]

ESG issue: We engaged with Safaricom on the M-Pesa fee structure in June 2021, following the governments removal of a transaction fee waiver that it had put in place to support M-Pesa users during the Covid-19 pandemic.

Objectives & process: We wanted to understand what management thought were fair fees, given the context of its regional peers and how any changes would impact its transactional volume and margins. It was also important to understand how the fee waiver removal had been received by Safaricom's customer base.

Outcomes: The engagement helped to clarify our views on how the fee waiver removal had been received by Safaricom's customers. We were encouraged to see that transactional volume growth remained high, despite the reintroduction of fees, as customers had become more entrenched in using mobile money services during the pandemic. Notably, following the fee waiver removal, Safaricom also reduced its fees by an average of 12–15% to show solidarity with its subscriber base during hard times. Management is aware that the fees may need to drop further over time, as has been seen in other markets with more advanced mobile money offerings. Nonetheless, this could be offset by volume growth as user penetration and service offerings increase.

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33. Bloomberg

Case study

LG Chem

LG Chem is one of the world's leading electric vehicle (EV) battery makers and is based in South Korea.[34]

ESG issue: Battery manufacturing often produces scrap due to chemical conversion or mechanical processing shortcomings. This scrap contains valuable metals, and LG Chem has been developing solutions to recycle these metals into raw materials for battery production.

Objectives & process: To discuss alternative recycling solutions and to understand their plans and aspirations for closed-loop metals processing with battery scrappage. Minerals for battery production that are sourced from scrap are expected to have a lower carbon footprint in comparison to mined ore. The processing of recycled materials is also far less polluting than mining. Because of this, the economic costs should be considerably lower.

Outcomes: We will continue to engage with the company and monitor their progress over the coming months. Also, for recycling to be a considered a standalone, viable proposition, a critical mass of spent batteries is needed. However, with EVs just starting to take off, the volume of EVs at or near the end of their useful lives is very small compared to battery makers' current demand for minerals. It is expected that, by the end of the decade, the required mass of spent batteries should increase as older EVs are retired.

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34. Bloomberg

Case study

Netcare

Netcare is a private hospital group. The company offers a range of medical and healthcare services in South Africa.[36]

ESG issue: We sought to understand Netcare's data privacy policies as it works towards digitalising its business. Data is viewed as a valuable commodity; the protection of data is critical and presents a real business risk to revenues and reputation if data is abused or kept unsecure.

Objectives & process: To engage with management to ensure that Netcare's data security policies and mechanisms are reviewed.

Outcomes: Netcare has rolled out digitalisation to only a small selection of hospitals due to delays caused by Covid-19. However, as its digitalisation gains scale, its data security policies and mechanisms are likely to evolve. We will continue to monitor progress on this front over the coming months.

ESG issue: The private healthcare industry faces perceptions of excess pricing. The South African Competition Commission's health-market inquiry found the market uncompetitive and over-utilised. Regulatory oversight from steep price increases is prevalent in the industry and can affect the risk profile and long-term growth potential of a company.

Objectives & process: In response to the inquiry's key conclusions, Netcare has been looking to structure low-cost packages for the out-of-pocket market and work with medical insurance companies to provide more network plans. We engaged with Netcare to better understand its low-cost packages.

Outcomes: We will continue to track this over time. Thus far, the packages are catered towards primary care and basic procedures. On a costing basis, they are more affordable than going directly to a primary care service provider. Netcare also bundles products for basic procedures to help manage patients' cost expectations.

