

Morgan Stanley

INVESTMENT MANAGEMENT

2023

ESG Report

Morgan Stanley European Direct Lending



ENVIRONMENTAL | SOCIAL | GOVERNANCE

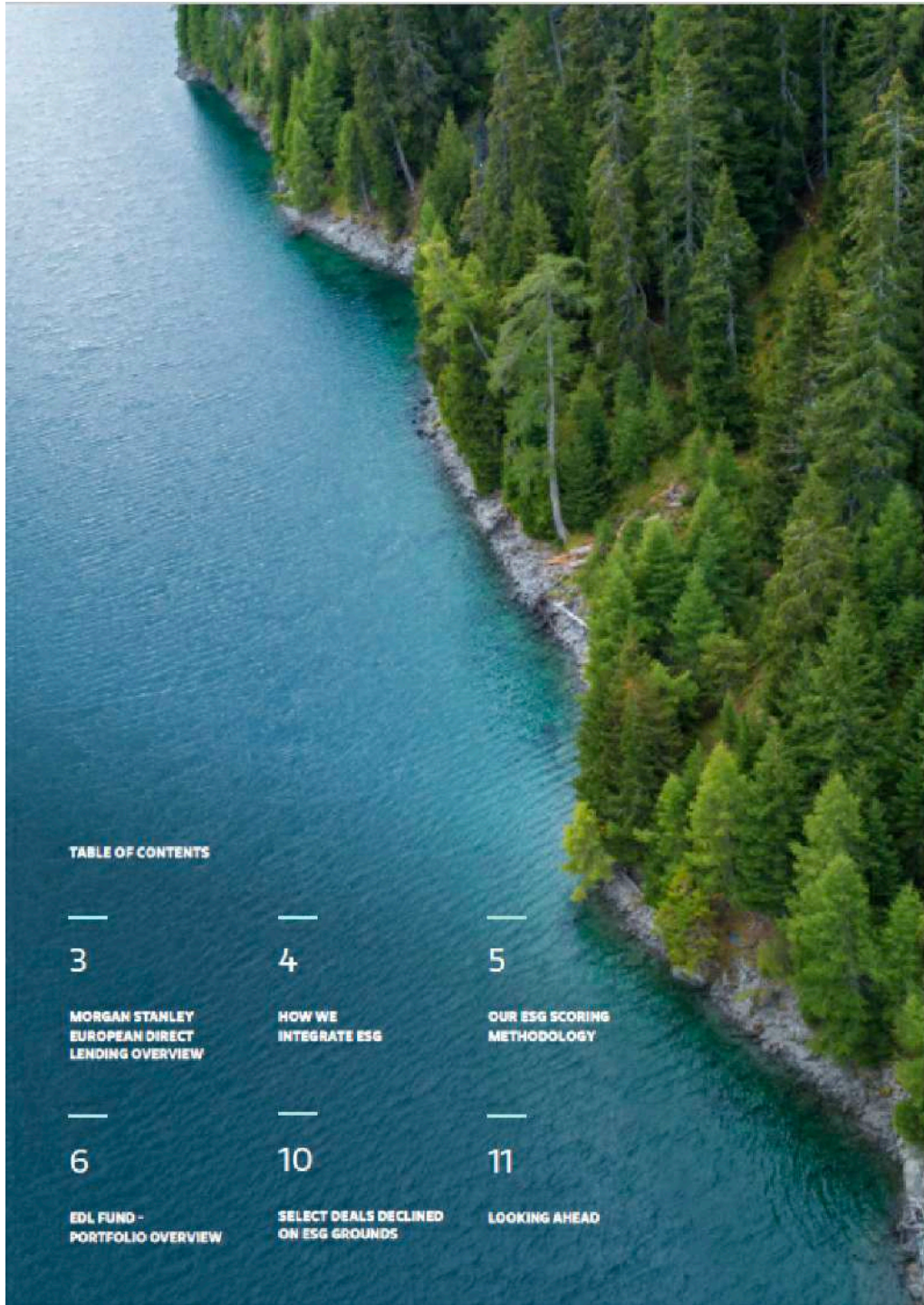


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Our Commitment to ESG

Dear Investor,

We are pleased to enclose the Annual ESG Report for the Morgan Stanley European Direct Lending Fund (the "Fund", "EDL") for the year ended December 31, 2023.

