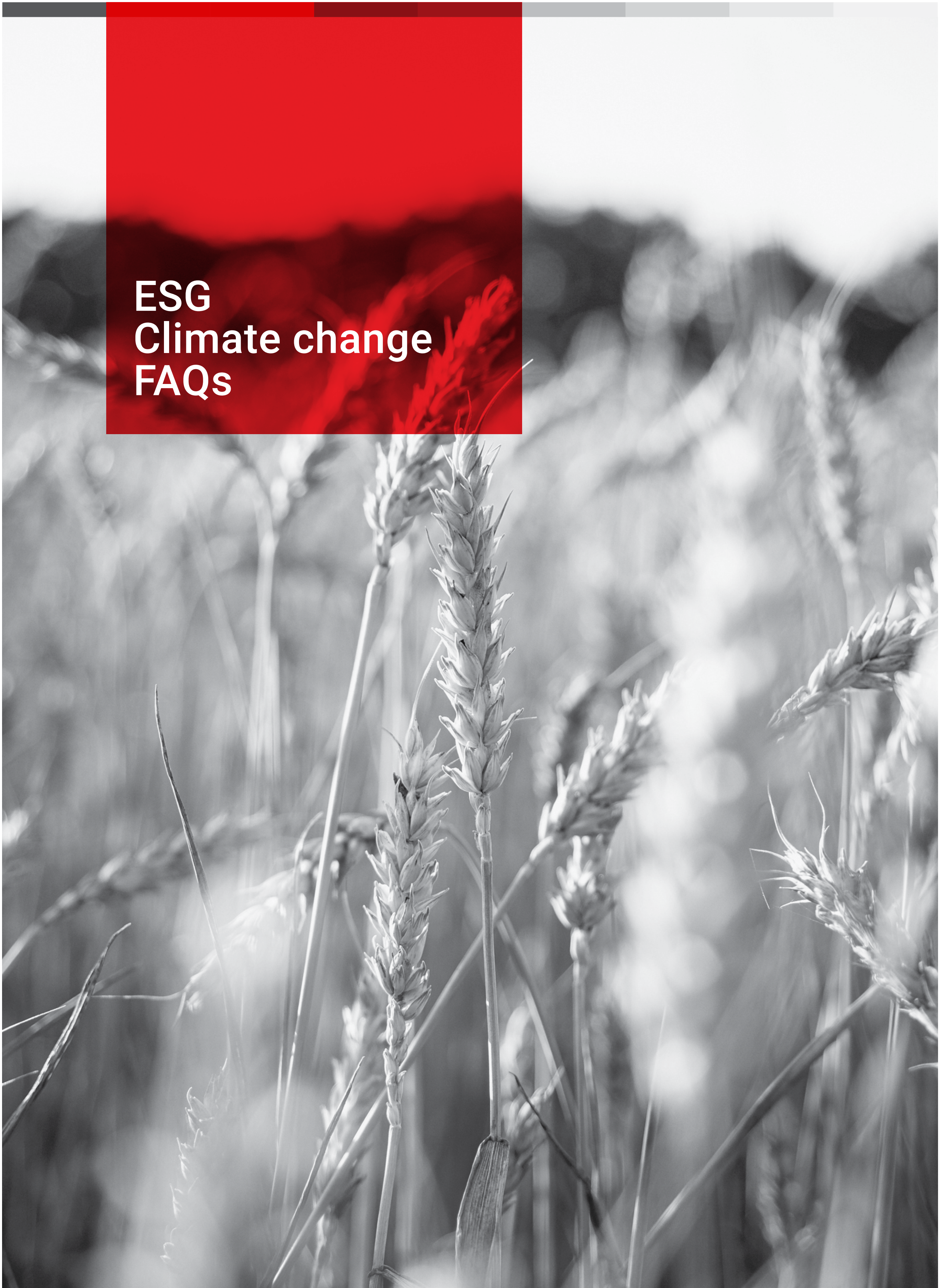
Allan Gray



ESG
Climate change
FAQs

1. How can your organisation have the biggest influence on the problems that need to be solved to get to net-zero emissions at the global economy level?

