Identifying Action Over Intent

In a world where sustainability has taken centre stage, the ability to measure a company's environmental performance is an essential tool for any investment manager. And while the recent growth in ESG ratings has provided deeper insight into certain aspects of a company's sustainability, a lack of consistent scoring has often resulted in confusion rather than clarity. Today's investors need to develop an expertise in understanding a company's sustainability track record in order to effectively compare companies to their peers. At Osmosis we believe this starts with the balance sheet. Our Model of Resource Efficiency (MoRE) requires tangible proof that a company is managing its impacts rather than distant commitments or promises of progress.

In this article we look at US healthcare company Baxter International to demonstrate the differences in our objective approach to environmental research when compared to some of the leading data providers.

Baxter focus their business on critical care, fluid systems, hospital and surgical products. The firm has a very strong and credible reporting history which dates back to 1997. Baxter began reporting Scope 1, 2 and certain Scope 3 GHG emissions in 1997, contributing to the development of the initial version of the Greenhouse Ga Protocol, and their reporting has since evolved into a comprehensive annual exercise.

The company has been recognised in various awards: Corporate Responsibility Magazine's *100 Best Corporate Citizens*, Forbes Magazine's '*America's Best Large Employers*,' a member of the FTSE4Good Index Series and Newsweek Magazine's *Green Ranking*.

Baxter is rated very highly by some of the well know ESG ratings agencies. The company is placed in the top 5% in RobecoSAM's Environmental analysis and the top 15% in Sustainalytics Environmental analysis[1].

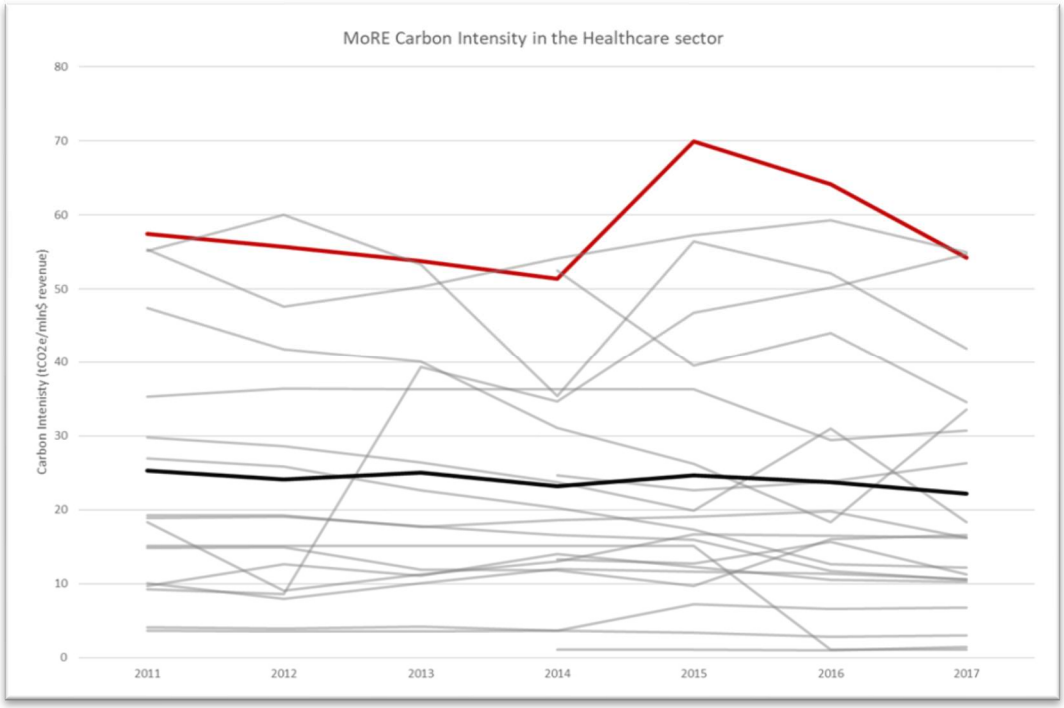
So, why is it sitting firmly at the bottom of Osmosis' Model of Resource Efficiency?

