Research & Engagement Brief

Fourth Quarter 2015

This annual summary of company engagement initiatives is our fourth report to clients on the reach and impact of these efforts across Walden's investment strategies. The results in 2015—Walden's 40th anniversary—continue to demonstrate that investor engagement can foster transformative corporate change on a range of environmental, social, and governance (ESG) topics.

REACH & IMPACT: THE NUMBERS

Through letters, company dialogues, and shareholder resolutions, Walden reached approximately 38 percent of the universe of portfolio companies across investment strategies (see **Table 1**). These include private conversations, outreach by small groups of investors, and coalition initiatives where collective action can leverage our influence. The topics most frequently addressed in the year, in order, were climate change, board diversity, LGBT equal employment opportunity, lobbying disclosure, and sustainability reporting. The numbers in Table 1 do not include outreach to companies that are not generally held in Walden portfolios, which often occurs through our participation in investor collaborations. Also, this accounting obscures Walden's frequent practice of engaging on multiple ESG issues at a single company.

Counting companies to determine Walden's engagement reach is an objective and simple process. In contrast, assessing the impact of our efforts requires significant judgment. As reported in our 2014 year-end summary, we consider engagement to be effective when we observe progress toward one or more of three potential outcomes: better corporate policies (e.g., amending board nominating charters to include explicit consideration of gender and race), more sustainable business practices (e.g., adoption of science-based greenhouse gas [GHG] goals), and increased transparency (e.g., implementing comprehensive lobbying disclosure or significantly improved sustainability reporting). While all engagement activity helps build company awareness about significant ESG matters, our measure of impact captures only improvement in policies, practices, and transparency.

In 2015, Walden is pleased to report that we achieved an "impact rate" of 45 percent (see **Table 2**). This rate reflects the percentage of companies demonstrating improvement relative to companies reached through engagement. By the primary ESG topic areas identified above, impact rates ranged from 22 to 52 percent. Specific examples of progress through engagement follow on page 2.

Table 1: Walden's Reach in 2015	
Reach	
# of Portfolio Companies Engaged	127
% of Approved List (336)	**38%**
Most Frequent ESG Topics Addressed (# of Companies)	
Climate Change	44
Board Diversity	35
LGBT Equal Employment Opportunity	23
Lobbying Disclosure	18
Sustainability Reporting	17

Table 2: Walden's Impact in 2015	
Impact	
# of Portfolio Companies	57
Impact Rate: % of Companies Engaged (127)	**45%**
Impact Rates for Most Frequent ESG Topics Addressed	
Climate Change	52%
Board Diversity	26%
LGBT Equal Employment Opportunity	48%
Lobbying Disclosure	22%
Sustainability Reporting	41%

LIMITATIONS TO THE MEASUREMENT OF IMPACT

We believe strongly in the importance of developing sound processes to monitor and measure the impact of our company engagement. A best practice approach calls for an assessment that is comparable, replicable, efficacious, and transparent. While there is no common industry approach to measure and report on the impact of company engagement, Walden supports efforts to develop such standards. Meanwhile, we continue to refine our own process that we hope can serve as a model.

Walden welcomes the opportunity to share the big picture results for 2015 as depicted on page 1, but we also recognize our responsibility to describe significant limitations inherent in our underlying approach to measuring impact. We have identified five primary challenges in measuring impact:

THE CONTINUUM OF PROGRESS

Corporate progress is often incremental and can span multiple years. For example, a successful engagement on water risk may include the following milestones: obtain a commitment to conduct a water risk assessment, establish process and baseline data for analysis, implement the assessment, and report on the process and conclusions. As long-term investors committed to report on our impact annually, Walden "counts" any milestone advancement observed along this continuum, even while the engagement is expected to continue to progress in the future.

ATTRIBUTION

Cause and effect cannot always be isolated. While sometimes progress is primarily catalyzed by Walden's engagement, observed improvement often represents the hard work of, and collaboration with, other investors and stakeholders. Additionally, our input and encouragement sometimes supports corporate advocates who are already committed to continuous ESG improvement or are motivated to make changes for other business reasons.