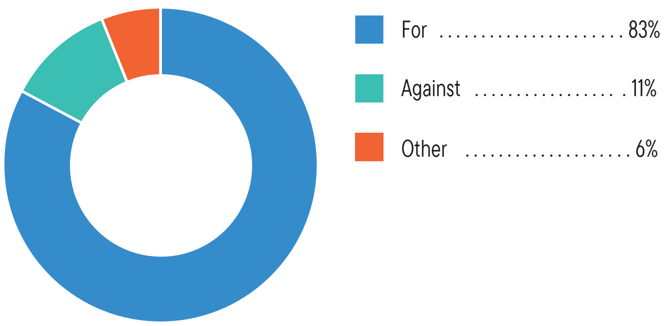
Case studies are used for illustrative purposes only and should not be construed as a recommendation to purchase a particular security or as an indication of trading intent for any Franklin Templeton strategy. It should not be assumed that securities discussed here were or will prove to be profitable.

35. Bloomberg

Proxy voting

Alongside company engagement, we view proxy voting as a key element of our responsibility as an active owner. Proxy voting helps us ensure that companies are managed in line with our ESG principles. All our voting decisions are made in-house by our investment team and are undertaken in accordance with our Corporate Governance Principles and in line with our clients' best interests. We are currently enhancing our own proxy voting principles and process.

Figure 23: Proxy voting record for 2021

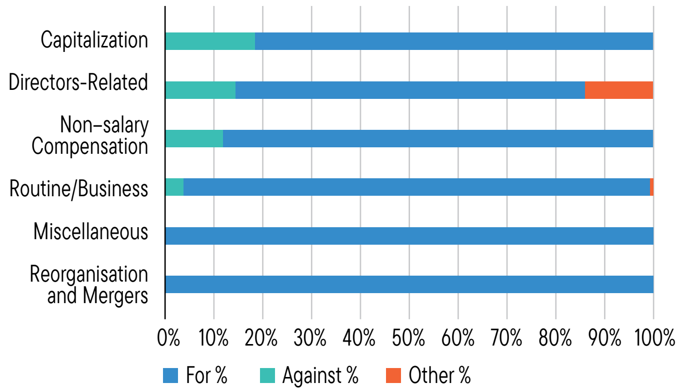


Source: Franklin Templeton; ISS

During 2021, we voted on 537 management proposals at annual and special general meetings. Most of these related to companies' capital structure, director appointments and routine business proposals. We voted against proposals in 11% of cases. We view votes against proposals as a formal way to communicate our views to management. We undertake votes based on our investment team's assessment of each motion in line with our clients' best interests.

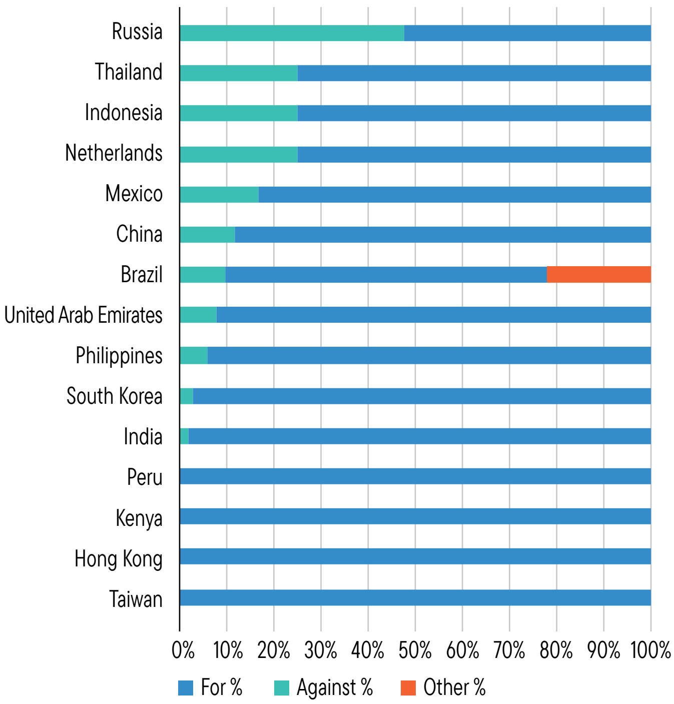
Shareholder proposals made up a very small number of votes. We recognise that shareholder proposals are increasing, particularly around environmental and social issues, though they remain uncommon in EMs.

