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TRANSCRIPT

Climatepalooza Pt. 1

Featuring:
Morgan Ellis, ESG Researcher, MSCI
Mathew Lee, ESG Researcher, MSCI
Elchin Mammadov, ESG Researcher, MSCI
Antonios Panagiotopoulos, ESG Researcher, MSCI

Mike Disabato:

What's up, everyone? And welcome to the weekly edition of ESG Now, where we cover how the environment, our society, and corporate governance affects and are affected by our economy.

Mike Disabato:

I'm your host, Mike Disabato. And we've got a bit of a different format for you this week because it's Climate Week in New York City. And we're going to take you through some ambitious and unambitious company carbon reduction plans, tell you what you should look out for and why, and give a bit of a roadmap for assessing climate proposals going forward.

Mike Disabato:

We're calling this episode, Climate Palooza. Thanks, as always, for joining us. Stay tuned.

Mike Disabato:

Climate Week in New York City is an event that has taken place every year in New York since 2009. The summit is alongside the UN General Assembly, and it brings together international leaders from business, government, and civil society to showcase global climate action.

Mike Disabato:

And showcase is an operative word here because, in 2021, leaders want to use anything they are doing to address the current climate crisis and shine it up for the people to admire. So, pledges are made, promises are put out into the media, and an atmosphere of optimism pervades the city. But once those promises are made, then comes the hard part, sorting through them, figuring out what is better, being carbon neutral or going net zero. Are the plans that companies are putting forth ambitious enough to address the dire warnings put forth by the scientific community? You have to ask yourself these questions.

Mike Disabato:

Well, today we are going to go over some of these plans and provide a roadmap for how you should think about them. We are going to split this up into two episodes. This week, we will focus on those sectors that are the most pollutive; energy, utilities, and cement, basically building materials. Next week, we will focus on those that are most pervasive in our society; banking and technology.

Mike Disabato:

So, let's start off with energy. And to do this, we want to talk about oil and gas companies. And I called up my colleague, Antonios Panagiotopoulos, and he focused on Royal Dutch Shell, the oil and gas major that actually has made an ambitious climate plan.

Antonios Panagiotopoulos:

First off, Shell has introduced a multiple, if you like, layer target, starting from short-term to medium-term and to a longer-term target, ending in 2050. And besides that... And this is a sign of the comprehensiveness of the target, how we assess the comprehensiveness at least... Shell is targeting its whole footprint. So, beyond the operational Scope 1 and 2 emissions, it's also targeting Scope 3 emissions and particularly the biggest chunk of its current footprint, which is the product use. So, Scope 3, Category 11.

Antonios Panagiotopoulos:

So, that means that the company, in a way, it communicates to investors and to the general public that it's thinking, or at least it's planning, to change its product.

Mike Disabato:

So, that's why Shell's ambitions are so important here. They've kind of set the gold standard. They said they're going to deal with their Scope 3 emissions. And the reason that's so important is because Shell's Scope 3 emissions accounts for around 90% of its overall emissions. Those are the indirect emissions Scope 3 is, not operational emissions. Those are Scope 1 and 2.

Mike Disabato:

Now, a majority of oil and gas companies have most of their emissions within their Scope 3 category. And some are actually dealing with this, and some aren't. European oil companies, for example, are more apt to add their Scope 3 emissions to their carbon reduction plans, while American companies are falling behind. So, if you see an oil and gas major that doesn't have Scope 3 emissions in its plans, then I would call that an unambitious plan.

Mike Disabato:

But let's get to the details of what Shell is actually going to do to cut its emissions.

Antonios Panagiotopoulos:

To cut down your Scope 1 and 2 emissions, first of all, you need to introduce more measures to increase your efficiency. And then the residual emissions, you need to potentially either use carbon capture and sequestration or offset those volumes.