The report comprises an overview of ESG performance at the portfolio level and how our key ESG metrics have shifted over the course of the year. We also provide granular details on ESG at the investment level for the Fund's recent investments.

SUSTAINABILITY AT MORGAN STANLEY

Morgan Stanley has been pioneering sustainable practices within financial services for over a decade, having established the Global Sustainable Finance group and Institute for Sustainable Investing in 2009 and 2013 respectively, and appointing the first Chief Sustainability Officer on Wall Street in 2017. More recently, the Firm went on to become the first large US bank to commit to net zero emissions by 2050 and to make the only commitment from a financial institution to eliminate 50 million metric tons of plastic waste by 2030. For more details on firmwide efforts to promote sustainability, please see [here](#).

MORGAN STANLEY EUROPEAN DIRECT LENDING FUND ESG OVERVIEW

The Fund's investment philosophy is underwritten by a strong conviction that the ESG characteristics of a potential investment are essential to the credit process and to fulfilling our responsibilities as a socially and environmentally conscious product. To that end, the investment team conducts binding ESG diligence on each potential investment alongside the traditional credit process. At each stage of the investment lifecycle, the Fund sets out criteria for what constitutes material ESG risks, the circumstances under which potential investments will be screened out due to ESG considerations, and the information and tools the investment teams utilise to fully understand, measure and monitor the ESG performance of each company.

ANNUAL ESG SUMMARY

Following its first close in August 2023, the Fund will issue this report on an annual basis. This report will outline the ESG profile of our first investment, Sinecra, which closed in Q4. Four additional investments have been signed since, and the ESG qualities of these companies will be duly shared as part of the Fund's Q1 2024. The remainder of this report will also outline some of the deal opportunities we have chosen to decline on ESG grounds.

As always, please do not hesitate to contact us should you have any questions.

Best regards,

Mark Jochims
Tom Cresswell



MARK JOCHIMS
Managing Director,
Head of European
Private Credit



TOM CRESSWELL
Executive Director,
Chief Operating
Officer of European
Private Credit

Morgan Stanley's Commitment to Sustainable Investing

For Over a Decade, MS has Charted a Leadership Position in Sustainable Finance

MS IS AN ESG EARLY-MOVER AMONGST PEERS

- MS named the first Chief Sustainability Officer on Wall Street
- First Wall Street bank to commit to **net-zero financed emissions** by 2050
- Issued **\$1Bn Social Bond** to support affordable housing portfolio company activities related to water use and efficiency and waste management

MS PUBLISHES ITS SUSTAINABILITY-LINKED TARGETS TO PROMOTE TRANSPARENCY

- Mobilise \$1Tr in sustainable solutions by 2030
- Achieve **carbon neutrality** across global operations by 2022¹
- Issued an inaugural **Green Bond** in 2015 to support its firmwide climate strategy

EDL's Article 8 Investment Strategy Supported By MS's Broader ESG Infrastructure

1	ENVIRONMENTAL AND SOCIAL RISK MANAGEMENT ("ESRM") ESRM provides expert-led and enhanced due diligence on transactions that involve potentially serious and complex ESG risks (e.g., oil extraction).
2	GLOBAL SUSTAINABLE FINANCE OFFICE ("GSO") Founded in 2009, GSO researches and facilitates the adoption of cutting-edge sustainability strategies across business lines.
3	INSTITUTE FOR SUSTAINABLE INVESTING Founded in 2013 and chaired by CEO James Gorman, the ISI is a research and advocacy institute dedicated to developing leading sustainable investing strategies.
4	SUSTAINABILITY MSIM TEAM ("ST") The ST executes MSIM's sustainability strategy and offers expertise on ESG data, product launches, regulatory compliance, and best practices.
5	MSIM SUSTAINABILITY COUNCIL The Council sets MSIM's sustainable investing strategy. It is chaired by the Head of Sustainability for MSIM and the Chief Responsible Investment Officer of Calvert.

MS ESG INFRASTRUCTURE	EDL IS AN ARTICLE 8 FUND	MULTI-LEVEL ESG FRAMEWORK
<ul style="list-style-type: none"> Expert ESG diligence Continuous ongoing support and expertise Regulatory/investment risk management 	<ul style="list-style-type: none"> Bound to promote ESG characteristics ESG integrated across the investment lifecycle ESG policies are binding across all investments 	<ol style="list-style-type: none"> Firm-level resources and risk management Investment screening, diligence, and monitoring led by the Investment Team

¹Morgan Stanley's Global Sustainability Office is in the process of collecting emissions data from retiring credits/offsets to properly verify carbon neutrality globally and will revert over the course of 2023 with an update.