Figure 24: Votes cast by category



Source: Franklin Templeton; ISS.

Figure 25: Votes cast by country



Source: Franklin Templeton; ISS.

Where "Other" votes were cast in Brazil, these were director-related votes. In these situations, we abstained from voting as we were not supportive of the candidates put forward for election or the company bundled several proposals into one, preventing us from voting on individual items.

Case study

Consumer internet group

Vote Proposal: Approve proposal related to remuneration policy

Vote Instruction: Against

Detail: As a long-term investor in the company, we sought to encourage management to link their executive remuneration with some quantitative measures to ensure a greater alignment of interests with minority shareholders. As such, we voted against their proposed remuneration policy and informed the company of the types of measures we believe would work best for our clients' interests. While the discussion is ongoing, and our engagement with the company will continue, we also felt that a formal vote against the proposal was warranted.

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Part four

Putting it all together—building the portfolio and measuring outcomes

Key points

- Portfolio focused on EM companies that achieve our highest AA and AAA internal ESG ratings.
- Reporting structured to assess overall portfolio alignment to our six positive outcome areas and each underlying UN SDG.
- The highly specific social and environmental outcomes achieved by the strategy can be measured and quantified to show investors what their holding is achieving.

Our unique three-pillar ESG process aims to provide the most robust and holistic approach available to identify sustainable equity opportunities across global EMs.

The final step is how we put these three elements together to rate companies overall and identify the best ideas for our portfolio. We have, therefore, developed a company scoring and rating system to ensure that we:

- **Focus on outcomes:** Our core focus is first and foremost on companies that provide goods and services that contribute to one or more of our six social and environmental positive outcome areas.
- **Manage ESG footprints:** We can see when companies have good products and services but their own ESG operational practices may need improvement.
- **Spot potential:** We can identify companies that currently have a strong sustainability profile and those that, with our targeted engagement, could in the future.

Our internal ESG rating

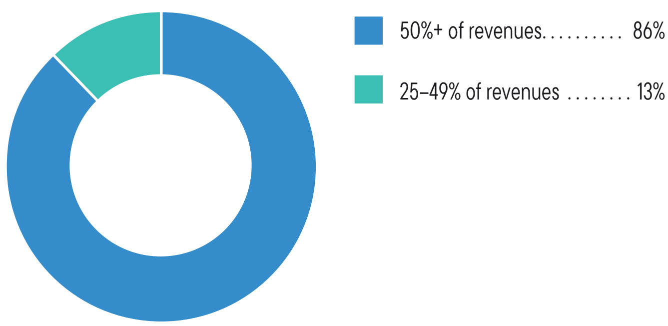
As we explained in Part Three of this report, companies are given a score on each of our three ESG pillars: alignment, intentionality and transition. To be considered for our portfolio, a company must achieve a minimum score on alignment, with at least 10% of its revenue aligning to one of our social or environmental positive outcome areas.

Furthermore, to help stakeholders easily see where a company sits on the spectrum from poor to excellent, each company's aggregate score is translated into an alphabetical rating of CCC (lowest) to AAA (highest). Companies must have an Internal ESG Rating of at least 'A' for inclusion in the Templeton Emerging Markets Sustainability Strategy.

Our analysis shows that most of our portfolio companies (86%) have over half their revenues aligned to one or more of our targeted positive outcome areas (see Figure 26). As of March 2022, 96% of the Strategy was held in companies with our highest Internal ESG Ratings – AA or AAA (see Figure 27).

