Climate change

Climate Change is one of the greatest challenges we confront in human history. Decades of scientific evidence from the Intergovernmental Panel on Climate Change (IPCC) detail the necessity of significant transition to contain severe climate-related risks. The latest report (August 2021) states that climate change is widespread, rapid and intensifying. As average temperatures rise, climate science finds that acute hazards such as heat waves, storms and floods grow in frequency and severity, and chronic hazards, such as drought and rising sea levels, intensify. Climate-related risks are related to amongst others food production, biodiversity, infrastructure, water supply, human security, and economic growth. Without rapid action against climate change, average global temperature is expected to rise over 3°C, resulting in a disastrous outcome for our natural world and humanity[1].

Climate change has been and will be a very important topic for the Sustainable Equity team. We believe climate change is a material risk making an increasing impact on global markets, with far-reaching consequences for the planet and human well-being. In our opinion, it is critical that all companies move towards net-zero carbon emissions across the value chain by 2050 or sooner.

In this transition to a low carbon economy some companies will do very well, some will survive and some will not make it. When consumers shift to low carbon products and regulators impose financial schemes to force the economy to decarbonize you better be prepared as a company.

The Paris Agreement, signed in 2015, was an important step in the right direction of international cooperation to combat climate change. It commits almost all countries to keep global warming well below 2°C this century (compared to pre-industrial levels), and to strive to limit the increase to 1.5°C[2]. Since then, the European Union (EU) together with more than 110 other countries have pledged carbon neutrality by 2050 (China by 2060). The EU is implementing its EU Sustainable Finance Action Plan to align European regulation with a climate-neutral economy[3]. Recently, the US has set a target to achieve 50–52% emission reductions (from 2005 levels) by 2030[4].

Figure 1 shows current state of the climate targets per country. Most countries still have their targets under discussion, almost a third have targets in their policy document, three countries have proposed legislation and merely ten percent of countries have their climate targets in law. Notably, Suriname and Buthan claim to be first at achieving their net-zero targets, largely due to their natural forests.

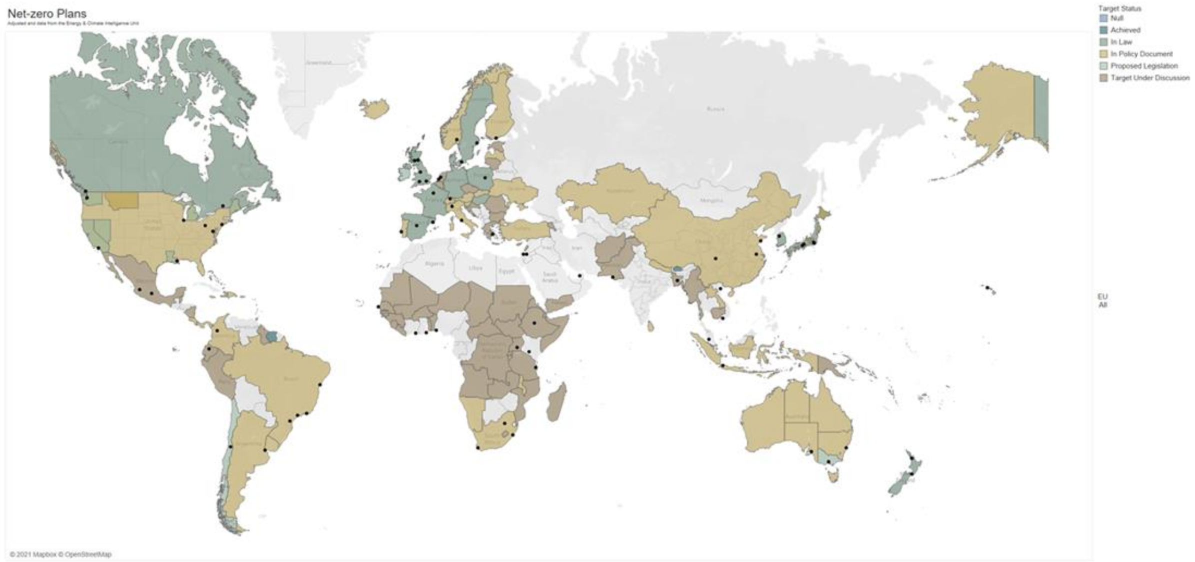

Figure 1 Net-zero plans per country, state and city. Adjusted and data (as of 2021-10-05) from the Energy & Climate Intelligence Unit (website: https://eciu.net/netzerotracker/map)