1 Morgan Stanley European Direct Lending Overview

Differentiated Model, Supported by Marquee Adviser

Scaled private credit business, leveraging the broader Morgan Stanley platform¹ to access differentiated investment opportunities.

Defensive Direct Lending Strategy

Primarily floating rate, first lien loans to borrowers in non-cyclical industries²

Rigorous Investment / Risk Management & Oversight

Disciplined investment process, leveraging enhanced Morgan Stanley due diligence capabilities

Attractive Industry & Market Tailwinds

Direct lending is an attractive asset class that has the potential to generate strong risk-adjusted returns

Alignment of Interest

Significant GP investment across MSPC and competitive investor fee discounts to further help generate attractive net returns

PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RETURNS. ACTUAL RESULTS MAY VARY. There is no guarantee that investment objective can be achieved. The statements above reflect the Manager's views and opinions as of the date hereof and not as of any future date. All expressions of opinion are subject to change without notice and are not intended to be a forecast of future events or results.

¹ Access to certain parts of Morgan Stanley may be limited in certain instances by a number of factors, including third party confidentiality obligations and information barriers established by Morgan Stanley in order to manage potential conflicts of interest and regulatory restrictions. Accordingly, the Fund's ability to source investments from other business units within Morgan Stanley may be limited. Such investment sources are not necessarily indicative of all sources that the Fund may utilize in sourcing investments. There can be no assurance that the Fund will be able to source investments from any one or more parts of the Morgan Stanley network, implement its strategy, achieve its investment objectives, find investments that fit its investment criteria or avoid substantial losses.

² There can be no assurance that the Fund or Manager will achieve its investment or portfolio construction objectives. Cyclical industries defined as restaurants, retail, energy, and other businesses that the Manager believes may be subject to business cycle volatility. A defensive portfolio does not assure a profit or protect against loss in a declining market.

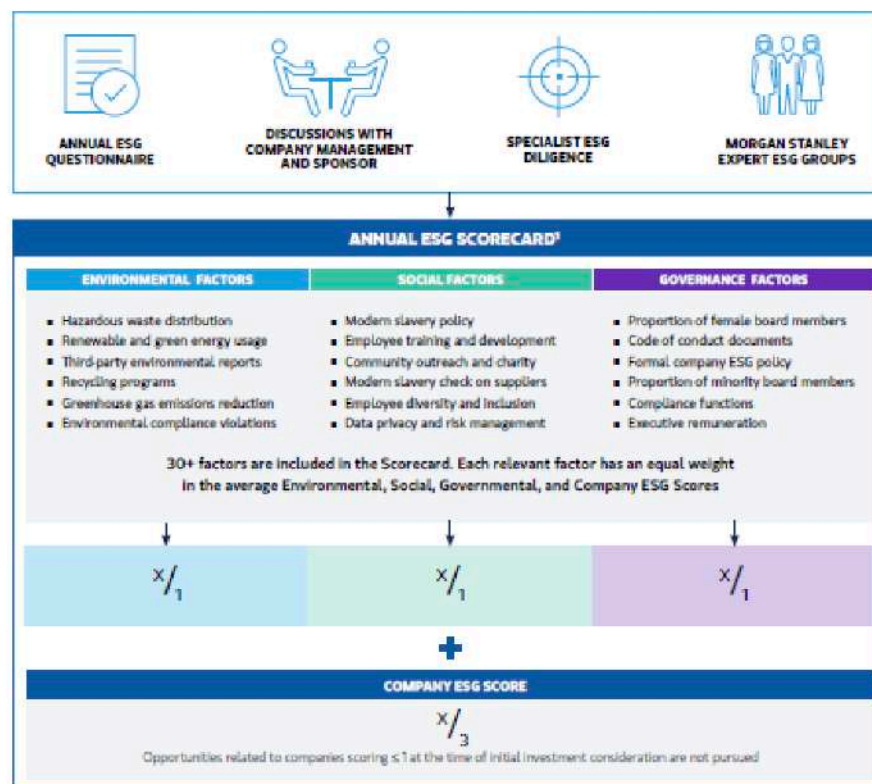
2 How We Integrate ESG

We are committed to embedding ESG analysis in each stage of the investment process, from origination through to portfolio monitoring. The five-stage process below encapsulates our approach to integrating ESG throughout the investment lifecycle. Please see the Fund’s ‘ESG Framework’ for more details.