Carbon accounting methodologies are evolving, as explained in our Carbon accounting primer. Previously, we reported the weighted-average carbon intensity (WACI) of the top 40 local equity holdings of the Allan Gray Balanced Fund against a benchmark. WACI measures a portfolio's exposure to carbon-intensive companies and was the metric originally recommended by the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) in 2017. In this first issue of our Carbon accounting report, published in 2023 covering 2022 issues and efforts, we introduce improvements across three areas:

a) Company-related engagements

As a financial services provider, Allan Gray's operational GHG emissions are low relative to materials and industrial businesses. Our greatest climate impact is via the investments we make on behalf of our clients, where a portion of investee companies' emissions may be considered attributable to Allan Gray in proportion to the value invested. This impact is particularly relevant in a resource-intensive investment universe such as the South African listed equity market.

Materiality is a key factor in our approach to ESG. We focus our time on research and engagements that are most likely to shift the needle on positive client outcomes (i.e. preserve and grow their wealth), while remaining mindful of the positive impact we can make on society as a conscientious corporate citizen. In relation to climate change, we prioritise material emitters within our clients' top holdings, as these typically face the greatest climate transition risk. We have used two data points for this assessment.

- Climate Action 100+ (CA100+) is an investor-led initiative where investors selectively engage with 166 of the world's largest GHG emitters – who account for ±80% of global corporate industrial GHG emissions - to spur action on climate change. While we have not signed up to CA100+, we identified 6 CA100+ companies that are listed in the South African market: Anglo American, BHP, Eskom (fixed income), Glencore, Sasol and South32. Most of these companies are dual listed.
- Within our client portfolios, Glencore and Sasol have been material equity holdings for the five years to 2023 and have thus been the primary focus of our climate engagements over the period. As an Eskom bondholder, we called for an ESG-focused meeting on Eskom's air pollution, during which we discussed its Just Energy Transition strategy to reduce both GHG emissions and air pollutants.
- Historically, we have also used weighted-average carbon intensity (WACI) calculations, explained in our Carbon accounting primer, to identify investee companies that contribute most to the carbon intensity of our clients' investment portfolios. This exercise highlighted additional companies for engagement, including Sappi (excluding the carbon sink from its plantations) and certain mining companies. We continue to engage on their progress relating to their GHG reduction targets and the independent verification of their targets' alignment with The Paris Agreement. Verification is generally provided by the Science-based Targets Initiative (SBTi)[1].

b) Industry advocacy

We strive to provide comprehensive feedback on and support for industry regulations, frameworks and surveys that aim to improve ESG performance across the industry, including on climate-related matters. Historical examples include:

- Providing detailed feedback to National Treasury during the consultation phase for South Africa's Green Finance Taxonomy, which focused on climate mitigation and adaptation. We expressed our support for the Taxonomy overall.
- Expressing our support for the JSE's Sustainability and Climate Disclosure Guidance, which seeks to improve South African-listed companies' climate disclosures. We also presented the "Investor perspective" at its launch.
- Serving as a member of the Association for Savings and Investment South Africa (ASISA) Responsible Investment Standing Committee
- Participating in the Just Share South African Asset Manager Climate Risk Survey, which was used to assess industry progress

c) Thought leadership

Achieving net-zero global emissions by 2050 is a formidable challenge and has prompted extensive and often emotive debate. As with all our research, we believe in critical thinking and reaching evidence-based conclusions underpinned by high-quality research. Our goal is to share some of this research over time and contribute positively and pragmatically to this debate in the South African context.

1. The SBTi is explained in our Climate initiatives in the financial sector document.

2. How do you identify, assess and manage climate-related risks impacting the portfolio?

Identification and assessment of climate-related risks

We integrate ESG factors, including climate change, into our investment research process using qualitative and quantitative research.