Antonios Panagiotopoulos:

Now, Shell's plan, at the moment, is to reduce oil, which has higher carbon intensity, increase the production of gas so, therefore, lower the carbon intensity of their products, and also invest in wind and solar. And beyond that, Shell is also looking... We have seen that, actually, in the UK, where they're buying more charging points. So, at least based on Shell's strategy, they want to offer consumers all the modes of energy that are available. And then, obviously, if society chooses to go to electricity, then they should be in a good position to take advantage of that switch.

Mike Disabato:

So, do you hear that? Shell is moving away from oil and trying to regain itself as the leader of the electron in all its forms. There's one caveat to this. They're likely going to need carbon offsets to truly hit their goals. And offsets are a whole other factor to watch out for with these climate plans.

Mike Disabato:

Offsets are the purchase or use of carbon-negative technology to net out a company's emissions. Basically, this is the meaning of net zero, and it's a tricky beast to tame. I'll give you one example why.

Mike Disabato:

A lot of offsets can be called natural offsets. They're nature-based solutions, like saving a forest from being cut down. And a company can say, "Look, we saved this big forest from being cut down." But, in reality, the forest was never at risk of being cut down. The company just kind of took advantage of something that people weren't paying attention to.

Mike Disabato:

I don't want to disparage offset, so they're extremely important for us to meet our climate goals, for everyone on the globe to meet their climate goals. I just want to let you know that if you see a company that is relying heavily on offsets, that you should be wary of the promises they make with them. They require a second look.

Mike Disabato:

Okay. Now, on to the utility sector, the industry that moves the energy to you, [Emmy 00:06:02]. For this, I called up two of my colleagues, Mathew Lee and Elchin Mammadov.

Mike Disabato:

First, Mathew told me about a climate plan for one of the largest power and gas companies in the US called American Electric Power, also called AEP. And then, Elchin told me about an important factor to watch out for, for the highly regulated utility sector; politics.

Mike Disabato:

So, here's Mathew first on AEP's plans.

Mathew Lee:

So, they're one of the top five utilities in America in terms of market capitalization. And, in March of this year, they updated their target to be, I quote, "net-zero carbon emissions by 2050, with an interim target of 80% emissions reductions from 2000 levels by 2030." And actually, last year in 2020, their total Scope 1 emissions were reported to be around 49 million tons of CO_2 equivalent, which is already 70% of an emissions reduction when you compare it to their two-year 2000 total, about 169 million tons.

Mathew Lee:

So, when I look at that and the interim goal of 80%, from a feasibility perspective, they've still got about 70, 80% of their fuel mix from natural gas and coal. So, there is about 17,000 megawatts of capacity they have to phase out to hit that goal by 2030. And I think the real challenge is going to be in the longer term. How are they going to replace all of that capacity to hit net zero by 2050? And I think that gets to the language you keep hearing in the utility circle. About 20 or so have announced, over the last two years, some form of a net-zero goal.

Mike Disabato:

I want to sum some of the things Mathew just said there for clarity. The first is the goal by 2030, that Mathew said AEP was close to achieving but not there yet. AEP will likely have to shut down its coal-fired power plants in the coming decade, if they want to meet their plan. The question that Mathew poses is what other types of fuel will be used to replace coal? At the moment, if I were a betting man, I'd probably say that it's natural gas. But who knows what will happen in the coming years with renewables?

Mike Disabato:

The second thing I want to point out is that this plan is all about Scope 1. Scope 1 emissions are the emissions from the company's operations. They are the carbon AEP emits in order to create energy that we all use to power our world. There are two things missing from that plan: Scope 2 emissions, which are actually the generation of electricity, AEP's main business. And so, as Matthew noted, AEP uses about 20% of its energy it creates to power its own systems. But leaving out Scope 2 isn't really a big deal for a utility. The bigger deal is that their plan is missing Scope 3 emissions. And you always want to see Scope 3 emissions noted in any company's climate plan. I've said this before. Scope 3 is so important, I'll even make a rhyme for it: Without accounting for Scope 3, your plan is a catastrophe.