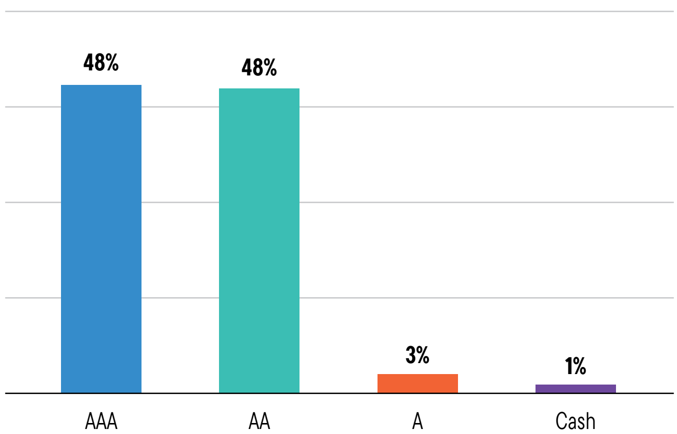
> **"To be considered for our portfolio, at least 10% of a company's revenue must align to one of our positive outcome areas. A company must also have an Internal ESG rating of at least 'A'."**

Figure 26: Portfolio breakdown by alignment of company revenues to positive outcome areas



Source: Franklin Templeton.

Figure 27: Portfolio breakdown by internal ESG Rating



Source: Franklin Templeton.

Our individual portfolio holdings

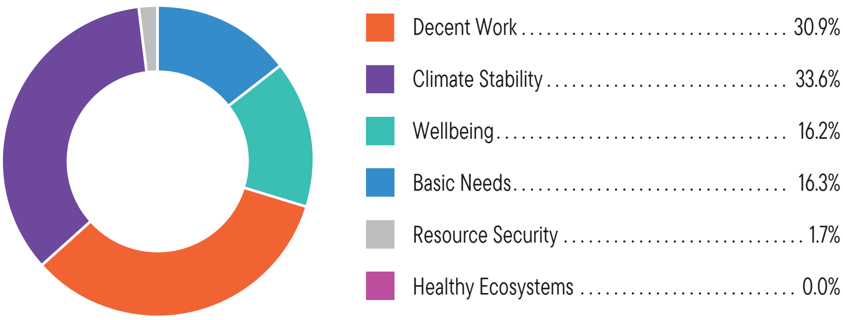
As of March 2022, the fund had 43 holdings. The top 10 holdings account for just over half of the portfolio by assets—see Figure 28. All the top 10 holdings carry our highest Internal ESG ratings of AA or AAA, based on how they have scored in our three-pillar ESG scoring process.

Figure 28: Our top 10 overweight positions by active weight

Top 10 Active Weights	Country	Sector	% of Total	Active Weight	Primary Positive Outcome Area	Internal ESG Rating	Primary UN SDG	Primary Positive Outcome Area Summary
ICICI Bank Limited	India	Financials	**5.50**	**4.82**	Basic Needs	AA	10 REDUCED INEQUALITIES	Indian bank focused on providing credit to an underpenetrated urban and rural population.
Apollo Hospitals Enterprise Limited	India	Healthcare	**4.07**	**3.99**	Wellbeing	AAA	3 GOOD HEALTH AND WELL-BEING	Largest healthcare services group in India, offering hospital services, retail pharmacy chain and retail healthcare (branded as AHLL and includes day care, birthing centers, diagnostics, clincs; 6.2%).
Samsung Electronics Co., Ltd.	South Korea	Information Technology	**7.67**	**3.34**	Climate Stability	AA	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	Leading semiconductor and mobile manufacturer with products designed to reduce energy and GHG emissions.
Credicorp LTD	Peru	Financials	**3.13**	**2.97**	Basic Needs	AAA	10 REDUCED INEQUALITIES	Credicorp is the largest financial services holding company in Peru. It comprises Peru's largest bank, Peru's largest insurance company, one of Peru's leading private pension funds, and an off-shore bank.
NAVER Corp.	South Korea	Information Technology	**3.42**	**2.95**	Decent Work	AAA	8 DECENT WORK AND ECONOMIC GROWTH	Leading Korean online ecosystem promoting SMEs to do business through its platform.
Itau Unibanco Holding S/A	Brazil	Financials	**3.18**	**2.80**	Decent Work	AA	8 DECENT WORK AND ECONOMIC GROWTH	One of Brazil's largest financial conglomerates, providing a full range of banking and financial services.
Tencent Holdings Ltd.	China	Information Technology	**6.46**	**2.70**	Decent Work	AA	8 DECENT WORK AND ECONOMIC GROWTH	Leading Chinese online platform empowering SMEs to do business with services such as WeChat Pay and WeChat userbase.
Infosys Limited	India	Information Technology	**3.70**	**2.55**	Decent Work	AAA	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	Infosys is a digital services and consulting company, which engages in the provision of end-to-end business solutions, improving business efficiency and supporting growth
Hon Hai Precision Industry Co., Ltd.	Taiwan	Information Technology	**3.09**	**2.46**	Climate Stability	AA	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	Hon Hai Precision is the largest electronics manufacturing service (EMS) in terms of design, manufacturing, global logistics and after-market services.
Taiwan Semiconductor Manufacturing Co., Ltd.	Taiwan	Information Technology	**9.39**	**2.38**	Climate Stability	AAA	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	Leading foundry for semiconductors aligned to transition to low carbon future.