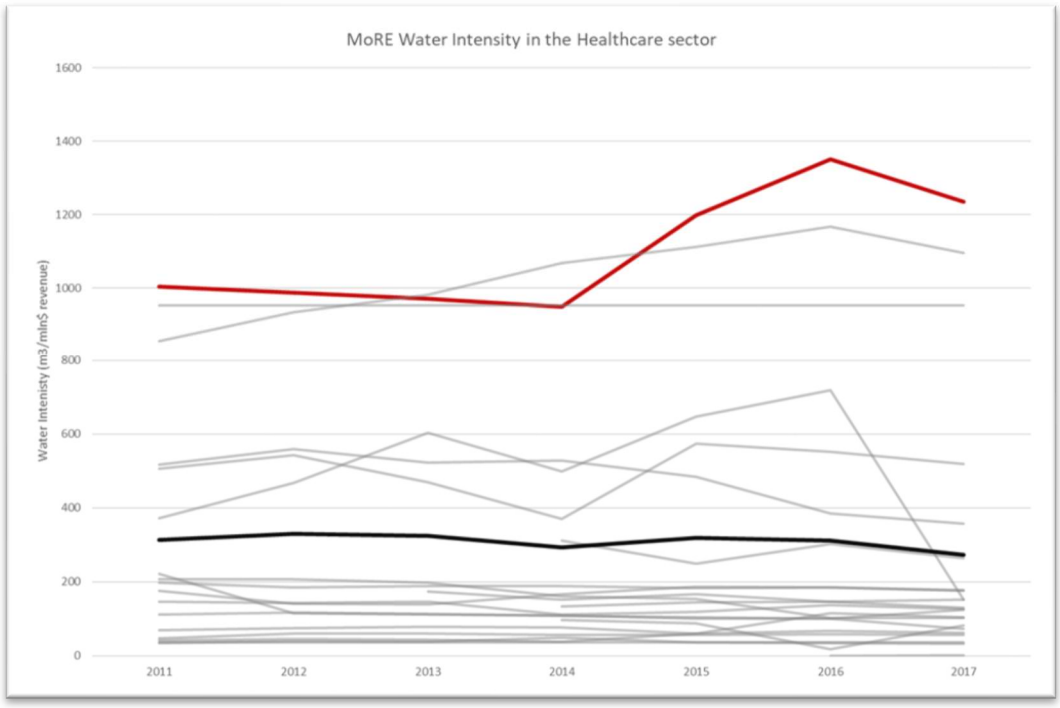
According to our model, Baxter is the most resource intensive company in its sector, irrespective of its awards and targets. Inefficiency in the MoRE model indicates that the company is very poor at creating revenue for each unit of carbon or waste it generates, or water it consumes. Across the sector, we see an inconsistency in how resource efficiency relates to 3rd party environmental assessments, with some of the most efficient companies scoring very poorly while inefficiency is often not penalised.

