ESG Research & Engagement Brief
First Quarter 2018

While the return of volatility is a fitting headline for financial markets in early 2018, we are pleased to report a steady-state of progress in our efforts to advance more sustainable business policies and practices through active ownership initiatives.

CLIMATE CHANGE

Encouraging companies to adopt science-based greenhouse gas (GHG) emissions reduction goals is a primary objective of our company engagement on climate change. Known as science-based targets (SBTs), these goals comport with Intergovernmental Panel on Climate Change (IPCC) research indicating that global GHG emissions must decline 55 percent by 2050 and reach net zero emissions by the end of the century to avoid the most catastrophic consequences of climate change.

McDonald's recently announced it will partner with franchisees to reduce absolute GHG emissions from its restaurants and offices by 36 percent by 2030 relative to 2015 levels. Additionally, it committed to a 31 percent reduction in emissions intensity (per metric ton of food and packaging) across its supply chain within the same timeframe. These targets were affirmed by the Science-Based Target Initiative, a partnership of CDP, UN Global Compact, World Resources Institute, and World Wildlife Fund, which described this groundbreaking commitment as "charting a course for sustainable growth." McDonald's also joined the "We Are Still In" declaration of businesses, investors, states, cities and other stakeholders who stand by the Paris Agreement despite the announced departure of the United States. Having been involved in formal stakeholder advisory groups as well as private discussions with McDonald's addressing climate change, SBTs, and other issues for many years, we commend the company's extraordinary leadership and encourage other companies to follow suit.

American Water Works recently set a robust GHG emissions reduction target with its commitment to reduce emissions 40 percent by 2025 from a 2007 baseline. This company is included in a collaboration co-led by Walden and the Interfaith Center on Corporate Responsibility (ICCR) that is encouraging more than one hundred companies to adopt science-based targets.

One Walden shareholder resolution on climate change went to a shareholder vote. For the third consecutive year we asked **Emerson Electric** to adopt time-bound, quantitative goals for reducing GHG emissions consistent with the goals of the Paris Agreement. The resolution garnered 39 percent support, up from 34 percent in 2017, sending a strong signal to management of widespread investor support.

EQUALITY

The wind is at our back with respect to engagement on workplace equality. We are helped by the endurance of the #MeToo movement as well as the proliferation of research, like S&P Global's "The Key to Unlocking U.S. GDP Growth? Women," that articulates a strong business case for making full use of our country's diverse human capital. This work takes several forms at Walden: advocating for greater board diversity; seeking disclosure of workforce composition data to hold companies more accountable for hiring, retaining, and promoting women and people of color; and assuring strong workplace protections for lesbian, gay, bisexual, and transgender (LGBT) employees. In each area, Walden has seen meaningful progress.

Board Diversity: The Nominating Committee Chair at **Valmont Industries** wrote to us to report on its January appointment of two new directors, one of whom is a woman. The Committee Chair also reported that another woman director will be added in April following the retirement of the lead director. In addition, Valmont expanded proxy disclosure on board diversity to affirmatively state that gender, race, and ethnicity of director candidates are considered in the nominating process. **Amdocs** elected a woman and a Hispanic man to its board of directors in January, and **Dentsply Sirona** recently added a woman director as well. **Tanger Factory Outlet Centers** updated its corporate governance policies to explicitly reference gender, race, and ethnicity as factors considered in director nominations.

Workforce Data Disclosure: Walden withdrew our resolution requesting disclosure of workforce composition statistics at **Dollar General**. The company agreed to report annually on its website the percentages of women and people of color among its officers (VP level and above) and management as well as the board of directors. **SunTrust Bank** delivered on its commitment to enhance diversity reporting in its recently published annual report, which includes a table on workforce composition at various levels within the organization. With lead proponent Arjuna Capital, Walden co-filed a different type of disclosure resolution that asked **American Express** to report on its policies and goals to reduce the gender pay gap. The resolution was withdrawn with the company's agreement to analyze and disclose its U.S. gender wage gap on its website. Importantly, American Express also committed to make compensation adjustments, as needed, with a goal of achieving full gender pay equity.

LGBT Protections: Walden withdrew our shareholder resolution asking **Chemed** to adopt an inclusive equal employment opportunity (EEO) policy. Chemed added language to its policy prohibiting discrimination based on gender identity and posted the new policy in the corporate governance section of its website. Unfortunately, our efforts to encourage North Carolina-based retailer **Cato** to strengthen its EEO policy were quashed, as they were last year, by the company's successful appeal to the SEC to omit Walden's resolution from the proxy ballot. Presently, we are evaluating our options regarding Cato.

GOVERNANCE

Walden's company engagement to foster good corporate governance spans a variety of topics, including requests of investment managers to evaluate and thoughtfully vote environmental, social, and governance (ESG) proxy resolutions filed by shareholders; lobbying transparency and oversight; board structure and accountability; and effective management and disclosure of ESG risks and opportunities.

- Asset manager **Cohen & Steers** has been responsive to Walden's feedback on their proxy voting polices and practices, prompting us to withdraw our shareholder resolution. Cohen & Steers reviewed its proxy voting record and processes for evaluating ESG proxy items, updated and posted on its website revised proxy voting guidelines, and strengthened its decision-making processes to better address shareholder resolutions.
- Walden withdrew our shareholder proposal at **ConocoPhillips** on lobbying disclosure, a resolution that we have filed each year since 2011 and that routinely earned the support of approximately one-quarter of shares voted. The substance and quality of our discussions and company participation improved significantly this year. ConocoPhillips agreed to expand its reporting on public policy and lobbying.
- A resolution led by the Sisters of St. Francis of Philadelphia and co-filed by Walden encouraging an independent board chair at **Johnson & Johnson** was withdrawn after a constructive dialogue. The company agreed to amend its corporate governance principles to reflect its commitment to an annual review of the prospect of separating CEO and Board Chair roles.
- Walden engaged natural gas utility **ONE Gas** regarding its minimal reporting on ESG risks and opportunities. Following our dialogue, the company formed a new Environmental, Health, Safety, and Compliance Board, which meets regularly regarding a three-year action plan. ONE Gas has also devoted new resources to expand public reporting on these issues in 2018.
- We co-filed and withdrew a resolution led by Mercy Investment Services at **Williams-Sonoma**, asking it to report on its due diligence efforts to ensure responsible recruitment within its operations and supply chain. The company agreed to augment reporting on implementation of labor supply chain and vendor code of conduct policies.

The Sustainability Accounting Standards Board (SASB) was created in 2011 to develop industry-specific sustainability accounting standards to enhance companies' management and disclosure of financially material ESG considerations. After a rigorous, multi-stakeholder development process, SASB standards are set to be codified this year. Walden is pleased to be part of SASB's Investor Advisory Group (IAG) of thirty-two global investment firms and asset owners representing approximately $26 trillion in assets. The IAG supports SASB's framework for consistent, comparable, and reliable disclosure of financially material, decision-useful ESG information. We continue to back and utilize other disclosure frameworks such as Global Reporting Initiative and CDP, and believe that SASB will help address widespread and persistent shortcomings in ESG disclosure by companies. Walden is facilitating four SASB IAG collaborative engagements with companies to encourage adoption of the standards. We hope to report positive results by year's end.

OUR PORTFOLIO CARBON FOOTPRINTS

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) 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_2 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_2 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.

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

Weighted Average Carbon Intensity (tCO_2e/$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
Carbon Intensity (*relative to benchmark**)	**-54%**	**-78%**	**-81%**	**-47%**	**-40%**
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.

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.[1] 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.

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_2 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.

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.

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.

[1] 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.