Mike Disabato:

The reason Scope 3 was left out of AE's plan is unknown but without it, by our measurement, AEP's carbon plan puts them at a level of reduction that would be consistent with a 3.7 degree Celsius rise in temperature, not a 2 degree Celsius rise in temperature like the Paris Accord would've liked. And it's not like there are no utilities out there that aren't putting Scope 1, 2, and 3 in their climate plan.

Mike Disabato:

Sempra, for example, a peer of AEP's, has all three scopes in its plan, and Sempra actually operates a more complex utility system. So, I wanted Mathew to compare the two. I thought it would be useful to hear about what AEP's plan is to decarbonize versus what Sempra's plan is to decarbonize. AEP only has Scope 1. Sempra has Scope 1, 2, and 3. So, I asked Mathew to kind of take me through both of their plans, what they would likely do, so we could see some comparison and start to understand why one seems a bit more ambitious than the other.

Mathew Lee:

AEP has more generation assets, and specifically still has a decent amount of coal generation compared to Sempra. So, that's why it's a direct Scope 1 emission they're looking to reduce there. And they have published a couple of scenarios where they phase out coal plants, and so that's likely the route they would go. It's just a matter of when and how quickly they would phase out their coal plants to reduce those Scope 1 emissions.

Mathew Lee:

Sempra, on the other end... So, they have much more transmission and distribution assets with natural gas. So, their improvements to cut emissions would be things like digitizing some of their systems that make decisions on how to allocate electricity, incorporating more battery storage when... and microgrids in the short term. And into the longer term, they're thinking of scaling up some green hydrogen and carbon capture and storage. Although again, I think a lot of that technology needs to demonstrate that it can come to market.

Mike Disabato:

And that market might be buoyed by what is happening with regulations at the moment. Decarbonizing the utility industry, in the US particularly, might have some wind in its sails if the Clean Energy Payment Program is passed by the Senate. Dubbed the CEPP, it is important for the utility industry because utilities are heavily regulated more so than other industries, especially in the US.

Mike Disabato:

And so, here's where I called up Elchin to come in to give us the details of what CEPP is all about because it could also be a benefit for European utilities that are making their way into the US market.

Elchin Mammadov:

Basically, it encourages utilities to build up their renewable portfolio and clean up their act, basically. And for those that don't do it, they get penalized. For those that are more proactive than the industry, and than the government expected, they're being rewarded for it in terms of tariffs and whatnot. And that provides opportunity for not only US utilities but also for European utilities that are already expanding into US, especially East Coast, when it comes to building offshore wind farms.

Elchin Mammadov:

So, in theory, the more ambitious the... If the CEPP plan goes ahead, which is a big if, then it could potentially unlock much more investment from the European utilities. And that's also good for US peers as well because what happens then is they often partner up. So, the likes of Eversource, for example, they have a joint venture with Ørsted, which is a Danish utility. Another US local utility, Dominion, and PSEG, they also have partnerships with Ørsted. [Hippadrolis 00:12:33] US-listed subsidiary, AVANGRID, is also very active in deploying this offshore wind project.

Mike Disabato:

And all those companies are going to get a boost from the CEPP if it's passed. But the one problem with that is, even if this is passed and the money's allocated and everything comes to fruition, there's still the problem of the state. The state has a lot of control as to what can be built and how it's built. A utility can have an ambitious decarbonization plan that runs afoul of a curmudgeon state governor, for example.

Mike Disabato:

So now, of the big three polluting industries, I left the most complicated for last. Cement. The cement industry is one of the hidden polluters in our society. Cement is everywhere. It is needed to build a lot of the low-carbon systems we hope to use, and it is hard to cut its emissions because they are heavily embedded in the chemical structure of cement itself. Still, plans are being made to try and lower the industry's emissions, especially during Climate Week. And so, to hear about them, I called up my colleague, Morgan Ellis, and he started off by telling me what to pay attention to when a cement company comes out and issues a climate edict.

Morgan Ellis:

So, companies that are targeting absolute emission reduction but also targeting a cement production-based emission reduction are the companies that have the better carbon reduction targets. So, the ambitious target that I'm talking about today is from a company called CRH. And they're a diversified construction materials company that has a significant amount of cement production as well.

