Breckinridge CAPITAL ADVISORS

Corporations Sign Net Zero Pledge, But Can They Back It Up?

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Key Takeaways

There's a lot of buzz about net zero carbon emissions and net zero pledges. This article explains what net zero is and how Breckinridge Capital Advisors monitors progress as companies pursue a pathway to towards net zero.

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Net zero emissions refers to the goal of not adding to the greenhouse gases (GHG) that have been emitted already into the earth's atmosphere. By making a net zero pledge, a company commits to reducing its GHG emissions to as close to zero as possible by 2050 and to offset any remaining GHG emissions using negative emissions technologies and carbon-credits, for example.

The net zero campaign stems from the 2015 Paris Agreement, an international treaty on climate change. The overall goal is to stop global warming from exceeding 1.5 degrees Celsius above that of preindustrial levels. Considering that global temperatures have already risen to 1.1 degrees Celsius above that level, this has become a priority of the world's political and corporate leaders.

Growth in Companies Announcing Net Zero Goals

A growing number of companies have publicly endorsed the Paris Agreement by setting net zero goals of their own. The *Net Zero Tracker* (NZT), an academic and nonprofit-led initiative, is monitoring the world's largest 2,000 companies for their GHG emission reduction goals. NZT determined that 717 – or 36 percent – of these companies have set a net zero goal in March 2022, up from 21 percent in March 2021.[1]

In addition, some of these companies have signed on to the *Climate Pledge*, an initiative started by Amazon Corp. The 312 signatories promise to achieve the more ambitious goal of net zero carbon emissions by 2040.

These companies have committed to:

- Measure and report their GHG emissions regularly
- Implement decarbonization strategies in line with the goals of the Paris Agreement
- Neutralize any remaining emissions through quantifiable carbon offsets.

Highlighting the need for transparent and consistent reporting

The net zero pursuit by companies is also attributed to their management teams' growing recognition that climate transition risk is a material ESG issue. Moody's forecasts that companies that proactively transition to a net zero business model over the next 10 years will cut their probability of default by 50% versus companies that postpone or are hesitant to act. As a result, we may consider the commitment to a net zero pledge as a credit positive. However, it is important to note that a net zero pledge represents a very ambitious and aspirational undertaking. Many companies express a commitment to reduce emissions by a set amount, yet they may lack transparency in how they intend to achieve their stated goals. There is also inconsistency around emissions reporting.

From an investment analysis perspective, it is important to not just disclose emissions reductions targets but also validate them, for example by an organization such as the Science Based Targets initiative (SBTi).

Only roughly one-third of organizations that have disclosed emissions reduction targets are validated as credible by the SBTi, according to the CDP's 2021 Climate Transition Plan report. Further, only 6 percent of all reporting organizations disclosed details of a net zero target.

With so many companies signing the Climate Pledge or publicly announcing their goal, it is uncertain whether they all know what their commitment entails. Certainly many Climate Pledge signatories are genuinely on board in their commitments. From an investment perspective, however, it is necessary to take a cautious view.

Scope 3 emissions are critical

A particular challenge for many companies is how to reduce scope 3 emissions, which lie outside of their control. Scope 1 are direct emissions and scope 2 are indirect emissions from the generation of purchased energy. Scope 3 are all indirect emissions stemming across a company's value chain, from upstream sourcing of raw materials to downstream use of a company's products or services.

To achieve net zero goals, companies must reduce emissions through their entire supply chain, source less energy-intensive raw materials, and/or develop products that have fewer use-phase emissions.

Although there is no uniform disclosure standard in the U.S., the vast majority of Fortune 500 companies follow the standards outlined by the Greenhouse Protocol. Emissions reporting must be scrutinized based on those metrics.

Decarbonizing effectively requires lower cost curves for existing alternative emissions technologies and for the development of new financially viable negative emissions technologies. For example, Morgan Stanley estimates that a price on carbon of $60/ton CO2 to $150/ton CO2 for Carbon Capture & Storage (CCS) to be economical, this compares to tax credits for captured CO2 of $50/ton in the US and $35/ton for CO2 sequestered through enhanced oil recovery. This illustrates that a higher price on carbon is likely needed to incentivize further CCS investment.[2]

Other technologies, such as hydrogen and energy storage, will also need to see their cost curves decline to become viable replacements for existing fossil fuel energy sources, so as to reduce GHG emissions.

Breckinridge is committed to accountability

Breckinridge Capital Advisors is monitoring net zero progress among corporations through its Climate Transition Risk framework, which combines quantitative and qualitative analysis to assess the long-term potential of a bond issuer to achieve a net zero outcome. Our engagement with corporate bond issuers is an integral aspect of our qualitative process.

The goal is to understand the ability of corporate bond issuers to achieve their net zero goals, because we view GHG emissions as a material risk to the long-term financial performance and viability of companies in many sectors. Maintaining an objective, detailed assessment as to what companies are doing to back up emissions reduction pledges with tangible progress is an integral component of our security research process.

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FOOTNOTES:

1. Shetty, D. (2021, March). A Fifth of the World's Largest Companies Committed to Net Zero. Forbes. Retrieved from: *https://www.forbes.com/sites/dishashetty/2021/03/24/a-fifth-of-worlds-largest-companies-committed-to-net-zero-target/?sh=4a0a3b67662*.
2. Morgan Stanley April 2021 report, "Carbon Capture: A hidden Opportunity."