

ESG Engagement Example

Q4 2022

BACKGROUND

This quarter, we want to highlight an engagement we had with an aerospace company, discussing ESG issues with two senior members of the organization. The primary goal of our engagement was to understand current environmental efforts and how the company has continued to be vigilant as it relates to governance issues.

ENGAGEMENT FOCUS

Safety

Sustainalytics scores this issuer low on product governance risk management compared to its peers due to missing important best practices measures such as external audit and safety/quality management system certifications. However, as a part of our independent internal research, we identified disclosures from the issuer about their safety management system implementation, certification requirements from suppliers, and commitments to training its employees. The company advised that the U.S. Federal Aviation Administration (FAA) formally accepted their safety management systems and completed an evaluation in 2021 which determined that their Commercial Airplanes meet the regulatory expectations. The issuer disclosed that they continue to work with the FAA to integrate these safety management systems into Defense, Space & Security, and other parts of the company.

In response to our concerns, the company emphasized the importance of safety in their culture and mentioned that safety is also a part of employee compensation goals. With respect to the ISO certifications, the issuer disclosed that their suppliers are required to be certified to ISO 9100 which is ISO 9001 supplemented by International Aerospace Quality Group (IAQG) sanctioned standards.

Environment

Regarding Sustainable Aviation Fuel (SAF) and the issuer's overall strategy to transition to net zero, investor relations outlined their decarbonization strategy's different pathways to achieve net zero by 2050.

While we had hoped the issuer would be able to outline a clear pathway to 100% use of SAF, we learned through our engagement that due to regulatory and infrastructure constraints outside of their control, they do not have full control over this pathway.

Their engines are certified to use 50% SAF, which would translate to an emissions reduction of 20-40% assuming improvements to infrastructure that would allow them to fully utilize their current engine capabilities.

In terms of aspects within their control, they provided the following ambitions:

- **Handling 100% usage:** Currently testing a drop-in solution that can enable 100% usage for present engine and aircraft.
- **Route optimization to reduce emissions:** low single digit % reduction in emissions.
- **Longer term sources of energy:** exploring hydrogen and battery-powered aircrafts as the technology advances.

Sustainability Linked Bonds (SLBs)

We asked if the issuer has plans to issue SLBs in the near future to fund any of the aforementioned environment efforts and were told by management that given the current state of the company's balance sheet, the company currently has no plans to issue SLBs and plans to use free cashflow to pay down debt as it matures and tender outstanding debt in order to improve credit metrics.

OUTCOME

Our engagement with the company gave us comfort that these issues are being monitored and addressed. We will continue to engage with them if we feel that these ESG issues challenge the risk priced into the securities.

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