Our investment approach

When selecting companies we analyze the carbon footprint looking at direct (scope 1 and 2) and indirect (scope 3) exposures. Companies with a very high carbon intensity (scope 1 and 2) or with products and services that significantly obstruct the transition (scope 3) will not be in our portfolio. The risk is simply too high that these companies don't make it in a low carbon economy.

However, companies with an acceptable and well managed direct carbon exposure are rewarded with a lower cost of capital in our valuation models. Products and services that contribute to the transition are rewarded in our analysis by assigning higher growth rates for the long-term.

Since 2017 we target the carbon intensity of our portfolio to be below 50% of the intensity of the benchmark, the MSCI World. As of last year we broadened the objective to be at net-zero in 2050 with intermediate milestones in place based on an average 7% reduction a year. For our strategy it's critical that selected companies set carbon targets in line with the Paris agreement. More than 90% of the selected companies have already carbon targets.

As an active long-term investor, we engage with companies individually and collaboratively (together with other investors). Kempen Capital Management is an active member in the global Climate Action 100+ initiative to encourage (large) companies to integrate climate change in their business model via strategy, governance, reporting, and targets. For our strategy we engage individually with smaller companies that have not set carbon targets yet. We discuss with management why we think it's important to do so and what we see as best practices. We ask management to implement a strong governance framework, to take action to reduce carbon emissions and to provide enhanced corporate disclosures. In addition, we will engage with the highest carbon intensity companies in our portfolio to cover at least 50% of the portfolio intensity.

Belimo
One of the companies we engage with is Belimo. This company develops and produces field devices for controlling heating, ventilation and air-conditioning systems. Sensors, control valves and damper actuators make up the company's core business.

As their products and services help to make buildings more energy efficient, safer and comfortable, the company plays an important role in the transition to a more sustainable economy. Although the company helps building owners to save energy and meet their carbon targets, the company itself has no carbon reduction target yet.

We have had our first contact on this topic in May 2021, raising our concern and creating the awareness by sending a letter and asking for a meeting. During the meeting we made the company aware that climate change and emission reduction is important to us and we want to get a better understanding about the company's intention to set a reduction target in the near future. Belimo explained that it is currently in the process of setting an emission reduction target and expects to publish it in the annual report of 2021. With respect to governance, the company has established a sustainability committee including the CEO and CFO, the head of strategy and newly appointed head of innovation. Furthermore the company is considering to further improve its standard carbon reporting, but continuous to report based on an inhouse developed impact model for now.

As the company has indicated to publish a carbon reduction target together with the publication of the annual report of 2021, we will monitor this closely and evaluate the quality of the target once published. We appreciate the company's explanation of the governance and reporting, and better understand the choices made. The reported data should enable us to be able to track the progress towards the emission reduction target, and we take this into account when evaluating the target.

1: International Panel on Climate Change. (2021). Sixth Assessment Report. IPCC.

2: United Nations Framework Convention on Climate Change. (2015). Adoption of the Paris Agreement, FCCC/CP/2015/L.9/Rev.1. Paris: United Nations. Retrieved 10 05, 2021, from https://unfccc.int/resource/docs/2015/cop21/eng/l09r01.pdf

3: European Commission. (2020, 01 14). Financing the green transition: The European Green Deal Investment Plan and Just Transition Mechanism. Retrieved 10 05, 2021, from European Commission: https://ec.europa.eu/commission/presscorner/detail/en/ip_20_17

4: Plumer, B., & Popovich, N. (2021, 04 22). The U.S. Has a New Climate Goal. How Does It Stack Up Globally? Retrieved from The New York Times: https://www.nytimes.com/interactive/2021/04/22/climate/new-climate-pledge.html#:~:text=How%20Does%20It%20Stack%20Up%20Globally%3F,-By%20Brad%20Plumer&text=The%20United%20States%20officially%20has,change%20over%20the%20next%20decade.&text=President%20Biden

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