Walden Asset Management
Advancing sustainable business practices since 1975

Fossil Fuel Company Exposure in Representative Walden Client Portfolios

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As a portfolio manager who integrates environmental, social, and governance (ESG) analysis into investment decisions and corporate engagement, managing climate change risk is among our highest priorities. We believe that increased public awareness is urgently needed to bring about the changes required to mitigate and adapt to climate change. In our view, strong public policy that places a price on carbon is of paramount importance. We think investors can bring a crucial and strategic voice toward that end.

How Walden Addresses Climate Change Risk

Walden Asset Management integrates climate change risk in portfolio management in a holistic manner—addressing the supply side (fossil fuel and related companies) as well as the demand side (all other portfolio companies as energy users). Our approach is multi-faceted; climate change risk is a consideration in company selection, corporate engagement activities, and public policy advocacy.

Walden considers several indicators of corporate performance on climate change when making investment decisions, including greenhouse gas reduction initiatives, energy efficiency and natural resource conservation, commitment to renewable fuel sources, and public policy positions. With respect to the energy sector and fossil fuels specifically, Walden seeks to invest in companies that contribute to more efficient energy production while simultaneously minimizing overall environmental impacts. This approach results in portfolios that have favorable carbon footprints relative to comparable benchmarks (approximately 30% more carbon efficient for a typical large cap portfolio using Trucost carbon footprint data).

More specifically, Walden portfolios exclude coal companies (the most carbon intensive fossil fuel) and have relatively little exposure to oil sands (also among the highest carbon intensity sources). We favor natural gas, a lower carbon fossil fuel that, in combination with resource conservation and energy-efficiency measures, can be an important energy source in the transition to cleaner fuel technologies. However, fugitive methane emissions must be prevented and controlled to maximize the potential benefits of natural gas.

Moreover, we understand that investment in any fossil fuel company brings a responsibility to address unique environmental, safety and human rights concerns. Hence, upon investment in energy companies, Walden devotes significant resources to various shareholder engagement strategies. We believe that our strong track record suggests corporate engagement can be effective.

Advocates of divestment of fossil fuel companies aim to raise awareness of the climate change crisis. Walden is pleased and supportive of the increased visibility and energy they bring to the need to reduce carbon emissions. For some clients with separately managed portfolios we have a long history of investing portfolios without exposure to fossil fuel companies. In our opinion, effective engagement and public policy advocacy—two areas where Walden has demonstrated unique expertise—can also help accomplish the goal of raising public consciousness to promote substantial action on climate change.

The chart on the next page identifies fossil fuel companies—those with carbon assets—held in representative Walden accounts, including the Walden mutual funds. Next, we summarize briefly each company and include a description of relevant engagement by Walden.

Walden Equity Fund	Walden Asset Management Fund	Walden Mid Cap Fund	Walden SMID Cap Innovations Fund	Walden Small Cap Innovations Fund
Apache	Apache	Cabot Oil & Gas	Denbury Resources	*No exposure*
BG Group	BG Group	Denbury Resources	Questar	
ConocoPhillips	ConocoPhillips	Energen		
Denbury Resources	Denbury Resources	Questar		

Apache

Apache is an integrated oil and gas company with roughly half of production in natural gas. Walden, often in coalition with other investors, has actively participated in multi-year dialogues (that regularly include meetings with CEO Faris) promoting best practices in greenhouse gas emissions management, hydraulic fracturing, human/indigenous rights, and lobbying and political spending related to climate change. Apache's performance trends with respect to many of these issues are positive. For example, while its greenhouse gas emissions relative to peers are concerning, the company's carbon intensity is improving. Furthermore, in 2012 Apache set the commendable goal to reduce greenhouse gas emissions on an absolute basis by 2 percent annually. On the topic of hydraulic fracturing, no unconventional natural gas production comes close to the highest standards at this time, but Apache was second best in a recent report of 24 companies, *Disclosing the Facts: Transparency and Risk in Hydraulic Fracturing Operations*. We are beginning to see signs of progress on political spending and lobbying transparency, but more improvement is needed.

BG Group

Natural gas represents roughly three-quarters of BG Group's production activity, a United Kingdom-based integrated natural gas company. The company is relatively transparent regarding greenhouse gas reduction targets and goals (CDP Climate Change and Water disclosure as well as third-party verified GRI reporting; the latter is considered best practice and is quite uncommon). BG Group's climate change policy supports a price on carbon (with a stated preference for an emissions trading scheme) and it commits to a 10% reduction in emission intensity between 2013 and 2017. Walden is in the early stages of engagement on greenhouse gas goals (seeking more robust science-based targets) and also participated recently in an investor coalition letter asking BG Group to assess its exposure to carbon asset risk, an initiative of Ceres' Investor Network on Climate Risk.

Cabot Oil & Gas

Houston, Texas-based Cabot Oil & Gas is an independent oil and gas firm that is primarily a U.S. natural gas producer (approximately 95% of production and reserves). Since 2010 Cabot Oil & Gas has participated in the Environmental Protection Agency's Natural Gas STAR Program, a voluntary government-industry partnership encouraging operational efficiencies and reductions in methane emissions. The company also discloses chemicals used for hydraulic fracturing through the public registry FracFocus. However, information on greenhouse gas management and reduction initiatives is insufficient, which prompted Walden to file a shareholder resolution for the 2014 annual general meeting calling for the adoption of quantitative goals for reducing greenhouse gas emissions.