Two types of climate risks are considered, as defined by the Task Force on Climate-related Financial Disclosures (TCFD):

- Transition risk: Risks arising from the uncertainty created by the global energy transition, such as related policy and regulatory changes, shifts in consumer preferences, reputational damage and market demand/supply shifts.
- Physical risk: Climate change leading to the damage of company assets and disruption of operations, such as drought or floods. Physical risks may be chronic or acute.

Qualitative research: Analysts are primarily responsible for researching climate-related risks relating to the companies they cover, as these must be factored into their forecasts and the assessment of the company's intrinsic value when material. Our ESG analysts assist with company deep-dives, sectoral comparisons and thematic research. This has included reports on thermal coal demand and policy shifts, nuclear energy and electric vehicles, as well as research comparing the climate commitments of mining companies.

Ad hoc meetings are also held on topics relevant to the energy transition. For example, the Investment team discussed an analyst report on the demand for base metals under future possible energy transition scenarios.

Our recently developed proprietary climate strategy assessment framework will assist in evaluating the credibility of material emitters' climate transition strategies going forward. While this was internally developed, it has been compared to external frameworks such as those of the Transition Pathways Initiative and CA100+ to evaluate completeness.

We use BloombergNEF's (BNEF's) high-quality climate-related research and data to support inhouse research on an ongoing basis and review annual energy transition scenario analyses produced by organisations such as the International Energy Agency, BNEF and the oil majors. While the energy transition will not perfectly follow any modelled decarbonisation pathway, it is important to consider the range of possible outcomes and how this may impact companies in our investment universe.

Quantitative research: Our annual review of the scope 1, 2 and 3 GHG emissions of our clients' material equity holdings, together with carbon footprint metrics, assists with the assessment and monitoring of material emitters in the portfolio. Large emitters typically face greater transition risk, such as escalating carbon prices or reputational damage. However, transition risk does not always arise because of a company's direct and indirect GHG emissions. For example, South Africa's platinum group metal (PGM) miners face transition risk from the market shift from internal combustion engines (ICE vehicles) to battery electric vehicles (BEVs). PGMs are primarily used in the catalytic converters of ICE vehicles, meaning that demand will be negatively impacted as the market shift occurs. Qualitative research is therefore an important complement to quantitative metrics.

Management of climate-related risks

Incorporation into investment decision-making: When possible, we attempt to quantify climate-related risks. For example, future escalations in South Africa's carbon tax will have a material financial impact on Sasol. We use the information currently available to estimate the potential valuation impact under different escalation scenarios.

Alternatively, when a risk is material but too uncertain to be assigned an explicit "cost", we reduce the company's valuation multiple to account for this greater ESG risk. For example, we would conservatively value a thermal coal company on a lower multiple of earnings than a future-facing commodity business such as copper or nickel, given that there is a greater risk to thermal coal demand in the medium- to long-term.

We may also choose to limit a company's position size in our clients' portfolios or not invest at all. We continue to monitor ESG factors once we are invested, which is crucial because ESG issues are dynamic.

Engagement: We closely follow the climate reporting of material emitters in our clients' portfolios to remain updated on their progress, holding meetings on their climate disclosures and strategy when warranted. We also engage with investee companies ahead of "Say on Climate" resolutions at their annual general meetings.

Executive remuneration: We support the incorporation of climate-related metrics in executive remuneration schemes when material to the investment case.

3. Do you disclose portfolio emissions?

In our 2019 and 2020 editions of our *Stewardship Report*, we reported on the WACI of the top 30 local equity holdings in our largest fund, the Allan Gray Balanced Fund (AGBF), as a proxy for our average client's GHG emissions exposure. In the 2021 Stewardship Report, we extended this analysis to the top 40 and added a benchmark comparison. The top 40 accounted for over 90% of AGBF's domestic equity holding and over 45% of the overall fund.

We have excluded the above reporting from the 2022 Stewardship Report, which is now disclosed in a separate Climate Report. For the 2022 reporting period (published in 2023), we have extended our disclosures to incorporate the "carbon emissions to value invested" methodology, also known as the relative carbon footprint or economic emissions intensity, for the first time. This is an ownership-based metric as opposed to WACI, which is efficiency based, and was first recommended by the Partnership for Carbon Accounting Financials. It has subsequently been supported by the TCFD. We also report on the percentage of our portfolio that has net zero-aligned targets.

