Innovation Industries

Sustainability risks and adverse impacts

Version 1.2 / September 2023

This document is a description of Innovation Industries' policies on the integration of sustainability risks and the consideration of adverse impacts on sustainability factors in its decision-making processes and ownership practices.

Innovation Industries has decided not to consider Principal Adverse Sustainability Impacts as defined per article 4 of the SFDR[1], and therefore not to make the disclosures as described in article 6 of the SFDR RTS[2]. The main rationale for this decision is that we feel that the administrative burden and the data challenges related to the collection of the principal adverse impact indicators are not proportional to the small size of both Innovation Industries and its portfolio companies.

However, through its Responsible investment policy statement, Innovation Industries has made a commitment to invest responsibly. This commitment implies that we consider and actively manage sustainability risks as well as adverse impacts on sustainability factors. Through this process, we seek to avoid significant harm to any sustainable objective, in line with the Do No Significant Harm (DNSH) principle under Article 2 (17) of the SFDR.

The concept materiality helps us define and prioritize the sustainability issues that are most important to our portfolio companies and their stakeholders. We define 'material ESG factors' as those factors that potentially have a substantial impact on a company's ability to create and preserve economic, social and environmental value. This definition ensures that we approach sustainability from two perspectives:

- risks posed by potentially material environmental, social and governance (ESG) issues, including those driven by external developments;
- positive and/or negative impact of our investee companies on ESG factors in their wider environment.

Our ESG management system (see figure 1) is tailored to the needs of and requirements for early stage and growth stage companies. It covers material sustainability risks and foreseen impacts, i.e. the ESG factors that are specifically relevant at these stages of business development. Our approach is detailed in two procedures: an ESG integration procedure (origination, screening, due diligence and decision-making) and an Investment monitoring & engagement procedure.

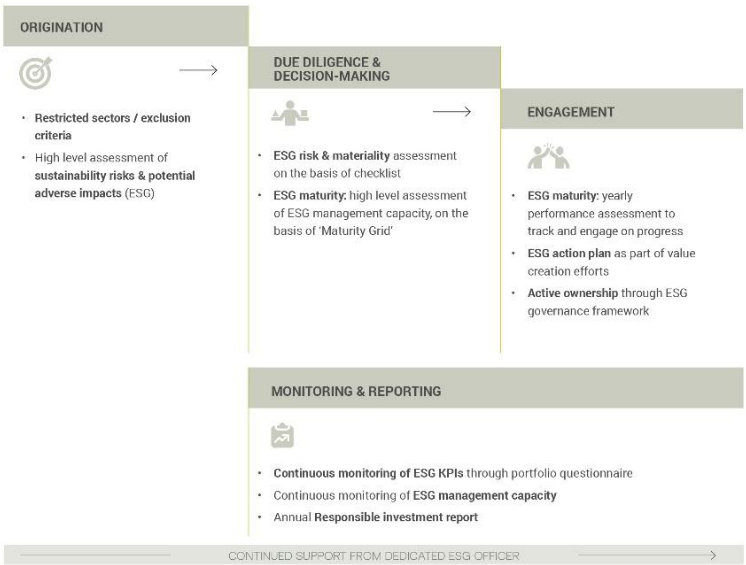

Figure 1. ESG Management System

[1] REGULATION (EU) 2019/2088 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 27 November 2019 on sustainability-related disclosures in the financial services sector
[2] Regulatory Technical Standards issued under the SFDR

Responsible investment

Our investment strategy leads us to invest in companies at a stage where their impact on sustainability factors is still low. It is designed to optimize our funds' potential for positive impact by considering sustainability factors during investment selection and decision-making. Active and long-term engagement is essential to the realization of this potential. All of this is captured in our Responsible investment policy statement.

ESG integration to identify and prioritize ESG factors

Our ESG integration procedure outlines how Innovation Industries' commitment to responsible investment is embedded into the practice of investment selection and decision-making. This procedure was written by the ESG Officer and formally approved by the General Partners of Innovation Industries on March 31st, 2022. The ESG Officer is responsible for implementation of the procedure.

Exclusion and positive screening

Through our standard list of restricted sectors / exclusion criteria, we exclude a number of industries and activities from our investment portfolio because, by definition, they do not comply with international agreements or treaties or because they do not comply with our ethical standards.

More generally, Innovation Industries excludes companies that are active in sectors or working in technology areas that we consider inherently unsustainable, meaning that their technology comes with sustainability risks or adverse impacts that are unmanageable and cannot be compensated by the positive impact that is foreseen. This is including but not limited to:

- companies active in the fossil fuel sector *(restricted sector);*
- companies involved in manufacturing or selling weapons and ammunition *(restricted sector);*
- companies with disproportional (expected) greenhouse gas emissions or (product/process) energy requirements;
- companies negatively affecting biodiversity-sensitive areas.

Innovation Industries also applies sustainability indicators as positive screening criteria. The details of our impact investment strategy are fund specific.

High-level assessment of sustainability risks & potential adverse impacts

A high level assessment of sustainability risks and potential adverse impacts is performed during screening of an investment opportunity. This provides early input into focus areas for the ESG due diligence.

Due diligence

During due diligence on an investment opportunity, we perform two assessments: a) a risk and materiality assessment, and b) a high-level assessment of ESG management capacity.

