William Blair

U.S. GROWTH & CORE EQUITY

Investment Management
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WILLIAM BLAIR U.S. EQUITY SUSTAINABILITY STRATEGY

Rising to Meet the Climate Challenge

Our society is in a race against time to decarbonize. As such, we spend a great deal of time studying how public policy intersects with the actions of the corporate sector to drive the necessary evolution of the global economy. Together with our deep industry knowledge and the bottom-up fundamental insights that emerge from our in-depth research on individual companies, we believe we are able to identify companies that have the potential to catalyze positive change.

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Rising to Meet the Climate Challenge

Of the many issues that enter into any conversation about the long-term sustainability of our planet, few are as important as climate change. This is mostly a function of the fact that we are in a race against time, where failure to decarbonize will have potentially dire long-term economic and social consequences if left unchecked.

The urgency increases with each passing year as we experience the impacts of climate change through record temperatures and more extreme weather events, and importantly, the disruption, displacement, and losses that occur as a result.

A Critical Partnership Opportunity for the Public and Private Sectors

The public and private sectors' combined actions create a powerful partnership. One cannot be effective without the other in addressing the urgency of the transition to a low-carbon economy.

Global policymakers have a catalytic role to play in the transition by making new, low-carbon solutions economically viable. Without price parity, it is often challenging for companies and individuals to adopt low-carbon solutions. Economic viability will drive rapid scale-up of low-carbon solutions, which also drives costs down and reduces the need for policy intervention in the long run. Carbon taxes and fees, incentives for research and adoption of new technologies, and related mechanisms all help catalyze the economic viability of climate-friendly solutions.

In the private sector, companies that can develop solutions for the climate transition, or build operational resilience in the face of it, will be in a position not only to survive but to thrive. In contributing to transition efforts, these companies will influence multiple stakeholders (such as suppliers, distributors, customers, and employees) across the value chain, thereby creating a positive multiplier effect.

As investors, we seek to understand how the long-term implications of emerging government policies around climate change combine with bottom-up, corporate initiatives in influencing long-term sustainable competitive advantage. We see the transition to a low-carbon economy as a major investment opportunity, potentially delivering financial returns for well-positioned companies while also enabling a more sustainable world.

The Climate Transition Presents Structural Changes

The transition to the low-carbon economy represents a structural change in how the global economy functions, and therefore in how sectors and markets function as well. Society will have to transform how it does things today to make this economywide shift. Some examples include the wholesale change in our energy sources, a greater emphasis on the extension of the lifecycle of goods and materials, and an evolution in our consumption habits. Customers and employees will increasingly make different purchasing and employment decisions in line with their values around climate change and sustainability.

Each company will respond to these structural shifts in different ways, dependent upon the implications for its corporate strategy, its asset base and operations, and its customer preferences. In turn, there will be a broad variety of downstream impacts. A structural shift in one sector can trigger a structural shift in another, thus pulling the whole economy forward in the process.

Our investment research process involves a keen awareness of sector-level and cross-sector structural shifts and their implications for investment idea generation and value creation for the companies in which we invest. We believe this allows us to identify transition-related growth opportunities, as well as mitigate risk.

