Emission Critical: Financing a Net Zero Commitment

When done properly, decarbonization strategy and implementation can create substantial value for a business. It communicates carbon reduction ambitions, drives deep operational efficiency, and can often finance itself through incentives and other economic benefits.

The Diffusion of Net Zero

Global Net Zero commitments cover 83 percent of emissions, 91 percent of GDP and 80 percent of the population.[1, 2] But does anyone really believe the world will reach an 83 percent reduction in emissions by 2050? To borrow an American Football analogy - companies are outkicking their coverage.

Many companies have committed to slash greenhouse gas emissions to Net Zero levels in recent years without detailed analysis of the timeframes, cost or complexity to achieve sweeping results. Unlike traditional business goals, which are developed with a clear understanding of the possibilities and strategy to achieve the goal, Net Zero goals are often created hastily due to internal and external pressures. They are sometimes developed without a clear pathway to their execution, possibly reliant on potential breakthrough technologies and highly dependent on other companies' emissions reductions (Scope 3).[3]

While some commitments to Net Zero may have been made in sub-optimal fashion, the benefits of a holistic decarbonization strategy and implementation can far outweigh the costs over time. **We offer the following reflections to begin the process of turning a commitment into actionable plans and tangible results.**

1. Begin with a Basic Framework

Leading practices for a decarbonization approach can begin with a variation of the 'RSIO' method to review how organizations can Reduce, Switch, Innovate and Offset greenhouse gas (GHG) emissions.

The first three elements of RSIO employ efficiencies and innovations that, when well executed, carry benefits up and down the value chain. For example:

- Reduced energy consumption lowers a carbon footprint while slashing costs
- Extending asset lives multiplies production efficiencies
- Logistics innovation re-introduces the benefits of re-onshoring and shortening of supply chains.

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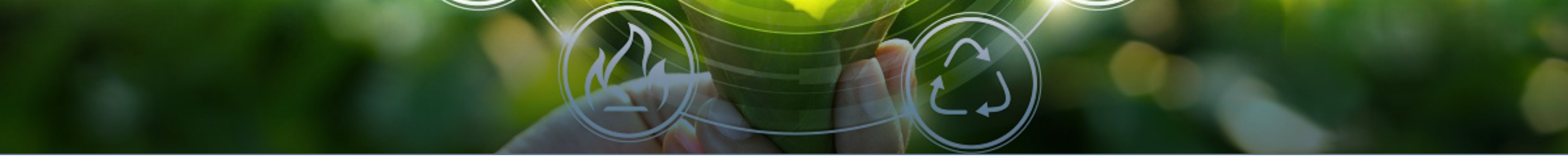
[1] https://zerotracker.net/

[2] Net Zero is defined as reducing carbon emissions to zero through all abatement means possible, before offsetting the residual emissions (note: this is different than Carbon Neutrality, which allows organizations to use offsets before/instead of emissions reduction if desired)

[3] Depending on the industry, Scope 3 emissions can account for more than 90% of a company's total GHG emissions, accordingly to the Greenhouse Gas Protocol



The offset market, which is a last resort to Net Zero (and a requirement for SBTi certification[4]), has its own ecosystem to generate value and make major environmental investments to meet the greater good. Although carbon offset investments today provide advantages to test the market, A&M's efforts are to address the first three to reduce absolute emissions before procuring offsets.

RSIO benefits drive functional synergies and contribute to operational excellence – and the same holds true for capital expenditures (CapEx).

Opportunity

Utilize RSIO analysis to categorize your sources of emissions and future reduction areas.

2. Incorporate Decarbonization into Capital Decisions and IRRs

CapEx is often an area where boards have a significant stake and decision authority over a large share of a company's resources. However, not enough boards are considering carbon as part of an internal rate of return for capital investments, particularly when the life of purchased assets may well stretch into the periods of interim carbon targets.