QUALITY VS. QUANTITY

Our assessment and reporting on impact treats all forms of progress equivalently. In part this neutral context is reasonable because clients have different ESG priorities. Yet efforts required by companies to improve ESG practices vary substantially (e.g., amending a corporate governance policy is significantly less time and resource intensive than developing and implementing science-based GHG goals) and some progress is more transformative (e.g., encouraging a company to establish a new best practice industry standard on climate change). Therefore we caution against simplistic interpretation of our reported results, including comparisons between different time periods.

TRANSPARENCY

Ideally, Walden would like to report publicly on each company where we have identified progress. However, some conversations are confidential until a company announces new policies or practices. In other instances we believe that full transparency could detract from progress by jeopardizing the trust Walden has established with companies.

REAL WORLD PROGRESS VS. CORPORATE CHANGE

Finally, we are mindful that corporate change defined as improvement in policies, practices, or transparency does not necessarily translate to real world impacts such as reduced GHG emissions (mitigation of global warming) or fewer incidents of discrimination in the workplace. However, we believe that corporate impact as we measure it is often a precursor to the broader progress we and our clients seek.

EXAMPLES OF IMPACT IN 2015

Climate Change: Climate Policy and GHG Goals

A core focus of Walden's climate related engagement is to encourage companies to adopt robust climate policies and science-based GHG goals, consistent with reports by the Intergovernmental Panel on Climate Change or IPCC. This translates to a reduction in GHG emissions of 55 percent globally by 2050 compared to 2010, the likely minimum decrease needed to avoid the most disastrous consequences of global warming. IPCC further projects the need to become carbon neutral by 2100.

- **Qualcomm** announced a substantial new target: a 30 percent absolute reduction in GHG emissions from global operations by 2025 relative to 2014 levels.
- **Lincoln Electric** published new 2020 GHG and energy intensity reduction goals of 15 percent and 30 percent, respectively (baseline of 2011). The company also launched an external environmental and safety microsite.
- **Costco Wholesale** committed to keep GHG emissions growth to less than sales growth over the next 5 years. The big box retailer also included a climate statement in its 2015 Sustainability Report with scientific context from IPCC and resumed reporting to CDP, the leading global repository of corporate responses to climate risk.
- **Union Pacific** adopted a new goal to reduce its locomotive fuel consumption rate by 1 percent annually through 2017, reportedly equating to an annual GHG decrease of 1 percent.
- **PNC Financial Services** adopted a more stringent mountain top removal (MTR) financing policy (coal producers cannot exceed 25 percent of production from MTR) and an enhanced due diligence process in financing high risk sectors that includes internal environmental stress tests.
- **U.S. Bancorp** committed to announce its first GHG goal in 2016.

Climate Change: Public Policy

Walden's other key climate strategy is to enlist the support of companies as advocates of effective public policy, or at the very least, to ensure that they do not impede progress. We led a coalition of over 60 institutional investors and organizations who wrote to approximately 50 companies with significant ties to the U.S. Chamber of Commerce. The Chamber recently filed a lawsuit against the Environmental Protection Agency over the Obama Administration's new carbon pollution standards for existing fossil fuel-fired power plants known as the Clean Power Plan (CPP). The letter asked the companies to use their leverage to encourage the Chamber to halt its campaign against the CPP and to publicly distance their firms from the organization's actions in opposition to the Plan. Several companies—such as **Johnson & Johnson**, **Microsoft**, and **PepsiCo**—let the Chamber know they did not share its opposition to the CPP while simultaneously speaking publicly in support of effective policy solutions.

Climate Change: Sustainable Palm Oil

The destruction of tropical forests and peatlands in Indonesia and Malaysia to make room for palm oil production contributes significantly to climate change. As context, during the 26 day period beginning September 1, 2015, researchers from VU University in Amsterdam calculated that daily GHG emissions from fires in Indonesia to clear land for palm oil and pulp production surpassed those of the entire U.S. Walden continues to see progress toward sustainable sourcing of palm oil at several portfolio companies.

