Dodge & Cox® Worldwide Funds

Video Transcript

Dodge & Cox's Approach to Evaluating ESG Factors

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Hallie Marshall: Hi, I'm Hallie Marshall, a member of the client service team at Dodge & Cox, and with me, is our firm's Director of Research, Bryan Cameron.

Bryan Cameron: It's great to be here, and let me also thank the audience for your interest.

Hallie Marshall: Welcome to a brief discussion on how Dodge & Cox incorporates environmental, social, and governance factors, commonly referred to as ESG, into our investment decision-making process. Investment companies around the world take different approaches to incorporating ESG. Some firms use ESG factors as a primary criteria for excluding companies or including companies in their portfolios, and other firms do not consider ESG factors at all. At Dodge & Cox, we thoroughly research all factors, including ESG factors, to investigate which might be material to our investment outcomes. To underscore our commitment to including ESG factors in our analysis, Dodge & Cox became a signatory to the UNPRI, the United Nations Principals for Responsible Investing, in 2012.

Bryan, would you please begin by briefly describing the investment process used by our research team?

Bryan Cameron: I'd be happy to. There are really four specifics steps in our process. First, is extensive due diligence. Second, is analysis of the information, where we're looking for critical opportunities and risks. Next, is consideration of the valuation in relationship to the long-term outlook for the company. And then finally, is the investment decision where we are looking for situations where our assessment of the value of that company is significantly greater than that implied by the current market valuation.

Hallie Marshall: So, please elaborate how exactly we incorporate ESG factors into this investment process you've just outlined.

Bryan Cameron: Well, regarding the due diligence, our analysts for all companies carefully and comprehensively review all the available public information on that company, and we also place a great deal of importance on meeting with company managements to discuss specific topics. Through that process, we learn a lot about various ESG factors and to supplement that research, we also ask our analysts to carefully review MSCI reports, which we subscribe to, which discuss in great detail the ESG variables. In our analysis for each investment, what we're really looking to do is identify three to four critical opportunities and risks for each particular investment, and we consider a broad set of factors that could materially impact the past, the present, and the future financial returns for that particular company and this could include ESG factors.

Hallie Marshall: And to emphasise that point, I think it's worth mentioning that we require our analysts to complete an ESG risks and opportunities checklist as part of every research report. This ESG checklist incorporates the issues and considerations or conclusions that we think are relevant for each company we study. Is that correct?

Bryan Cameron: That's right, and what we're really trying to do is determine whether or not a particular factor is a material opportunity or risk. In many instances, we may conclude that ESG variables are not material in any way, but in other situations we conclude that one or more ESG variables is material to that particular decision. And then again, valuation is a significant component of our investment framework and we base our long-term—we base our decisions on the long-term outlook relative to that valuation.

Hallie Marshall: Axis Bank is one of my favourite examples I like to tell clients about. In the case of Axis Bank, social factors are material to our investment thesis. Axis Bank is one of the largest banks in India, a country where a significant portion of the population does not have access to banking services. And as part of a new program, Axis Bank is offering banking products to under-banked and un-banked portions of the population, putting it in a strong position to impact positively both the social and financial well-being of the country's population. And moreover, financial inclusion and offering products and services to new populations are a key part of our investment thesis because it will enhance the long-term growth opportunity at the company.

Bryan, in our last few minutes, let's turn to the G in ESG, and that is governance.

Bryan Cameron: Well, from my perspective, governance issues are the ones most likely to rise to a material level of opportunity or risk in a given situation. We believe strong governance practises and process enhance opportunities for shareholders and conversely poor process and decisions can lead to adverse outcomes for shareholders. One example was Hewlett-Packard's purchase of Autonomy back in 2011 for $11 billion dollars. The purchase price was about 13 times trailing revenues and soon thereafter Hewlett-Packard wrote off $9 billion dollars of the investment.

Hallie Marshall: And in the aftermath of that transaction, I know we engaged with the company's management. Can you elaborate how we addressed that situation?

Bryan Cameron: We certainly did, but here I need to make a distinction between being an activist investor, which we are not, and an active investor, which we are. So, after HP's purchase of Autonomy, we were proactive in having serious conversations with management and the board about capital allocation and the risks of expensive acquisitions, and then we also voted consistently against two members of the board. More generally, beyond the HP example, we engage with the management of a company where we believe their decisions are not necessarily aligned with the long-term interests of the shareholders, and the topics we talk about certainly include capital allocation, investment decision, cost structures, and certain ESG variables, most often governance issues. So, what we're really doing is discussing with management or representing our clients as long-term owners or investors in a particular company.

Hallie Marshall: We hope this conversation has helped your understanding of how Dodge & Cox incorporates ESG factors into our research process. Specifically, we conduct thorough research on ESG variables, we look for material factors that could impact our investment outcome, and we engage with management teams as active owners on behalf of our clients when warranted. For additional details, we encourage you to read our **ESG Insight Paper**, which can be found on our website. We thank you very much for your time and for your interest in Dodge & Cox.

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