

A new climate for change

“This one trend, climate change, affects all trends.”

Barack Obama
UN Climate Change Conference
Paris, 2015

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REDPOINT INVESTMENT Management believes that one of the greatest challenges facing investors today is the impact of climate change. Since the first Intergovernmental Panel on Climate Change (IPCC) Assessment report in 1990 the issue of greenhouse gas (GHG) emissions has evolved from a government reporting matter to recognition of climate change as a key investment risk.

The investment challenge of climate risk is multi-faceted. The current focus has been on portfolio exposure to stranded assets. A more complex consideration is the exposure of all companies to GHG emissions in their processes and supply chains. While the almost certain imposition of a cost in relation to those emissions will ultimately impact asset values, the timing and mechanism for this is uncertain.

TABLE 1: TNT vs Expeditors

	TNT	Expeditors
Revenue (US\$m)	8,585	6,565
Scope 1 (tonne CO ₂)	1,266,926	6,767
Scope 2 (tonne CO ₂)	49,342	44,153
Total (Scope 1 and Scope 2)	1,316,268	50,920
Scope 1 & 2 carbon intensity	153	8
Scope 3 (tonne CO ₂)	402,163	6,185,674
Trucost carbon intensity	166	886

Source: Redpoint Investment Management and Trucost. Data from 2014. Carbon intensity: calculated for each company as metric tonnes of GHG emissions (in carbon dioxide equivalents – CO₂e) divided by company revenue in millions of US dollars.

STRANDED ASSETS

The concept of a ‘stranded asset’ is not new. Think of the transition from fixed line phones to mobiles and from cellulose film to digital cameras. At present, companies that own fossil fuel deposits may face a similar demise based on either government imposed extraction quotas or competitive and technological substitution by companies that utilise such fuels.

The identification of assets with the potential to be stranded by policy or competitive forces of climate change is non-trivial, but reasonably straightforward. Coal mines and mine-owning utilities are such examples. So, to more accurately and effectively reduce a portfolio’s exposure to carbon risk requires deeper analysis.

ASSESSING CARBON INTENSITY

GHG emissions of companies are typically characterised as:¹

- **Scope 1 emissions:** direct GHG emissions from sources owned or controlled by the company;
- **Scope 2 emissions:** indirect GHG emissions resulting from the company’s consumption of electricity, heat or steam; and
- **Scope 3 emissions:** all other indirect GHG emissions excluding Scope 2 caused by the business but released from sources not owned or controlled by the company.

Data from Scope 1 and Scope 2 is required to be reported by companies if they are to comply with the GHG Protocol corporate accounting standard.² Scope 3 reporting is an optional disclosure. Given the high-level of company compliance with the minimum requirements of the standard, Scope 1 and Scope 2 data is often used to calculate carbon intensity.

UK based Trucost Plc, experts in environmental data capture and analysis,

has been assessing the economic impact of the dependence that companies have on natural resources for over a decade. Trucost’s preferred measure extends to incorporate those Scope 3 emissions that arise from direct service providers within a company’s supply chain. This allows for more accurate comparisons between companies with similar activities underpinning their outputs, but with different degrees of outsourcing. It is supported by a mix of modelling and data collection to determine Scopes 1, 2 & 3 where the data is not directly reported by the companies themselves.

WHY IS EXTENDED REPORTING IMPORTANT TO INVESTORS?

The differences between carbon intensity estimates is highlighted by comparing two similar logistics companies: delivery specialists TNT and Expeditors International.

Table 1 highlights the quite different conclusions that can be drawn based on the choice of intensity measure. Using only Scope 1 and Scope 2 data, Expeditors appears to have significantly lower carbon intensity than TNT. Trucost’s measure, which includes the bulk of Scope 3 emissions, reveals Expeditors having a vastly higher carbon intensity. This impact is due to Expeditors’ business model: being a non-asset global logistics provider that outsources its transportation needs.

This depth of analysis and insight will become more important for investors as they seek to understand their investments in the context of climate risk. Consideration of stranded assets is a valuable start but insights into the carbon intensity of all companies will assist innovative investors to more effectively account for this important social and financial risk; and improve risk and return outcomes. **B**



1. The latest carbon footprint data is sourced from Trucost, which maintains the world’s largest database of greenhouse gas (GHG) disclosures. See <http://www.trucost.com/> for further details.
2. The Greenhouse Gas (GHG) Protocol, developed by World Resources Institute (WRI) and World Business Council on Sustainable Development (WBCSD), sets the global standard for how to measure, manage, and report greenhouse gas emissions.