Our aim is to continue making annual improvements in our climate-related disclosures, including greater coverage of our clients' portfolio emissions.

4. Do you have targets for portfolio-level emissions? If not, why?

We keep abreast of target setting initiatives and methodologies for the financial sector, which continue to evolve at a fast pace. To date, three primary methodologies are used for the calculation of portfolio-level baseline emissions and subsequent reductions: 1) weighted-average carbon intensity; 2) emissions to value invested, also known as carbon footprint or economic emissions intensity; and 3) SBTi guidance for the financial sector. Please refer to our Carbon accounting primer for how each is calculated.

We incorporate WACI and carbon footprint calculations into our investment research, as they are useful data points for identifying and monitoring material emitters in our clients' investment portfolios. However, we believe these methodologies have shortcomings in the context of target setting. Specifically, they fluctuate year-on-year due to factors unrelated to investee companies' GHG emission performance, such as commodity price cycles, exchange rate movements, inflation and market performance, as we demonstrate in our Carbon accounting primer.

While guidelines have been developed for adjusting for the above-mentioned variables, this process of "carbon accounting" becomes complex and time-consuming. In most cases, the calculations are outsourced to third-party global ESG data and rating providers, at a high cost from a South African perspective.

Furthermore, an asset manager could simply reduce their WACI or carbon footprint by divesting large emitters. The climate is no better off, as ownership has simply changed hands. We believe in maintaining a focus on real-world outcomes and encouraging companies to minimise negative externalities such as GHG emissions, which most closely aligns with the aforementioned SBTi methodology. We have not formally committed to a target-setting initiative such as the Net Zero Asset Managers Initiative (NZAMI), but in our 2021 Stewardship Report, we published a target to engage with investee companies to set science-based GHG emission reduction targets. The objective is that emitters representing at least 30% of our clients' top 40 domestic equity holdings' financed emissions must have committed to a science-based target by 2025, preferably verified by an independent organisation such as the SBTi (if not, on an explain basis). This is a short-term target, following which we will re-evaluate and set future targets.

5. What percentage of investee companies have published a plan to achieve carbon neutrality? What follow-up do you do to monitor execution against that plan?

We recognise that companies are at differing points in their climate journeys. It is now common for multinational companies to have climate strategies and targets in place, whereas smaller listed South African-focused companies are mostly still working to improve on climate-related measurement, monitoring and disclosure. We adjust our expectations accordingly and engage with companies on a case-by-case basis.

In terms of carbon neutrality commitments, we focus our research and monitoring on material holdings and emitters. In our 2021 Stewardship Report, we provided an update on how our clients' top 10 equity holdings were performing with regards to climate commitments, as shown below. We commit to providing clients with updates over time. As part of this process, we plan to extend the breadth of reporting.

Table 5: Climate commitments of the top holdings in the Balanced Fund (as published by 30 April 2022)