Large-scale projects go through numerous reviews, must meet many internal and external regulatory hurdles, and satisfy a business case aligned with the company's overall strategy. In many cases, these tradeoffs are made in a one-dimensional cost vacuum without consideration of reduced maintenance, less downtime, less energy consumption and the equivalent cost of a carbon offset 10, 20, or 25 years from now.

The same treatment should be applied to portfolio and M&A analysis, where factoring in a cost of carbon over the life of an asset or division can make an enormous difference in assessing potential value creation or destruction.

Opportunity

Establish an implicit cost of carbon reduction as part of the capital budgeting process via a comparison of the cost of carbon pricing / offsets, year-after-year in the future.

3. Reimagine Carbon Reduction as a Financial Opportunity

It is only through this level of integrated analysis that carbon is positioned as a value creator, not a cost center, and it is here where there is more financial opportunity than most companies realize.

Develop Partnerships that Provide a Unique Advantage

Renewable energy and carbon offset markets are fragmented with variable methodologies and registration rules. Offset pricing ranges from $1 to $300 a ton of CO_2e, which drives sizable risks and opportunities. And given most companies will require offsets to achieve Net Zero commitments, there is an urgency around planning for this emissions shortfall.

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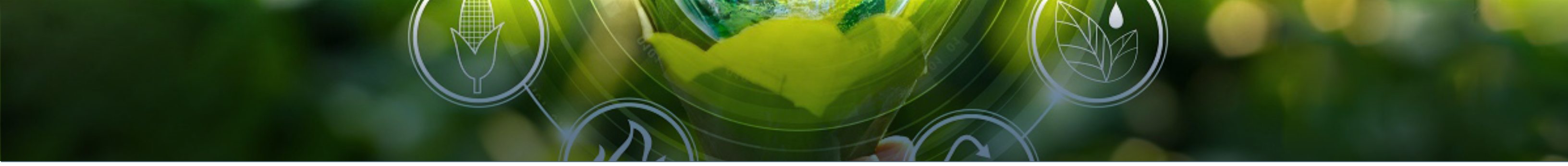
[4] Net Zero targets will only be 'certified' by the Science Based Targets Initiative (SBTi) provided that all available avenues for emissions reduction have been explored before using offsets to make up the shortfall



A&M works with clients to develop energy and utility investments and partnerships to sustain a carbon strategy with benefits well into the future. For reference, an investment in renewable energy in the early 2000s would have returned 20+ percent IRR. Today is it only six to eight percent.

Opportunity

Be proactive around renewable energy partnerships, as they will pay dividends well into the future.

Companies that Innovate Will be Rewarded

Over the next decade, annual climate spending in the United States is anticipated to be $80 billion. This is through the introduction of the CHIPS and Science Act, the Infrastructure Investment and Jobs Act, and the Inflation Reduction Act. The Rocky Mountain Institute describes these three as the 'brains, backbone, and engine' of clean energy investment, respectively.

So, while some clients view emissions reduction efforts as a profit sink – this is no longer the case. Tax credits and incentives abound in green investment.

A&M provides expert advice and targeted initiatives to leverage (or create) incentives and capture non-discretionary credits – many of which may be available for activities already underway.

Opportunity

Identify which CapEx projects can 'pay for themselves' over time.

Decarbonization is an Opportunity to Organize for Success… and Profitability

Market leaders in this space have explored a level of organizational control that results in developing a profit center from their initiatives inside and outside the business. This provides a crucial link between deep operational efficiency (Reduce, Switch), capturing credits and incentives in pursuit of new sustainable activities (Innovate), and renewable energy procurement (Offset).

A&M can also advise multinational companies regarding the proper business entities, organization and structure to unlock financial advantages, as well as developing profit centers focused on GHG emissions.

Opportunity

Stand up an organization that supports long-term emissions reduction goals, which can also be a profit center.

The advantages provided through a multi-disciplinary decarbonization strategy can help companies organize strategically around an executable, financed carbon emissions reduction plan.

[5] https://rmi.org/climate-innovation-investment-and-industrial-policy

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