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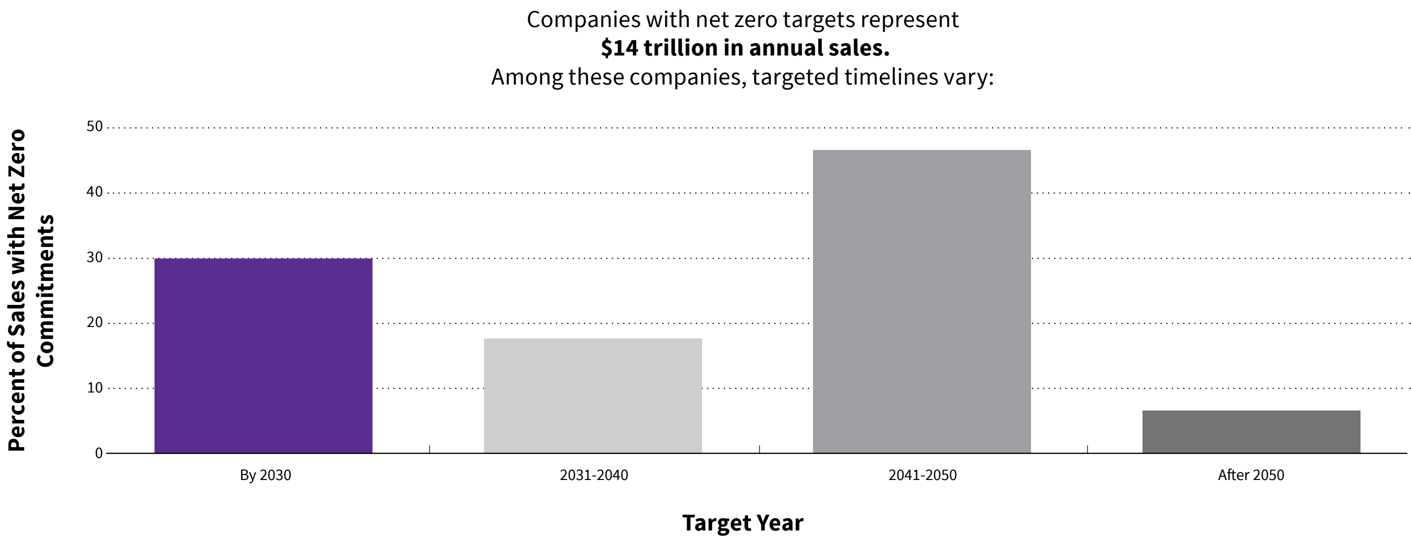
EXHIBIT 1

Company Commitments to Net Zero

The number of companies committing to net zero continues to increase and the timeline of these commitments varies.



Source: "TAKING STOCK: A Global Assessment of Net Zero Targets." The Energy & Climate Intelligence Unit and Oxford Net Zero. March 2021.

Sector Linkages: A Case Study

Let's consider how the consumer, materials, and financial sectors could be linked in the transition to a low-carbon economy. A major beauty company may identify growing customer concern about the environmental footprint of plastic packaging and make a net-zero commitment. In order to effectively address its sustainability commitments, as well as the change in customer preferences, the company would need to measure the carbon footprint of its packaging and improve and report on the environmental impact of its supply chain. Without a strategic approach and effective execution, the company risks customer retention and reputational damage.

The beauty company's increased focus on sustainability has implications along its value chain. For example, it may begin to seek out alternatives to its virgin plastic packaging, putting its relationships with plastics suppliers at risk. As a result, companies that supply plastics will need to innovate to meet their customer's new needs, or otherwise stand to lose a top customer.

Packaging companies might also recognize that the beauty company's commitment to sustainability is unlikely to remain unique, considering the inevitable cross-sector structural shifts that the transition to the low-carbon economy will trigger, and that their virgin plastics business is likely to decline. In this scenario, the plastics companies and the beauty company might collaborate to develop recycled and alternative packaging solutions, with the beauty company potentially providing incentives or other financial structures to support the plastics companies' research and development processes.

The financial sector may also recognize that plastic packaging feedstocks are petrochemicals with high carbon footprints that may fall out of favor with the rise in corporate commitments to net zero and waste reduction. Companies within the financial sector might use their lending and investment power to back companies with low-emission, circular, and biodegradable packaging solutions as a growth opportunity, while monitoring the heightened risk of business decline in virgin plastics companies. This would provide an opportunity to mitigate transition risk, promote environmental sustainability, and generate financial returns.

A Dedicated Sustainability Portfolio

Weighing Sustainability and Investment Return Considerations

Seeking to drive superior investment returns will always be the core of what we do. We believe in making investment decisions based on the durability of a company's business model, operations, and value chain, and the valuation of the security. Every company in our U.S. Equity Sustainability strategy has both an investment and sustainability thesis, and they are often tightly linked. The sustainability thesis outlines what makes the company a Sustainability Champion, Enabler, or Improver, and tracks key details of the unique sustainability characteristics of the company over time.