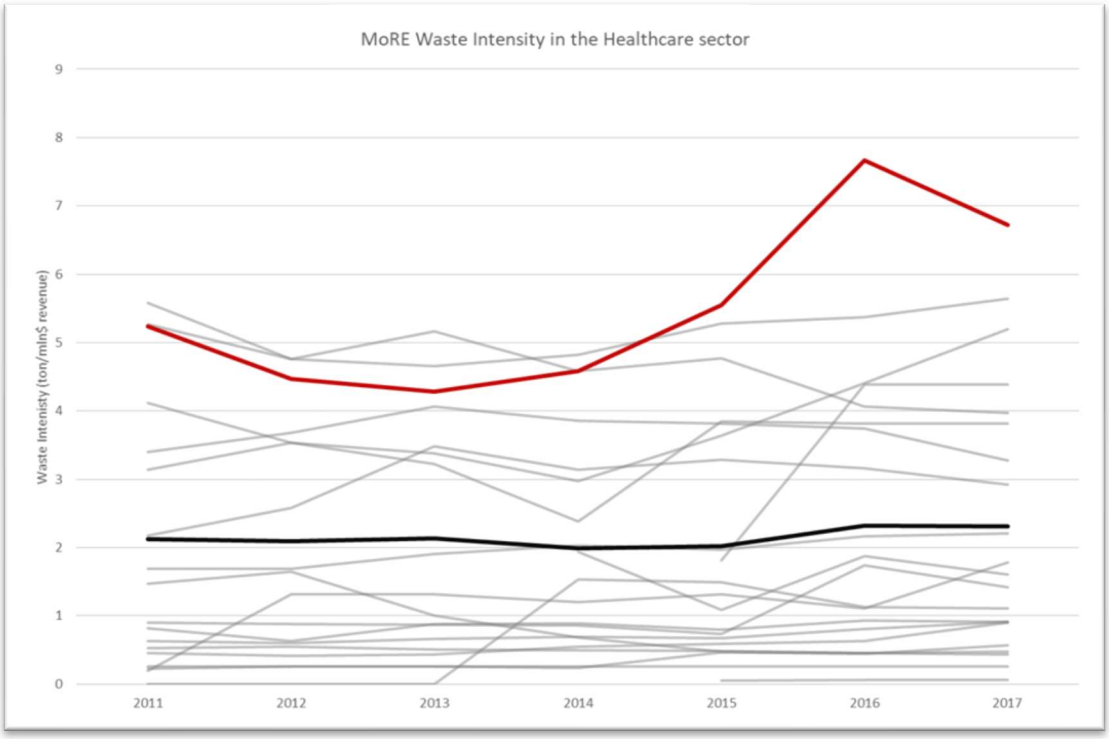
The graphs below show Baxter's relative resource intensity versus the healthcare sector. Using all three environmental metrics of carbon, water and waste we plot Baxter (in red) versus its peer group with the

[1] Source: Bloomberg 17 September 2019

black line showing the sector average. Against all three metrics Baxter is one of the most resource intensive companies in its sector.







Source: Osmosis investment management 2019

What is responsible for the difference in viewpoint?

Firstly, the subjective nature of some ESG metrics is known to muddy the waters. Various metrics/targets are interpreted differently by observers depending on their house view. Differences in house policies relating to materiality also make comparisons, or interpretation of scores, difficult. The lack of transparency in different agencies' in-house views or underlying assumptions is alarming when you consider how many investment managers rely on the data to feed into their investment processes.

Secondly, in environmental rankings, companies that provide granular reporting and extensive goal and target setting are often rewarded positively. In 2015, Baxter set a goal for 2020, which was to cut emissions by 10% versus a 2015 baseline[2]. While any efficiency improvements are positive, given Baxter's starting point relative to the sector, its questionable whether they should be rewarded for such an unambitious target.

Looking at the company's operational emissions, Baxter achieved their 10% reduction by 2017, three years ahead of target. However, despite these efforts, it is still lagging, and the firm is placed in the bottom quartile of its sector peers in our model. This analysis indicates that goal setting can be a poor metric for how progressive and sustainable a company is.

[2] Baxter's 2015 CSR report

At Osmosis, we strip away any subjective data, leaving only measurable and verifiable data to input into our models. While we actively encourage target setting as a good business practice, it only affects how we evaluate companies to the extent that it enables them to continuously reduce their environmental impacts. As a stand-alone metric we do not evaluate it, and it will not impact our assessments. This gives a more objective view of a company's progress, and importantly, one that allows for economic alignment and in turn comparability.

The approach taken by Osmosis is that the economic and environmental efficiency of the company is relevant and objectively comparable. By taking a per dollar revenue carbon, water and waste figure, the firm can transparently compare companies within sectors and across sectors, due to standardisation on an in-sector basis.

We believe such a transparent and comparable approach is key to encouraging the mainstream adoption of sustainable investing. Investors want proof that incorporating ESG factors has an impact on the bottom line.