Factors that are considered when rating/scoring an issuer may be subjective and, consequently, the investment manager's or a third party's scoring may not always accurately assess the sustainability practices an issuer.

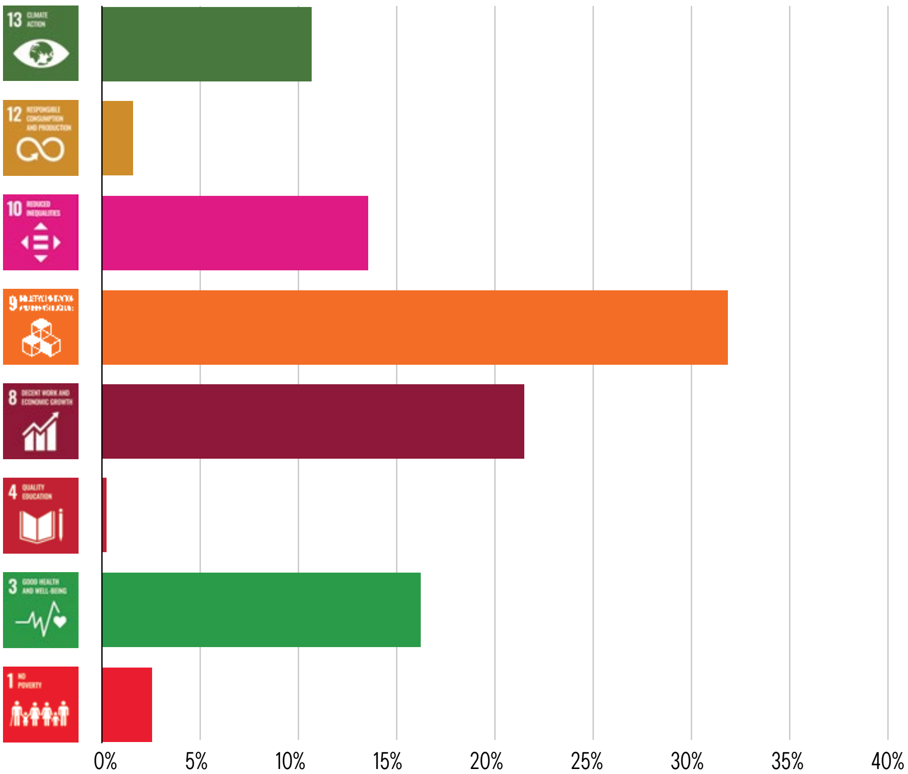
Figure 29: Breaking down our portfolio by primary positive outcome area



Our portfolio allocation by positive outcome area

Alongside standard industry sector, and geographical portfolio breakdowns, we look to report the strategies exposure to our six positive outcome areas. This is done by breaking down our portfolio by company weighting and then by the primary positive outcome area and primary UN SDG to which each company is contributing. As explained in part three, this is based on each company's main sources of revenue or other relevant income data.