Company	% of Fund	Scope 1 and 2 greenhouse gas emissions	Scope 3 greenhouse gas emissions	Baseline	TCFD alignment[1]	SBTi[2]
Naspers and Prosus	5.3%	Carbon neutral at group level by end 2022. Will communicate decarbonisation roadmap with multi-year targets in 2022.	Will include scope 3 emission measuring from 2022.	N/A	Yes	No
British American Tobacco	5.2%	Carbon neutral by 2030 (-50% by 2025).	-30% by 2030, carbon neutral by 2050. 70% of its direct material suppliers by spend will set science-based scope 1 and 2 targets by 2023.	2017	Yes	Yes. 2°C.
Glencore	4.6%	-50% by 2035, net zero by 2050. Offered first advisory 'say on climate' vote to shareholders in 2021.	-50% by 2035, net zero by 2050.	2019	Yes	No[3]
Woolworths	2.3%	Net zero by 2040 (-50% by 2030). Target 100% renewable energy in electricity mix by 2030. First African retailer to have an approved science-based target for carbon emissions reduction.	Work with top suppliers (=25% of total procurement spend) to set science-based scope 1 and 2 reduction targets by 2024. These suppliers are responsible for 80% of Woolworths' emissions from purchased goods and services based on procurement spend.	2019	Yes	Yes. 1.5°C.
Nedbank	2.2%	-30% by the end of 2025.	Will not finance: new coal power plants (in place); new coal mines post-2025 (post-2021 for ex-SA); oil and gas exploration post-2021; oil production post-2035; gas power post-2030 (unless for integrated renewable energy gas backup); gas production indefinitely. Targeting zero exposure to fossil fuel activities by 2045.	2019	Yes	No
Sasol	2.1%	-30% by 2030, net zero by 2050. Exclude Natref[4]. Offered first advisory "say on climate" vote to shareholders in 2021.	-20% by 2030 for energy and chemicals businesses.	2017 (scope 3: 2019.)	Yes	No, but SA 1.5°C -aligned.
Remgro	2.0%	Holding company. No targets at present, but we have engaged with Remgro several times in the past 12 months on their strategy to incorporate ESG (look-through to operating companies).		N/A	No[5]	No
Standard Bank	2.0%	Net zero by 2030 for newly built facilities and by 2040 for existing facilities.	Published some fossil fuel exposure targets in 1H2022. Shareholder resolution at 2022 AGM will result in target setting for financed greenhouse gas emissions from oil and gas by March 2025.	2014	Yes	No[6]
Anheuser-Busch InBev	2.0%	-35% by 2025. Increase renewable energy from 7% in 2016 to 100% in 2025. Net zero across value chain (including scope 3) by 2040.	Reduce emissions across the value chain (scopes 1-3) by 25% per beverage by 2025. Include 87% of scope 3 emissions in science-based target (well over 2/3 inclusion threshold).	2017	Yes	Yes. 1.5°C.
Sibanye-Stillwater	1.8%	-27.3% by 2025 (pre-Marikana, will be updated to include in 2022). Carbon neutral by 2040.	Planned to extend their decarbonisation initiatives to scope 3 in 2021. Await updated reporting.	2010	Yes	Yes. 2°C, but to be updated.

Source: Company reports, Allan Gray research

1. Task Force on Climate-Related Financial Disclosures (TCFD); partial or full disclosure
2. Science-Based Targets initiative (SBTi) verification
3. Noted that the SBTi is not applicable for diversified miners at this stage, as intensity measures are too complex to apply to cross-commodity companies
4. One of Sasol's SA facilities but it is a joint venture with Total and they exclude it from their calculations
5. Under consideration
6. Noted that they would like to be verified by the SBTi, but that data challenges and resource constraints meant that their methodology was not considered compliant by the SBTi

6. Use an example to illustrate your approach to managing climate-related risks at investee companies that cannot reduce emissions significantly due to the nature of their activities.

Sasol is the largest contributor to our clients' portfolio GHG emissions. Most of its emissions are attributable to its Secunda plant in South Africa, which uses a process of coal gasification to produce syngas which is then converted into a range of synthetic fuels and chemicals. By its nature, this process will always be a large emitter, and we appreciate that implementing change is a significant challenge.

We wrote a letter to the former joint-CEOs of Sasol in 2018 which focused on numerous ESG disclosure and performance recommendations. One of these was for Sasol to set a long-term GHG reduction stretch target to show proactivity in relation to climate change, which Sasol has subsequently incorporated, together with some of our disclosure recommendations. These included disclosing GHG emissions and intensity per region/facility for more meaningful shareholder analysis; providing more meaningful insight into how past projects undertaken have contributed to emissions reduction versus production changes; and giving more tangible details on options under consideration to reduce GHG emissions, such as renewables, gas and green hydrogen in the long term. Sasol has also become more proactive about approaching shareholders annually to discuss its climate strategy – another suggestion we made. All the above provides shareholders with more decision-useful information and improves our ability to analyse the associated risk on behalf of our clients.