3 Our ESG Scoring Methodology

Our ESG scoring methodology relies on several internal and external sources. Borrowers are assessed on 30+ ESG-related factors. Below, we illustrate how the scorecard works and how we use it to filter out companies with poor ESG records.



*The criteria listed for each subsection of the scorecard are not exhaustive.

4

EDL Fund – Portfolio Overview



Company Name	Sitecore	Date of Investment	November 2023
Headquarters	Denmark	Currency	EUR
Financial Sponsor	EQT	Instrument	Senior Loan
Industry	Software	MSPC Commitment	€50MM

BUSINESS DESCRIPTION

Sitecore is a provider of enterprise-grade digital experience management software across the Americas (56% of revenue), EMEA (32%) and APAC (12%). Its software enables users to create and optimize customer experiences across their websites, apps, emails, and social media. Sitecore benefits from (i) a position as one of the leading providers of end-to-end digital experience software globally, (ii) significant market growth and white space, (iii) a diverse and growing customer base exhibiting strong retention rates, and (iv) a recurring subscription-based revenue model.

ESG RATING (UNWEIGHTED) ¹	ESG RATING (WEIGHTED) ¹
2.42	2.51

ESG FINDINGS

Overall, Sitecore was found to exhibit a strong and embedded focus on ESG through a combination of outside-in due diligence and an array of commercial due diligence reports. Its approach is enshrined in a new ESG Programme that was developed jointly between the company, the sponsor (EQT), and an ESG-specialist consultancy. The business has adopted ambitious ESG targets, including:

- Goals to become 100% carbon neutral, reduce energy consumption by 20%, reduce water usage by 25%, and divert 50% of waste to sustainable recycling.
- Goals to have 45% of management positions and 50% of internships held by women and deepen existing partnerships with Plan International and United Nations bodies focused on gender equality.

Governance was a key focus of the deal team’s ESG diligence. Sitecore was found to have a strong and well-documented data privacy, supplier management, and broader governance framework. Given the business’s focus on large enterprise customers, it has also introduced stringent KYC and onboarding protocols. Its areas for improvement include progress on reporting carbon emissions from its data centres, working towards the diversity and environmental targets above, and potentially linking executive remuneration to successfully fulfilling ESG initiatives.

¹ ESG ratings refer to companies’ scores on EDL’s proprietary ESG scorecard, which returns scores between 0 and 3 based on borrowers’ performance on over 30 different ESG criteria. All new borrowers are scored at the time of the initial investment and we seek to rescore portfolio companies at least annually. ESG Portfolio Overview Data from January 2023 to December 2023.

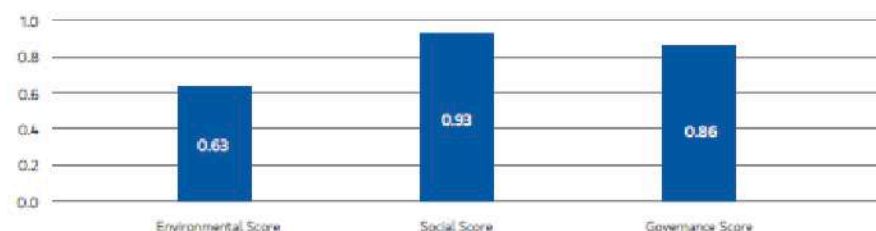
Portfolio RepRisk Summary and Disaggregated Scores

REPRISK¹ DATA

To avoid providing financing to companies with serious historic or ongoing ESG issues, we use RepRisk¹ to conduct a preliminary screening of all potential investments to understand any company-specific and sector-specific risks. RepRisk is an AI-powered platform that combs global news and media sources to identify any negative ESG-related coverage associated with a company.

