



# Annual Carbon Footprint Report

April 2018

For the fifth consecutive year, we are pleased to disclose carbon footprint metrics of representative client portfolios. Our disclosure has expanded over time to include additional strategies and the majority of assets under management. This year we introduce a new metric—the weighted average carbon intensity—and analyze the carbon reduction commitments of companies in the Large Cap portfolio.

## New Metric: Weighted Average Carbon Intensity

The decision to change the carbon footprint metric was prompted by the recommendations released in 2017 by the Task Force on Climate-related Financial Disclosure (TCFD). Established in 2015 under the mandate of the Financial Stability Board and the G20, the purpose of the TCFD is to “develop recommendations for voluntary climate-related financial disclosures that are consistent, comparable, reliable, clear, and efficient, and provide decision-useful information to lenders, insurers, and investors.” (For more info: [www.fsb-tcfd.org](http://www.fsb-tcfd.org)) In the past, Walden disclosed a carbon footprint metric that captured total carbon emissions



for a portfolio normalized by the market value of the portfolio, expressed in tons of CO<sub>2</sub> equivalent per million dollars *invested*. The weighted average carbon intensity reveals a portfolio’s exposure to carbon-intensive companies and is expressed in tons of CO<sub>2</sub> equivalent per million dollars of *revenue*. According to the TCFD, benefits of this metric include its applicability across asset classes and that it is relatively simple to understand and communicate.

Weighted Average Carbon Intensity (tCO <sub>2</sub> e/\$million sales) as of 12/31/17					
	Small Cap	SMID Cap	Mid Cap	Large Cap	FFF Large Cap
Weighted Average Carbon Intensity—Walden	77	54	59	112	126
Weighted Average Carbon Intensity—Benchmark	166	246	308	211	211
<b>Carbon Intensity (relative to benchmark*)</b>	<b>-54%</b>	<b>-78%</b>	<b>-81%</b>	<b>-47%</b>	<b>-40%</b>
Attribution: Sector Allocation	27	-8	6	-14	-53
Attribution: Stock Selection	-115	-184	-254	-85	-33
#1 Contributing Stock	HE	HP	ED	PX	APD
#2 Contributing Stock	OGS	OGS	DLR	COP	PX
#3 Contributing Stock	CHH	CHH/NJR	OGS	UNP	UNP

Source: Boston Trust/Walden, MSCI

\*In order, the benchmarks are as follows: Russell 2000®, Russell 2500™, Russell Midcap®, Russell 1000®, Russell 1000®.

Note: 4% of the small cap benchmark, by market value, discloses GHG emissions; 11% of the SMID cap benchmark discloses emissions; 37% of the mid cap benchmark discloses emissions; and 67% of the large cap benchmark discloses emissions. Boston Trust/Walden references MSCI estimates where data is not publicly disclosed.

Using the weighted average carbon intensity metric, our portfolios continue to compare favorably to their benchmarks, ranging from 40 percent to 81 percent less carbon intensive than their respective benchmarks (see table below).

The utilities **Hawaiian Electric**, **New Jersey Resources**, and **ONE Gas** and the oil and gas service provider **Helmerich & Payne** are the largest contributors to the Small and SMID Cap portfolios. **Choice Hotels International** also makes the Top 3 in the Small and SMID cap portfolios. For comparison, Hawaiian Electric's emissions intensity is three times that of Choice Hotels. Moreover, Choice Hotels does not disclose its emissions, and we therefore rely on estimates from MSCI. It is unclear if the emissions model recognizes Choice Hotels' franchise business model, which should lower its carbon intensity. We are following up with the data provider.

The SMID and Mid Cap portfolios have the best relative performance of all Walden strategies, with a weighted average carbon intensity that is about 80 percent less than their benchmarks. In both cases, stock selection, in contrast to sector allocation, accounts for most of the outperformance. The SMID and Mid Cap benchmarks are replete with carbon intensive utilities and energy companies. In contrast the top two contributors to the Mid Cap portfolio's emission intensity, **Consolidated Edison** and **Eversource**, are highly carbon efficient relative to most utilities because they do not produce electricity, but rather focus on transmission and distribution. Similarly, **Helmerich & Payne** is far more carbon efficient than many companies in its sector, which includes oil and gas producers that have more carbon-intensive business models.

**Air Products**, **Praxair**, and **Union Pacific** are among the largest contributors to the Large Cap and Fossil Fuel Free (FFF) Large Cap portfolios' carbon intensity. Both Praxair and Air Products are carbon intensive industrial gas companies but their products enable customers to be more carbon efficient—a factor that is not reflected in the metric.<sup>1</sup> While carbon intensive, railways are a relatively carbon efficient method of transportation. According to the Rocky Mountain Institute, the average freight train has an efficiency of 400 ton-miles per gallon whereas trucks average about 130 ton-miles per gallon.

**As part of our climate advocacy work, we ask companies to set emissions reduction targets. If the companies meet their stated reduction targets, the climate-related risk implied by the weighted average carbon intensity metric may be less than it appears.**

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Readers might be surprised that the carbon intensity of the FFF Large Cap portfolio is slightly higher than the unrestricted Large Cap portfolio. This result reflects another shortcoming of the intensity metric: namely, the measure does not capture emissions associated with the use of products. The FFF strategy would appear superior if the metric included the emissions associated with the use of the oil produced by **ConocoPhillips** and **Apache**, holdings in the Large Cap portfolio. Our analysis indicates that the carbon intensity of the Large Cap portfolio would increase to 221 metric tons of CO<sub>2</sub> equivalent per million dollars of revenue, compared to 126 for the FFF portfolio, if emissions associated with burning the oil brought to market by these fossil fuel companies were included.

### Company Carbon Reduction Commitments

In addition to not accounting for emissions associated with the use of products, carbon footprint metrics typically capture the carbon intensity of a company at a past moment in time, but do not indicate a company's intention (or lack thereof) to reduce its greenhouse gas (GHG) footprint in the future. To address the backward-looking nature of the metrics, we researched the companies in our Large Cap portfolio for public commitments to reduce GHG emissions. This research complements and informs our climate advocacy work asking all companies to set emissions reduction targets that limit warming to 2 degrees Celsius above preindustrial levels. We focused on large cap companies since their emissions tend to be significantly larger than smaller cap companies.

Forty-seven of sixty-six companies in the portfolio as of December 31, 2017 have either an absolute or intensity

-based (emissions normalized by sales, production volume, or something similar) GHG emissions reduction target. The varied degree of ambition among these targets is as varied as the companies themselves. Among companies with emissions exceeding one million tons per year, **3M** committed to reduce emissions by 50%, **Johnson & Johnson** by 80%, **PepsiCo** by 20% (inclusive of its value chain), and **Google** and **Microsoft** set goals of carbon neutrality. The heaviest emitters in our portfolio have also committed to reductions, albeit on a more modest scale. **ConocoPhillips** announced a new emissions reduction target in 2017, and **Praxair**, **Union Pacific**, and **United Parcel Service** have all committed to improve the carbon intensity of their operations. If the companies meet their stated reduction targets, the portfolio climate-related risk may be less than it appears based on the weighted average carbon intensity metric alone.

In addition to the recommended use of a weighted average carbon intensity metric, the TCFD provided a comprehensive climate risk disclosure framework, including specific guidance for asset managers. Stay tuned for a publication aligned with the TCFD framework.

<sup>1</sup>For a more detailed discussion of the challenges associated with carbon footprint metrics see: <http://waldenassetmgmt.com/wp-content/uploads/2017/10/CarbonFootprinting-Feb2016.pdf>.