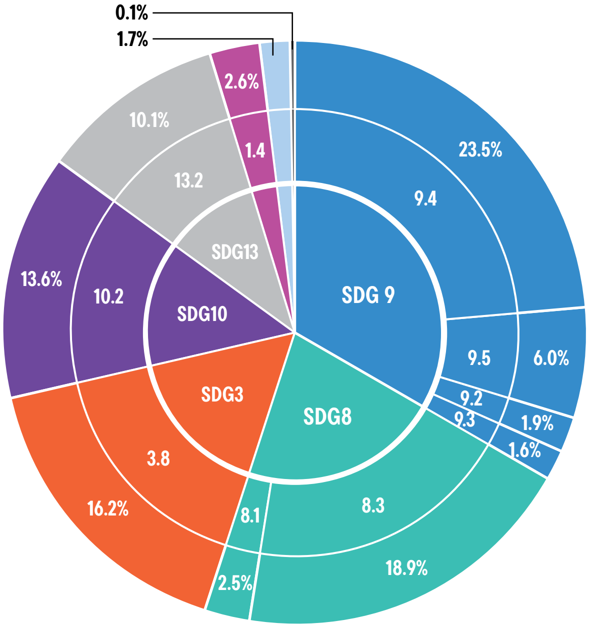
Figure 30: Breaking down our portfolio by alignment to the UN SDGs



Source: Franklin Templeton.

We recognise that the implementation of the 17 SDGs is supported by a framework of underlying indicators for which we have mapped the portfolio holdings.

Figure 31: Breaking down our portfolio by alignment to: 1) UN SDG 2) SDG indicator 3) % weight of portfolio linked to each indicator.



SDG	SDG Indicator	% Weight	Description
1	1.4	2.6	Ensure that all men and women, the poor and the vulnerable in particular, have equal rights to economic resources and access to basic services.
3	3.8	16.2	Achieve universal health coverage, including financial risk protection, access to quality essential health-care services and access to safe, effective, quality, and affordable essential medicines and vaccines for all.
4	4.4	0.1	Substantially increase the number of youth and adults who have relevant skills, including technical and vocational skills, for employment, decent jobs, and entrepreneurship.
8	8.3	18.9	Promote development-oriented policies that support productive activities, decent job creation, entrepreneurship, creativity and innovation, and encourage the formalization and growth of micro, small and medium-sized enterprises, including through access to financial services.
8	8.1	2.5	Strengthen the capacity of domestic financial institutions to encourage and expand access to banking, insurance, and financial services for all.
9	9.2	1.9	Promote inclusive and sustainable industrialization; significantly raise the industry's share of employment and gross domestic product, in line with national circumstances; and double its share in least developed countries.
9	9.3	1.6	Increase the access of small-scale industrial and other enterprises, in developing countries especially, to financial services. This includes affordable credit and their integration into value chains and markets.
9	9.4	23.5	Upgrade infrastructure and retrofit industries to make them sustainable, with increased resource-use efficiency and greater adoption of clean and environmentally sound technologies and industrial processes.
9	9.5	6.0	Enhance scientific research, upgrade the technological capabilities of industrial sectors, including encouraging innovation and substantially increasing the number of research and development workers.
10	10.2	13.6	Empower and promote social, economic, and political inclusion of all.
12	12.2	1.7	Achieve the sustainable management, and efficient use, of natural resources.
13	13.2	10.1	Integrate climate change measures into national policies, strategies, and planning.