ConocoPhillips

ConocoPhillips is an independent, diversified energy exploration and production company (approximately 45% of production is natural gas, 38% is oil, 10% is natural gas liquids, and 7% is bitumen). In 2007, it was the first U.S. oil company to call for mandatory greenhouse gas reductions, and, in 2010, the CEO testified before Congress on the need for legislation establishing a price on carbon. Overall, the company is somewhat transparent on initiatives and progress to minimize its own environmental footprint. Walden, along with other concerned investors, has a long history of corporate engagement with ConocoPhillips on greenhouse gas reduction goals, oil sands development, and indigenous rights. On the latter, we think the company is evolving toward a leadership position that is approaching best practice Free, Prior and Informed Consent standards of consultation with affected communities. In recent years we have also focused attention on political spending and lobbying policies and transparency (focusing on alignment with corporate environmental policies and practices), where we have also begun to see meaningful progress.

Denbury Resources

Denbury Resources in an independent oil and natural gas company that operates primarily in the Gulf Coast and Rocky Mountain regions. Denbury specializes in enhanced oil recovery (EOR) operations, which involves injecting CO_2 into wells in mature fields to help enhance production from older wells. This practice is highly beneficial compared to the use of water for extracting hydrocarbons. At the same time, the gas is sequestered, or trapped, in rock formations deep below the surface of the earth. The primary source of CO_2 used is currently from natural deposits. However, the company has begun using manmade CO_2 captured from industrial facilities in the Gulf Coast region. If recent activity using industrial CO_2 in its EOR processes gears up, there is the potential for Denbury to safely and permanently capture and store CO_2. This is unique technology with the potential to positively address climate change risk. Engagement in the past has focused on managing water risk. This year we filed a resolution with the company asking them to set a specific target for reducing GHG emissions associated with their operations.

Energen

Energen Corporation is a relatively small oil and gas exploration and production company with headquarters in Birmingham, Alabama and production in Texas and New Mexico. Approximately half of production comes from natural gas. Since 2003, Energen has participated in the Environmental Protection Agency's Natural Gas STAR Program, reporting its emissions annually and reducing methane emissions substantially. While we commend the company for its participation in the FracFocus Chemical Disclosure Registry, its disclosure related to climate change could and should be improved. To that end, we co-filed a resolution for 2014 asking Energen to issue a report reviewing the company's policies, actions, and plans to measure, disclose, mitigate, and set reduction targets for methane emissions resulting from all operations under its financial or operational control.

Questar

Questar Corporation is an integrated natural gas company that develops, produces and delivers natural gas in the Mountain West. Its emissions in 2012 were 0.00726 GT of CO2e (7.26 Mega tonnes), 90 percent of which resulted from the use of natural gas. To manage the environmental impact of production, the company has pursued a variety of initiatives, including increasing the efficiency of drilling, and using "green" completions, which require less water and result in fewer emissions during a well's completion phase. The company has also been a leader in demand-side conversation programs, working with nearly one in five customers to reduce use of natural gas. Additionally, the company has been a leader in building compressed natural gas filling-station networks, currently operating 40 stations. Questar is expanding this network in Texas, Connecticut and Kansas. Walden plans to encourage CDP disclosure because its transparency related to climate risk management has diminished recently.

Portfolio Management Considerations

From an investment perspective, Walden continues to find investment opportunities among some fossil fuel companies, and we believe they can hold an important place within diversified equity and balanced portfolios. If new legislation is enacted that limits the use of coal, oil, and gas, there is no doubt that these companies will need to change how they do business. Nonetheless, the following four points summarize our rationale for continued, selective investment:

- First, greenhouse gas emissions vary by the type of hydrocarbon burned; in broad terms natural gas is more carbon-efficient than oil, which is in turn more efficient than coal. Natural gas may therefore provide a bridge as society moves away from coal toward renewable sources of energy, and natural gas companies may benefit.
- Second, we believe that government regulation limiting fossil fuel use will be phased in gradually, allowing companies to produce and sell their existing fossil fuel reserves and either invest in cleaner energy projects or return cash to investors. Most of the value of publicly traded fossil-fuel companies is associated with their

production and cash flow over the next ten years; a gradual transition away from hydrocarbons should reduce the risk of holding these investments and allow investors to harvest their value.

- Third, energy companies understand the risk of additional regulations and taxes on carbon, and engage in scenario analysis around future carbon prices when they evaluate exploration opportunities. Walden supports a dialogue with company management teams to ensure they are doing this rigorously, given the substantial risks in both magnitude and timing.
- Fourth, fossil fuel companies are generally an important diversifying asset within portfolios. For example, a price shock in oil or gas will likely have the opposite impact on fossil fuel production companies than it will have on most other portfolio companies.

As already noted, for Walden clients who prefer to exclude investment in fossil fuel companies altogether, we have decades of experience successfully implementing separately managed portfolios without direct exposure to coal, natural gas, and oil companies (including the exclusion of oil service providers, utilities, and other companies that are highly dependent on fossil fuel companies but are often below the radar of the divestment campaign). By substituting with companies that are positively correlated with rising energy prices we have been able to reduce the portfolio impact of avoiding these companies.

Walden remains committed to integrating ESG considerations in its investment process and to utilizing share ownership to promote positive corporate change, including with fossil fuel companies.

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