- After mapping its supply chain and benchmarking competitors and suppliers, **International Flavors & Fragrances** has a new policy to procure 100% of palm oil from sustainable sources by 2020 and also committed to report annually on its progress.
- **Sysco** worked with an external expert to trace, map, and analyze its palm oil supply chain to develop a policy and plan. The new palm oil policy is being submitted to the Board for approval.
- We succeeded in encouraging **Colgate-Palmolive** to sign a coalition letter calling on the Roundtable on Sustainable Palm Oil, the primary standard-setter and certifier of sustainable palm oil, to enhance its standards regarding deforestation-free palm oil.

Board Diversity

The vast majority of conversations with companies on board diversity stem from our long-standing proxy voting policy that stipulates voting against directors serving on nominating committees of boards with relatively few women or people of color. December 2015 research from the U.S. Government Accountability Office (GAO) estimates that it would take more than 40 years to reach gender parity on U.S. boards from women's current representation of 16 percent in the S&P 1500, even if one out of every two new appointees are women. (Walden was one of six investor constituencies interviewed by GAO for this research that looked at federal disclosure requirements as a means to increase board diversity.)

Based on our conversations with companies in 2015, the good news is that they seem to understand the strong business case for increasing board diversity and many fruitful discussions are underway. We ask companies to explicitly identify gender and race as among the factors considered for nominating directors and to commit to a diverse candidate pool in new searches.

- Four companies added a woman director in 2015—**Encore Capital Group**, **Franklin Electric**, **Mettler-Toledo**, and **Plantronics**—and we expect announcements of new women directors at a handful of other companies in 2016.
- Similarly, **Artisan Partners Asset Management** and **Cohen & Steers** adopted more explicit nominating criteria and we anticipate that several other companies will also revise their policies soon.

Lobbying Disclosure

As we enter the 2016 presidential election cycle, we expect increasing attention to corporate influence in the political sphere. Comprehensive disclosure of lobbying activities and expenditures enables investors to identify reputational risks and determine if shareholder capital used for public policy purposes aligns with a company's expressed corporate goals. Both **Apache** and **Becton Dickinson** committed to increased website disclosure of lobbying, including indirect lobbying through trade associations.

Equal Employment Opportunity (EEO): LGBT

Walden celebrated an important milestone in client Core Equity portfolios in 2015—all companies in this strategy include sexual orientation in their EEO policies. In addition, more than four out of five of these same companies now also explicitly prohibit discrimination based on gender identity. Companies that adopted more inclusive EEO policies over 2015 include: **The Cheesecake Factory**, **Cullen Frost Bankers**, **Expeditors International**, **First NBC Bank Holding Co.**, **IDEX**, **Interval Leisure Group**, and **Syntel**. We also successfully encouraged other companies to make their inclusive policies more accessible to current and prospective employees by posting them on their websites.

Sustainability Reporting

Once again, we have observed that persistence—and long term ownership—yields results. After five consecutive years of receiving a shareholder resolution led by Walden, **C.R. Bard** produced its inaugural sustainability report in October. The report was based on Global Reporting Initiative (GRI) standards, which provide best practice ESG reporting guidance. Walden has already provided constructive feedback on ways C.R. Bard can improve disclosure in the future. Good disclosure that includes metrics and goals helps investors understand how companies manage ESG risks and opportunities. **Wolverine Worldwide** also produced a first-time report in 2015 and **Commercial Metals** committed to initiate reporting this year. Commercial Metals took this step after investors accounting for 46 percent of shares backed a Walden-led shareholder resolution, an extremely high level of support that likely provided impetus for management to act.

Water Risk

Water use has not been a major focus area for Walden, but we engage with companies on a strategic basis as opportunities arise. While water risk is linked to global climate change, the impacts are local and often much more company-specific. Of five company dialogues on water risk, mostly addressing water scarcity within supply chains, two led to meaningful progress.

- **Flowers Foods** committed to respond to CDP Water (a public repository of corporate water management practices), create a GRI-based sustainability report, and consider furthering its alliance with NGO Field to Market to better support its farmer suppliers in water conservation and management.
- **McCormick** increased disclosure of water risk management in its 2015 sustainability report and also set a new water use reduction goal for its direct operations.

We look back on 2015 with a strong sense of accomplishment that Walden's ESG engagement contributed to more sustainable business practices. Foremost, we thank you, our clients, for your partnership in these endeavors and for entrusting us to put your financial assets to work for positive change.