COMPANY	REPRISK INDEX (CLOSE) ¹	REPRISK INDEX (LATEST) ¹	CHANGE SINCE CLOSE	REPRISK RATING (LATEST) ²
Sitecore	0	0	0%	AAA

Disaggregated ESG Scores³



Sitecore has expanded existing CSR policies into a comprehensive ESG framework, with targets including:

Environmental	100% carbon neutrality, as well as: <ul style="list-style-type: none"> ■ 20% energy reduction, ■ 25% water reduction, ■ 50% waste diversion
Social	45% of management positions filled by women and 50% of internships held by women or people from minority groups
Governance	Encourage centralised discussion of cross-functional privacy and security objectives, identify data governance risks, and implement customer orientated solutions

¹ The RepRisk Index (RRI) is a proprietary algorithm developed by RepRisk that dynamically captures and quantifies a company’s or project’s reputational risk exposure to ESG issues. The RRI facilitates an initial assessment of the ESG risks associated with investments or business relationships, allows the comparison of a company’s exposure with that of its peers, and helps track risk trends over time. 0-25 generally denotes low risk exposure, 26-49 denotes medium risk exposure, 50-59 denotes high risk exposure, and 60-100 denotes very high / extremely high-risk exposure. Data as at December 2023.

² The RepRisk Rating (RRR) is a letter rating (AAA to D) that facilitates corporate benchmarking against a peer group and the sector, as well as integration of ESG and business conduct risks into business processes. The Rating provides decision support in risk management, compliance, investment management, and supplier risk assessment. In contrast to the RepRisk Index (RRI), the RepRisk Rating depends not only on a company’s own performance (i.e., on its own risk incidents) but also on its country and sector affiliations. Data as at December 2023.

³ Environmental, social, and governance scores are out of 1 and are calculated through the ESG Scorecard. Portfolio-level scores are weighted averages. Data as at November 2023.

Disaggregated ESG Scorecard Data - Sitecore Investment¹

SURVEY QUESTION	ACHIEVEMENT (AS AT 31/12/23)
ENVIRONMENTAL INDICATORS	
Proportion of companies with no site contamination issues or environmental compliance violations. ²	
Proportion of companies that have completed third-party environmental reports. ²	
Proportion of companies that have hazardous waste distribution practices. ²	
Proportion of companies that maintain recycling and/or waste efficiency programs. ²	
Proportion of companies that maintain energy efficiency programs. ²	
Proportion of companies that set targets to reduce their water consumption. ²	
Proportion of companies that use renewables and/or green energy. ²	
Proportion of companies that track carbon emissions (scope 1 and 2). ^{2,3}	
Proportion of companies that have a policy/strategy to reduce or minimize greenhouse gas emissions. ²	
SOCIAL INDICATORS	
Proportion of companies that maintain policies to ensure fair Labour practices within the company and its suppliers. ²	
Proportion of companies that have a modern slavery policy or statement. ²	
Proportion of companies that have a process to review and assess risks from their suppliers and partners with respect to modern slavery. ²	
Proportion of companies with suppliers that have their own modern slavery policy. ²	
Proportion of companies that have any past violations or issues pertaining to modern slavery in the last 3 years. ²	
Proportion of companies that provide training and development opportunities for employees.	
Proportion of companies that maintain employee health and wellbeing programs.	
Proportion of companies that performed an employee survey in the last year.	
Proportion of companies that track employee diversity statistics.	

■ Yes ■ No ■ N/A

¹ EDL does not expect to show granular data from the ESG Scorecard on an individual investment basis in future reports.

² This refers to questions that companies may elect to answer with "not applicable" in the ESG scorecard. Generally, this option is included to reflect the fact that some ESG questions that may not apply to certain sectors or businesses (e.g., hazardous waste distribution practices may not be relevant to software companies). Hence, portfolio statistics for such questions refer to the proportion of companies to which those questions are applicable.

³ Scope 1 emissions are direct greenhouse gas (GHG) emissions that occur from sources that are controlled or owned by an organisation (e.g., emissions associated with fuel combustion in boilers, furnaces, vehicles, etc.). Scope 2 emissions are indirect GHG emissions associated with the electricity, steam, heat, and/or cooling that the business purchases.