Currently, Sasol's greatest medium-term climate-related transition risk is carbon tax escalations in South Africa leading up to 2030. We quantify the potential impact under various scenarios and assign a probability-based discount to our calculation of its intrinsic value. We also consider other risks such as the potential implications of Europe's carbon border adjustment mechanism. These risks are debated in our internal policy group meetings, in which we discuss the investment case for shares to be included or excluded from our portfolios. Finally, we limit Sasol's position size in our clients' portfolios given its above-average risk profile.

We continue to engage with Sasol, often several times a year, on its climate strategy and the feasibility and economics of options to reduce GHG emissions. We also appreciate that Sasol has tabled a "Say on Climate" resolution at its AGM, providing shareholders with a platform to voice dissatisfaction with the company's management of climate-related risks if necessary.

7. Do you have targets for your firm's operational carbon footprint? If not, why not?

Currently, we do not measure our operational GHG emissions annually and have not set a target. However, we commissioned a study of our carbon footprint in 2011, 2012 and again in 2017 to identify key emission sources. The results will serve as a baseline for future repetitions of this study. Allan Gray's scope 1 and 2 emissions were calculated, as well as certain scope 3 corporate emissions, such as travel. As expected for a financial services company, our primary operational GHG emissions relate to our electricity usage, followed by business travel and employee commuting and paper usage.

Several Allan Gray initiatives have reduced these GHG emissions, the main ones being:

- The building of a new head office in Cape Town, which was the first building in South Africa to achieve a 6-star (world-leading) Green Star certification and reduced our electricity and water consumption. This was in addition to other environmental and ergonomic improvements to the way we live and work at the office.
- The reduction in the use of paper in our daily operations.
- The introduction of video conference functionality in most of our meeting spaces to reduce business travel.
- The introduction of a commuting allowance, to subsidise employees to use public and active transport to work, and the building of a bicycle storage area and shower facilities for active transport commuters, to reduce the negative impact of employee commuting. The introduction of hybrid working has further, and significantly, reduced the employee commuter load.

We continue to apply our minds to initiatives that will reduce our environmental footprint. Having identified where we need to improve, we introduce incremental improvements wherever opportunities to do so arise. We have presently commissioned an independent study to assess further electricity reduction measures that we hope to implement in the near term.

We will continue to measure our carbon footprint intermittently to use it as a measure of our progress as we work towards our best possible sustainable way of living and working.

8. Does your firm produce reporting that is aligned with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD)?

We have not signed up to be a TCFD supporter. However, we continue to take guidance from the TCFD recommendations and align our disclosures with some of its key recommendations.

Historical and current disclosures include:

- Descriptions of how we have assessed climate-related risks for top holdings in the portfolio. Most recently, in our 2021 Stewardship Report, published in 2022, we provided an update on how our clients' top 10 equity holdings were performing with regards to climate commitments.
- Under the TCFD's "Metrics and Targets" pillar, supplemental guidance for asset managers recommends the disclosure of the WACI of each product or investment strategy, together with other carbon footprint metrics. In the 2019 and 2020 editions of our Stewardship Report we reported on the WACI of the top 30 local equity holdings in our largest fund, the Allan Gray Balanced Fund. In the 2021 Stewardship Report, we extended this analysis to the top 40 and added a benchmark comparison. The top 40 accounted for over 90% of the Allan Gray Balanced Fund's domestic equity and over 45% of the overall fund. We have excluded this reporting from the 2022 Stewardship Report, as it will be disclosed separately going forward.
- From 2023, we report on the carbon emissions to value invested, also known as the relative carbon footprint or economic emissions intensity, of our local equity and corporate fixed income holdings for the first time. This is an ownership-based metric as opposed to WACI which is efficiency based and was first recommended by the Partnership for Carbon Accounting Financials. It has subsequently been supported by the TCFD.
- In our 2021 Stewardship Report, we announced a target for engaging with investee companies to set science-based GHG reduction targets, together with other ESG-related targets for achievement by 2025.

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