The Impact of Enablers

A Sustainability Enabler is a company whose products or services help improve environmental, social, and governance (ESG) standards or outcomes in society. These companies influence the future state of sustainability for an industry or advance a sustainability theme. The impact they have is in that influence.

Our approach is to understand the enabling role that the company plays, develop a sustainability thesis that outlines that role, and link it to the company's strategy, operations, business model, value chain, or industry. Sometimes the thesis begins qualitatively, and as we track progress and continue to engage with the company, the quantitative opportunity becomes clearer.

An example of an enabler of the transition to a low-carbon economy would be an integrated circuit manufacturer whose products are used in consumer and industrial electronic devices, such as cell phone battery chargers and household appliances on the consumer side, or internet of things (IoT) devices on the industrial side. The company's products enable the optimization of power consumption during AC/DC conversion or voltage fluctuations. For example, during a light load, power would be reduced to an amount necessary to run the device efficiently, and during standby, or no-load, power is effectively shut down. It is estimated that in the United States alone, roughly 10% of energy use is a function of standby power consumption. The sustainability thesis for this company would center on the cumulative energy saved by installing its chips in a wide variety of products, which could be further converted to avoided greenhouse gas emissions.

Improvers to Champions

A Sustainability Champion is a company with leading sustainability standards and practices, and a Sustainability Improver is a company with scope for significant improvements in both of these areas that has made a commitment to implement such initiatives. These designations are based on peer comparisons to allow for variety in progress toward sustainability standards across sectors and market capitalizations. Champions have an impact by setting a high bar for sustainability practices among industry peers, while Improvers have an impact through the rapid and progressive enhancement of sustainability practices, as well as improving disclosure.

A building materials company, for example, could be considered a Champion given its long history of managing and disclosing material sustainability issues in its operations and value chain. The company's industrial processes require intense heat and were historically powered by fossil fuels, including coal. Recognizing that having high carbon-emissions intensity was a material risk for the company in an environment where policy to mitigate emissions was becoming more stringent, the company invested in replacing equipment to reduce its Scope 1 and 2 carbon emissions. The new equipment was more efficient and could be powered by alternative energy sources. The company also developed a vendor sustainability program and worked with partners along its value chain to set emissions reduction targets, which helped the company reduce its Scope 3 emissions.

When the climate policies in certain high-risk jurisdictions changed, the company was already well positioned to minimize penalties for high carbon emissions. The company could be seen by others as a model for transforming operations to minimize transition risks. So not only are its reduced operational and value-chain emissions a key driver of its impact, but by setting a high bar on best practices, the company is also positively influencing developments across its entire industry.

> "Not all Sustainability Improvers become Champions, but there is the potential for them to do so."
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> **David Fording, CFA, Partner**

When this building materials company began its sustainability journey, taking steps to reduce its emissions, it could have been considered an Improver. Though the company would have started out with small goals, our focus is on positive change and whether a company is committed to, and capable of, delivering best-in-class reductions in emissions over time. Not all Improvers become Champions, but there is the potential for them to do so.

Conclusion

Increased societal awareness around sustainability, combined with ever-evolving expectations and demands from stakeholders, is creating structural changes in society. Our U.S. Equity Sustainability strategy aims to identify the companies that are in front of the curve in responding to these changes, and that see their own internal actions as drivers of sustainable competitive advantage and thus long-term value. These companies implicitly recognize the value in leading the climate transition, both from a societal and shareholder value point of view.

About William Blair

William Blair is committed to building enduring relationships with our clients and providing expertise and solutions to meet their evolving needs. We work closely with most sophisticated investors globally across institutional and intermediary channels. We are 100% active-employee-owned with broad-based ownership. Our investment teams are solely focused on active management and employ disciplined, analytical research processes across a wide range of strategies. As of December 31, 2021, we manage $79.6 billion in assets. We are based in Chicago with resources in New York, London, Zurich, Sydney, Stockholm, The Hague, and Singapore and dedicated coverage for Canada.[1]

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