SURVEY QUESTION	ACHIEVEMENT (AS AT 31/12/23)
Proportion of companies that have a formal employee inclusivity policy and/or recruitment targets for minority applicants.	
Proportion of companies that partner with any diversity and inclusion-focused organisations.	
Proportion of companies that conduct community outreach or support programs.	
Proportion of companies that have formal relationships with charitable schemes.	
Proportion of companies that have had to recall any product or reimburse customers significant amounts for unfulfilled or poor quality services in the last 3 years. ²	
Proportion of companies that take an active approach to data privacy and cyber risk management (e.g., by having relevant policies in place).	
GOVERNANCE INDICATORS	
Proportion of companies with a formal ESG policy.	
Proportion of companies that have employed ESG consultants to review and/or shape their environmental, social, or governance practices/policies in the last 3 years.	
Proportion of companies that are members of any ESG standards organisations.	
Proportion of companies that have regularly scheduled and documented Board of Directors meetings.	
Average proportion of females on portfolio companies' Board of Directors >20%	
Average proportion of either racial or other (e.g., LGBTQ+) minority groups on portfolio companies' Board of Directors >10%	
Proportion of companies that have set targets to achieve greater diversity within board, executive, or senior management positions.	
Proportion of companies that have independent board members.	
Proportion of companies that have an ESG escalation process to either management or the Board of Directors for ESG issues or violations.	
Proportion of companies that link executive remuneration to ESG targets.	
Proportion of companies that have confidential whistleblowing mechanisms in place to report unethical or illegal business practices.	
Proportion of companies that retain code of conduct documents including, for instance, policies on anti-discrimination, sexual harassment, employee rights, and general compliance.	
Proportion of companies that have processes in place to ensure compliance with any new local and global regulatory requirements that might be applicable to the company.	
Proportion of financial sponsors that have a formal ESG policy.	

■ Yes ■ No ■ N/A

² This refers to questions that companies may elect to answer with "not applicable" in the ESG scorecard. Generally, this option is included to reflect the fact that some ESG questions that may not apply to certain sectors or businesses (e.g., hazardous waste distribution practices may not be relevant to software companies). Hence, portfolio statistics for such questions refer to the proportion of companies to which those questions are applicable.

5 Select Deals Declined on ESG Grounds (01/01/23 to 12/31/23)

COMPANY OVERVIEW		REASONS FOR DECLINE
Company A	UK-based education agency providing students globally with access to foundation courses at UK and European universities	<ul style="list-style-type: none"> Scope for abuse of university application systems by ghost-writing applications Similar companies have been accused of wrongdoing and experienced public controversies
Company B	UK-based outsourced installer of equipment and technology for large energy companies	<ul style="list-style-type: none"> A founder and significant equity owner at the company was found to have a criminal record Initially thought to be non-financial crime, further due diligence uncovered a potential instance of financial crime
Company C	Disruptive digital company in Australia's online sports betting market	<ul style="list-style-type: none"> Concerns around gambling sector and social repercussions of problem gambling Potential risks around gambling controls and anti-addiction frameworks given the company is relatively nascent
Company D	Distributor of video surveillance, access control, fire detection and intruder detection systems	<ul style="list-style-type: none"> Due diligence revealed that two of the company's major suppliers were found to be Chinese entities under sanctions Additional concerns surfaced around surveillance risks given China exposure and Huawei scandal
Company E	Designer, manufacturer, and distributor of environmental control, containment and response products	<ul style="list-style-type: none"> The company's products are used to store highly corrosive chemicals, which has a detrimental impact on the environment in the event of product failure
Company F	UK-based foster care agency and special educational needs schooling provider	<ul style="list-style-type: none"> Potential for quality of care deficits in foster homes and special educational needs schools was deemed to be high, given the vulnerability of the children involved Companies in the same sector have previously experienced similar issues, with serious negative repercussions on quality of care and the businesses's standing

6 Looking Ahead

We strongly believe that integrating ESG practices enhances the credit quality of our broader portfolio by highlighting forward-thinking and prudent management teams and private equity sponsors. Throughout 2024, we will seek to execute on and further enhance our ESG philosophy.

As we look ahead to 2024 and beyond, we plan to continue to execute against the established ESG cadence both at the fund and portfolio levels with an eye towards refinement and improvement through broadening our engagement with external ESG experts and further leveraging the Morgan Stanley Sustainability Resources and Expertise.

- Further expand the MS EDL team ESG acumen and expertise** (Icon: Group of people)
- Empower portfolio companies with additional support to advance their ESG programs** (Icon: Line graph with upward arrow)
- Strengthen the portfolio ESG metric assessment, tracking and reporting framework** (Icon: Bar chart)
- Stay abreast of ESG industry developments and methodologies to improve current processes** (Icon: Three trees)
- Collaborate and share best ESG practices across MSIM and the Firm** (Icon: Venn diagram)

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