Constructive Engagement Series

HeidelbergCement: Engaging Toward Low-Carbon Economy Resilience

HeidelbergCement AG (HeidelbergCement)[1] is a global producer of aggregates, cement, ready-mixed concrete and asphalt. The main ingredient in cement is *clinker*, a biproduct of sintering limestone and other materials, and its production is carbon emissions-intensive. Our frequent and productive conversations with the CEO, CFO, Investor Relations as well as the Director of ESG (Environment, Social, Governance) have demonstrated the company's commitment to climate change leadership, as it has increasingly integrated climate transition risk mitigation into its value proposition, by proactively mitigating its carbon footprint. We have engaged HeidelbergCement for nearly five years and they have taken steps to reduce their long-term carbon footprint.

A CARBON-INTENSE SOCIAL DEPENDENCY

The frequency of our engagements with HeidelbergCement, as well as their progress on various climate targets, has strengthened our conviction that the company is committed to a low-carbon economy. While the production of cement and concrete is an energy-intensive business creating a substantial carbon footprint, cement remains an essential and growing societal dependency with no scalable replacement. The carbon footprint of the sector is high due to the production process of clinker. During clinker production, 35% of the carbon footprint comes from generating temperatures of nearly 1500°C in special kiln systems. The remaining carbon footprint comes from $CO2$ which is released when the limestone needed to make clinker is heated up above 800°C. Cement demand will likely increase due to growing urbanization and as climate change requires cities and countries to adapt to physical impacts such as rising sea levels and intensifying wildfires. Therefore, the focus of our engagement with HeidelbergCement has been on the long-term sustainability of greenhouse gas emissions reductions so that they are prepared and appropriately positioned as emissions regulations intensify.

OUR PHILOSOPHY ON ESG ENGAGEMENT

At Rockefeller Asset Management, we believe that rigorous, ESG-integrated analysis coupled with deep shareholder engagement can deliver strong long-term results for our clients. We also believe that companies working to improve their ESG performance will see stronger financial performance over time. Shareholder engagement is a core part of our investment process - evaluated before purchasing a stock and employed throughout the holding period. We appreciate companies that recognize that achieving ESG leadership requires continuous improvement.

C-SUITE DIALOGUES TOWARD STRATEGIC EMISSIONS REDUCTIONS

We have been fortunate to host HeidelbergCement's former CEO, Dr. Bernd Scheifele and CFO, Dr. Lorenz Näger in our offices multiple times a year since becoming shareholders roughly five years ago. We have also had compelling conversations with the company's Director of ESG, Mr. Peter Lukas. Initial conversations indicated that the company was well aware of the climate transition risks it faced and was embracing a strategic choice to position itself as a climate leader. Over the years these discussions have centered on the enterprise-wide strategy to reduce their carbon footprint through the replacement of inefficient kilns, alongside substantial Research & Development (R&D) investments in creating lower embedded carbon products. The company has been increasingly focused on growing the share of sustainable low-carbon products, designing factories that operate with alternative raw materials and fuels as well as investigating the possibility of implementing carbon capture & storage at certain facilities where feasible. Currently HeidelbergCement allocates about 80% of its R&D spend on solving for energy consumption in the manufacturing process.

EMISSIONS PERFORMANCE AND LEADERSHIP IN TARGET SETTING

Shortly after we became shareholders HeidelbergCement acquired Italcementi, whose older facilities required more capital investment to improve efficiency. We raised a concern that this would increase the company's carbon footprint and impact operating margins in the short term.

[1] See Company Factsheet: https://www.heidelbergcement.com/system/files_force/assets/document/7e/8c/co2-strategie_factsheets_en.pdf

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Source: Heidelberg Cement

We were reassured, however, to learn that a strategic phaseout of high-emitting processes should lead to substantial emissions reductions and cost savings over time. Worldwide, HeidelbergCement has committed to replacing coal with natural gas or alternative (bio-)fuels and to replace older technology with state-of-the-art kiln systems. Additionally, the company leads several strategic partnerships for emerging technologies to reduce carbon dioxide in building materials, including their leadership in the Innovandi Research Network of the Global Cement and Concrete Association (GCCA), and collaborations with industrial partners to develop deep offshore carbon capture & storage. After years of thoughtful discussions around target setting, we were pleased to see the company adopt a Science-Based Targets initiative (SBTi)-approved target for emissions reduction[2]. In 2019 HeidelbergCement became the first cement company to announce an emissions-reduction target that is in-line with the Paris Climate Accord target of 2°C. We believe this increases the company's competitive advantage as the European Union and China tighten regulations.

DIVING DEEP ON TRANSITION RISK RESILIENCY

In recent years we have discussed the company's approach to forecasting carbon price assumptions. We were pleased that a shadow price was being applied internally to the entire portfolio of assets, not just those subject to the European Union's Emissions Trading Scheme (ETS). However, we questioned whether pegging future price assumptions to current market prices of emission credits was realistic. When we first raised this concern, ETS prices were hovering around €5. On our most recent call in July of 2020, HeidelbergCement informed us they had decided to implement a "dynamic" internal carbon price of €30/tonCO2e, which will scale to €150 by 2050. We suggested that they should consider compressing their timeframe as we have seen recent forecasts (and subsequent asset write-downs) by several major oil and gas companies suggesting a price of €100/tonCO2e by 2030.

> "We very much appreciate Rockefeller's engagement with HeidelbergCement on ESG related topics. As we are striving to be forerunners on ESG in our respective areas, we very much value our open discussions which help us to further improve and strengthen our efforts."
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> Christoph Beumelburg
> *Director, Group Communication and Investor Relations, Nov '20*

NEXT STEPS

CONTINUOUS IMPROVEMENT

Climate regulation within HeidelbergCement's major markets still remains a concern. We look forward to continued dialogues as we anticipate commitments from the EU to reduce emissions and China's emissions trading scheme to come online. As demand for cement grows, and as resilience/adaptation to climate change adds to that demand, we intend to continue to work with HeidelbergCement to mitigate the contribution of cement production to further global warming.

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[2]A Science-based target is one that is determined by incorporating the IPCC's recommendations for sector and firm carbon budgets to keep global warming below 2 degrees Celsius.

SUSTAINABLE DEVELOPMENT GOALS

Goal 13
Climate Action

Goal 9
Industry, Innovation and Infrastructure

Goal 11
Sustainable Cities and Communities

Goals listed above represent the United Nations Sustainable Developments Goals, which seek to promote prosperity while protecting the planet, established in 2015.

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