Dodge & Cox Funds®

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Dodge & Cox's Approach to Evaluating ESG Factors

Christophe Orly: I'm Christophe Orly, Managing Director of Dodge & Cox Worldwide Investments. And with me is Bryan Cameron, Director of Research at Dodge & Cox. Welcome to a brief discussion on how we at Dodge & Cox integrate ESG factors into our investment decision-making process. Investment firms around the world take very different views and approaches on ESG. At Dodge & Cox we carefully and comprehensively look at all factors, including ESG, that could materially impact our investments. In 2012, we became signatory of the UNPRI, further underscoring our commitment to ESG. So Bryan, could you speak in more detail about how we incorporate ESG factors into our investment decision-making process?

Bryan Cameron: I'd be happy to. With all of our investments, what we try to do is identify three or four critical opportunities and risks out over the next three to five years. To do that, we're looking at a broad set of factors, some of which we would call external variables such as macroeconomic or industry conditions, and some are more related to a specific company, such as our assessment of its management's capabilities and strategies. Certainly all the ESG variables as commonly defined are included in our research and considered as to whether or not they're material or not. Frankly, in many cases, an ESG variable or factor would not rise to the level of what we would consider to be a material risk or opportunity. But in select instances, one or more ESG variables could rise to the level of a materiality.

Christophe Orly: A case in point is our recent investment in Engie, the French utility company.

Bryan Cameron: Right. Engie, like any electric utility company, would have emissions related issues, and so in the course of our analysis, our analysts carefully reviewed a lot of materials related to Engie's past experiences and practices, and then had very serious conversations with the management about any problems or issues at the company related to emissions, and also talked about future strategies, which—what was encouraging to us was the management's stated strategy of diversifying their power sources over time, with a leaning towards lower emission power sources.

Christophe Orly: So how do Dodge & Cox's analysts learn about these ESG issues?

Bryan Cameron: So our analysts in all cases carefully review all public information about a company, starting with the annual report or the 10k, supplementing that with careful review of media articles, sell-side reports., and we periodically meet with managements to discuss their long-term outlook and strategies. So clearly, we're also discussing ESG type variables with management, and through this whole process, we end up learning a lot about ESG factors or variables. With each of the companies that we're invested in, we require the analysts to review a report written by MSCI ESG related to that particular company's ESG past experiences and practices. Finally, in each of our reports, we require the analyst to complete a checklist, which reviews all the issues related to various ESG variables as well as our conclusions about whether any ESG variable rises to the level of material risk or opportunity.

Christophe Orly: Is there one ESG issue that tends to be a more material factor than others?

Bryan Cameron: Well in my experience, that would be governance. Actually, good governance practices and procedures can lead to opportunities for shareholders, and conversely, poor practices or procedures can lead to bad outcomes and decisions. One example would be Hewlett-Packard's acquisition of Autonomy, a British software company, in 2011. They purchased the company for about $11 billion. The market had a very adverse reaction to the acquisition and we had very serious concerns. It was within a year or two that HP wrote off almost $9 billion of the $11 billion purchase price.

Christophe Orly: And AkzoNobel was a more recent example of that.

Bryan Cameron: Exactly. So AkzoNobel, over the course of the past one year, has received three proposals from PPG, an American company, to purchase Akzo. Our issue with Akzo's governance in this case was how it reacted to those proposals, which, so far as we could tell, the company refused to enter into serious negotiations with PPG, or involve shareholders in either the outcome through a vote or other means by which management might include shareholders in that very important decision. So what we did in reaction to Akzo was have discussions with management over what we thought would be good or better governance practices, and we also wrote a letter to a court, which was hearing a case related to this matter with our advocacy for shareholder rights, including the right to vote on such proposals.

Christophe Orly: So Bryan, let me summarize our conversation. At Dodge & Cox we carefully research and consider ESG factors into our investment decision-making process. We focus on material issues that could have an impact on the risk/reward profile of our investments. And, as an active owner, we have a history of engagement with management on issues we believe are material to our investment thesis. For more details, please download our ESG insight paper on our website. Thank you.