Risk & materiality assessments

A sector-based ESG checklist is used as a template for the identification and assessment of material ESG factors. We have developed different templates, each tailored to one of the main sectors within our investment scope. Using the checklist, relevant issues are classified on an industry level as *high risk*, *medium risk* or *low risk*, taking into account the probability that risks will materialize as well as the severity of impact (on the company or its wider environment).

Subsequently, issues are classified based on their materiality for the investment opportunity. Materiality is determined by assessing a company's business model, its strategic and sustainability objectives and possible threats (or opportunities) associated with ESG factors and related developments such as climate change, food scarcity and the rising cost of healthcare. Issues classified as medium/high materiality topics are assessed in more detail.

Assessment of ESG management capacity
On the basis of our 'ESG Technology Start-up Maturity Grid' (hereafter *ESG Maturity Grid*, see section below), we perform a preliminary, high-level assessment of the extent to which the company has (or is in the process of developing) the general ability to manage ESG-related risks and exploit opportunities. At this point, the assessment is focused on establishing confidence within the deal team that material factors can be managed post-deal. Key here is the level of commitment amongst management to do so.

Decision-making

Due diligence can lead to the exclusion of investments that are deemed unsustainable in the long-term (see the section on exclusion). In most cases, the due diligence process does not lead to exclusion based on ESG-criteria, for two reasons:

- Pre-selection takes place during the origination phase, based on a high level assessment of sustainability risks and foreseen impact.
- Foreseen impact is usually still largely unrealized at the time of investment, which provides us with an opportunity to build a sustainable and, hence, resilient company. This approach reinforces the additionality of our investments.

If the deal is continued, the outcome of due diligence provides valuable input for engagement during the post-investment phase.

Investment monitoring & engagement

Our Investment monitoring & engagement procedure outlines how Innovation Industries' commitment to responsible investment is embedded into the practice of active ownership. This procedure was written by the ESG Officer and formally approved by the General Partners of Innovation Industries on March 31st, 2022. The ESG Officer is responsible for implementation of the procedure.

ESG action plan
Through a company-specific post-investment action plan, we establish the risks that need to be addressed in the short-term and the actions required to improve an investee company's ESG management capacity. In this way, we mitigate material risks and steer its development towards a sustainable and resilient company.

Active ownership
We apply a standard but flexible governance framework for active ownership, which serves to protect and create value. It specifies roles and responsibilities and establishes the yearly engagement cycle. The framework is designed to mitigate sustainability risks as well as avoid or minimalize adverse impact.

One of our General Partners is appointed a seat on the supervisory board of the company. This General Partner acts as lead for engaging with the company and monitoring progress. Also central to engagement on ESG factors is our ESG officer. The ESG officer meets regularly (at least once a year) with a key contact person for the company, to discuss relevant developments, provide guidance where needed and collect information to support the monitoring of progress. Where feasible, the investment manager joins the engagement meeting.

ESG Maturity Grid
In each of these processes, we use our ESG Maturity Grid. This proprietary tool is essentially an overview of the development we expect to see in how companies deal with ESG factors over the different stages of their evolution from seed to full maturity. In the first year of our investment period, we perform a detailed baseline assessment of a company's *ESG management capacity* within different issue categories. Herein we consider a broad range of aspects, from level of responsiveness amongst the Management Team to implementation of mitigating measures. As such, we establish the level of *maturity of* the company's *issue management* capacity, which is evaluated in consideration of its stage of development and monitored over time. This approach

allows us to offer focused guidance and induce action where it is most needed, in view of the risks, challenges and opportunities linked to the stage the company is in.

The ESG Maturity Grid has two axes: company stage and issue category.

We distinguish six stages of company development:

1. Seed capital
2. Start-up
3. First stage
4. Second stage
5. Small tech company
6. Mature

Early stage (1–2)

Growth stage (2–5)

We distinguish seven issue categories, as depicted in table 1. Where a category encompasses multiple ESG factors, this is specified under 'Description'.

Table 1. Issue categories and ESG factors

ISSUE CATEGORY	KEY BUSINESS FUNCTION(S)	DESCRIPTION
Environment	R&D (process), production	GHG emissions & Energy efficiency, hazardous materials, resource efficiency, (hazardous) waste management
Product design & lifecycle	R&D (product): material input, use phase and end-of-life	GHG emissions & Energy efficiency, hazardous materials, resource efficiency, (hazardous) waste management
Human capital	Human capital management	Employee attraction & retention, performance management, mental health & wellbeing, culture, (gender) diversity & inclusion
Occupational health & safety	R&D (process and product), production, sales	Health & safety in the workplace, product safety
Supply chain	Supply chain management	Supply chain management addressing all material issues, including human rights
Data privacy & security	HR, customer relationship management, IT	Collection, retention & use of personal data, information security
Business ethics	All	Business conduct, including bribery & corruption, conflict of interest, fraud

References to international standards

Innovation industries endorses and has, through the ESG management system, aligned its investment practice with:

- The OECD Guidelines for Multinational Enterprises
- The OECD Due Diligence Guidance for Responsible Business Conduct
- The UN Guiding Principles on Business and Human Rights
- The ten principles of the UN Global Compact

Innovation Industries is signatory of the United Nations Principles for Responsible Investment (UN PRI).