An example of SDG mapping

Company	SDG	SDG Indicator
Daqo New Energy	**13 – Climate Action**	**13.2**
Polysilicon enables the conversion of solar light into electricity. Daqo New Energy, a polysilicon producer based in China, is one of the few companies producing polysilicon, which is used in solar wafers. Polysilicon production is a technologically advanced process but decades of experience has made us confident that Daqo stays ahead of competitors in terms of costs and quality.	Daqo's products and services contribute to SDG 13, which is to take urgent action to combat climate change and its impacts. One hundred percent of the company's operations are in the production of polysilicon, which is, in turn, used to produce solar modules.	Daqo's products contribute to decarbonization and play an important role in China's 2030 carbon peak and 2060 carbon neutrality goal by allowing affordable clean energy. For this reason, we have mapped Daqo to SDG Indicator 13.2; it contributes to the integration of climate change measures into national policies, strategies, and planning.

Positive outcomes in numbers

To ensure the strategy is delivering meaningful social and environmental outcomes, we assess both the beneficial products and services generated by our portfolio companies and how these are translating into positive social or environmental outcomes in the real world.

To do this, we assign each company a relevant sustainability indicator, which can be used to calculate what positive outcome is being achieved by its core activities over a given period in clear and measurable units. Often, this data is published in annual reports. If it is not publicly available, we will use our corporate access to get information from companies directly (see examples in Figure 32).

Figure 32: Sustainability indicators to measure company outcome

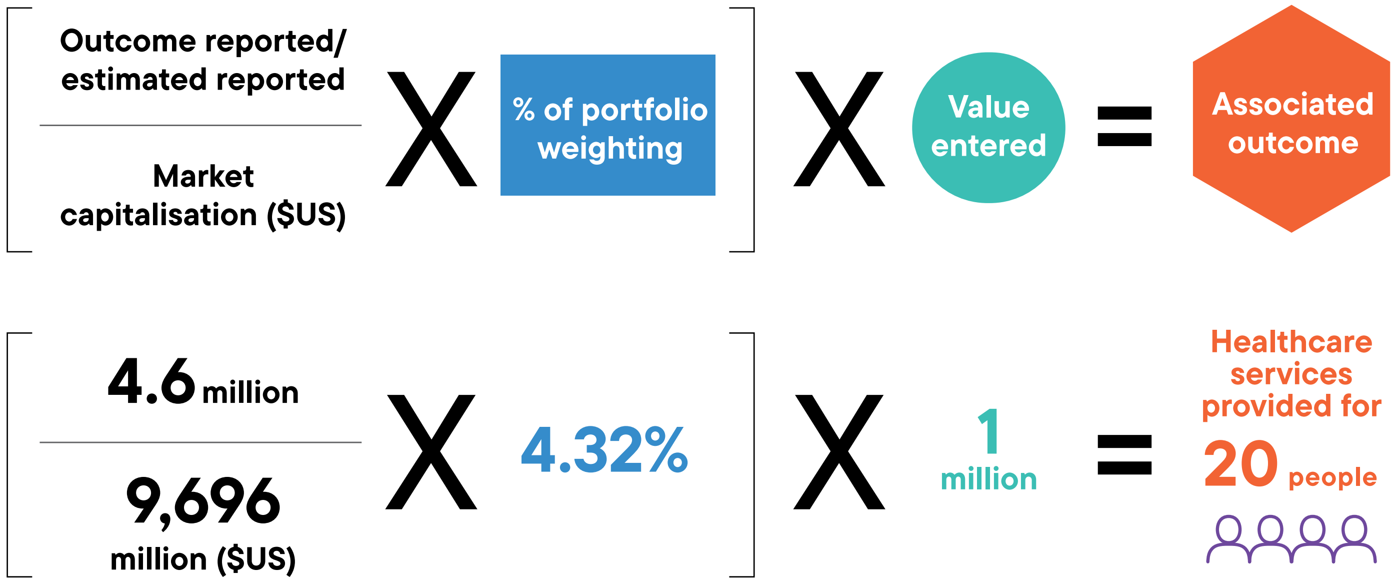
Type of Company	Positive Outcome Area (Typical)	Sustainability Indicator (Example)	Unit Measurement
Banks	Basic Needs	No. of people provided with a specified service	Millions pa
Healthcare	Wellbeing	No. of patients treated	Millions pa
Telecoms	Basic Needs	No. of people provided with mobile phone service	Millions pa
Energy	Climate Stability	Amount of CO_2 avoided	CO_2/tonnes mn pa
Online Retail	Decent Work	No. of users	Millions pa
Banks	Basic Needs	No. of people provided access to microfinance services	Millions pa
Consumer Products	Wellbeing	Basic needs products sold	Millions pa
Service Providers	Decent Work	No. of clients provides with services	Millions pa