Morgan Ellis:

So, they have set a net-zero target by 2050. And they've set that as an absolute carbon emissions target, where a lot of companies in the industry set intensity targets, which is hard to get down to zero because you're basing that on a revenue or production. But CRH is doing that absolute emissions across its operations by 2050.

Morgan Ellis:

And, as we all know, the net-zero target is good but 2050 is still a long way away. So, being able to show how they can get to that is what makes these targets stand out as being not just ambitious but also achievable. So, CRH also has an interim target for 2030 as a way to get there.

Mike Disabato:

So, CRH has a target to reduce its absolute emissions. That's much better than just saying it's going to reduce its emissions intensity, which is relative to a monetary goal. They have a target that is incremental, and thus achievable, but the problem is you don't hear Morgan mention Scope 3, do you? You didn't even hear him mention Scope 2. CRH's plan only involves Scope 1 emissions or the emissions that occur from sources that are controlled or owned by an organization like the rotating kiln that actually makes cement itself.

Mike Disabato:

CRH reports its emissions by Scope 1, 2, and 3. And Scope 1, the actual making of cement again, accounts for more than 50% of them. But Scope 3 accounts for around 45%. So, them not having that in their plan is kind of a problem.

Mike Disabato:

Another concern is CRH is a bit vague on the details of their plan. They say they want to reduce their carbon emissions by 33% by 2030, yes. But they don't give many specifics on how they're going to do that. They say things like, "We are developing innovative products and enhancing our material strength." But what does that mean in detail? I asked Morgan.

Morgan Ellis:

There are a couple of different points that they can do to knock off low-hanging fruit to get to these interim targets. Stuff around energy efficiency on the manufacturing plant, substituting fossil fuels for renewable electricity sources as well. And then, there are things like reducing the amount of pollen cement that they use, reducing the clinker factor, and increasing the use of alternative materials. But there are also some things that technologies that they need to commercialize. The industry needs to get beyond the R&D stages and commercialize. And some of these technologies, like carbon capture and storage, use of alternative cement materials, and also negative cements, are things that are coming in that technologies that are good at research stages to absorb CO2 as the cement is curing, and things like that.

Morgan Ellis:

So, there's technologies that can get them there. They just need to commercialize them and produce them at scale.

Mike Disabato:

So, it seems that, unlike the energy industry and the utility industry, the cement industry still has longer to go to develop new products that will allow companies in the sector to cut their emissions at the rate necessary to hit our climate goals.

Mike Disabato:

What's been most interesting about this conversation for me is that Shell, Royal Dutch Shell, is really the only company we talked about today, aside from Sempra, the utility company Matthew mentioned, that is cutting its Scope 3 emissions. Maybe investor and community pressure does work enforcing companies to develop a robust decarbonization policy.

Mike Disabato:

And that is sort of what Climate Week is all about. It's a chance for stakeholders to voice their concerns to business leaders and the like, and to let them know they might not agree with how slowly we are decarbonizing our society. But in our minds, the only way to do that well is to understand the nuts and bolts of some very ambitious, but also some very pollutive, industries' climate plans.

Mike Disabato:

So, I hope today, this episode kind of gave you some more information and armed you with the tools to be able to look at these climate plans that are put forth into our world and to have a discerning eye when you see a company throw out a flashy sustainability report at you.

Mike Disabato:

And that's it for the week. I wanted to thank Antonio and Matthew and Elchin and Morgan for talking to me about the news with an ESG twist. I wanted to thank you so much for listening.

Mike Disabato:

Don't forget to tune in next week where we have Part 2, where we talk about the same thing we did this week but just about banks and technology companies. They're very, very important because they're very pervasive in our society. So, you'll want to tune in for that.

Mike Disabato:

But if you like what you heard today, don't forget to rate and review us. And, of course, subscribe. That always helps.

Mike Disabato:

Thanks again, and talk to you soon.

Speaker 6:

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