Calculating our portfolio outcomes

Based on our ownership stakes in each company, we use a formula to calculate and quantify the outcomes achieved by each of our holdings (see Figure 33).

Figure 33: Formula to calculate the positive contribution of a portfolio holding

Using a company's capitalisation, its reported or estimated outcome(s) and our portfolio weighting in that company, we can quantify the associated outcome to which our ownership stake contributes. As an example, the calculation below shows the outcome generated by a $1mn investment in the fund through our position in "Apollo Hospitals", which reports treating 4.6+ million in and outpatients in the latest reportig year.



In turn, we can then calculate the aggregated outcomes across our whole portfolio. We currently measure to these specific outcome indicators for 78% of the portfolio. A minority of companies are left out of this calculation where their activities fall outside these indicators.

This enables us to indicate to investors, based on the portfolio's total assets under management, how their holding may translate into a range of positive outcomes over a given period of time. Figure 34, for example, shows some of the key outcomes we estimate to be achieved by a $1 million investment in the strategy. The data collected for this calculator is based on latest available annual data, or a reasonable assumption otherwise, as at 30th April 2022.

Figure 34: A $1 million investment in the Templeton Emerging Markets Sustainability Strategy helped to...

Save
36 tonnes
of CO_2 emissions

Deliver
1,095
basic needs products

Provide
249 people
with healthcare services

Provide
46 people
with mobile phone services

Provide
growth services to
2 business

Give
85 people or micro, small and medium-sized enterprises
access to microfinance services

Provide
155 people
with access to retail banking services

Provide
636 people
with access to internet services/users*

*May include daily, monthly or annual active users.

Note these outcomes are estimates only and are not guaranteed.

Final thoughts: A strategy built to achieve our dual objectives

Templeton Emerging Markets Sustainability Strategy is a unique strategy in terms of its holistic approach to assessing companies on their external social and environmental outcomes, their internal ESG practices, and their scope for further improvement through shareholder engagement.

As we hope to have shown, the Strategies portfolio is already delivering measurable real-world outcomes – reducing carbon emissions, creating greater financial equality, meeting basic needs, and enabling worthwhile livelihoods. As corporate standards rise across EMs, and companies across these economies seek to play a central role in contributing to the UN SDGs, we are confident that this strategy's viable investment universe will continue to expand and deepen.

Mutually beneficial goals

The Strategies dual objective to deliver both long-term financial outperformance and significant real-world positive outcomes is ambitious and still revolutionary.

We believe that delivering on this "double bottom line" is not just feasible, but that each goal supports the other; well-managed, financially sound companies are best positioned to deliver goods and services that generate positive outcomes. Companies that can play a pivotal role in addressing the world's most pressing social and environmental challenges, arguably, offer some of the greatest sustained earnings growth potential.

Next steps

Applying a sustainable investment approach that suits the characteristics of EMs and evaluates companies on all aspects of sustainability is not a single act, but a continual process.

We will continue to engage with companies across EMs to ensure that they keep raising their operational ESG standards, provide greater and accurate disclosure on the real-world outcomes delivered by their products and services, and focus their core activities on the social and environmental challenges the world urgently needs to solve.

As the world's emerging economies continue to grow, evolve, and diversify, we are excited about the role their home-grown companies can play in creating a fairer, healthier, and more sustainable planet. We are proud to be able to bring these companies to a wider investment audience through the Templeton Emerging Markets Sustainability Strategy.

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MSCI ESG data is as of January 4, 2022.