Boston Trust Walden

Principled Investing.

ESG IMPACT REPORT

Fourth Quarter 2022

A modern, competitive, and healthy financial marketplace requires investors to consistently evaluate, identify, and address evolving market risk. For decades, we at Boston Trust Walden have seen the changing climate physically disrupt global supply chains, halt manufacturing, and strain natural resource availability. We've witnessed persistent inequality and toxic workplaces lead to employee strikes, regulatory noncompliance, and heightened reputational risk. Yet, we have also observed effective management of material environmental, social, and governance (ESG) risks increase operational efficiency, help attract and retain key talent, strengthen supply chains, and successfully identify new products and markets.

Since 1975, Boston Trust Walden has integrated ESG factors into investment strategies on behalf of our clients — one of the longest track records of any institutional investment manager. ESG considerations are integral to our investment philosophy and part of our fiduciary duty to ensure client assets are invested in a set of securities well positioned to minimize risk and produce sustainable returns. To be competitive, companies must effectively manage material ESG risks and capitalize on emerging opportunities.

Foundational to our equity research process is recognizing the financial materiality (or significance) of ESG factors. Each company considered for investment in portfolios is reviewed simultaneously and collaboratively by an ESG analyst and an investment analyst. Together our analysts evaluate a company's performance to enhance our understanding of potential financial outcomes associated with issues ranging from risks (e.g., physical risk to operations) to opportunities (e.g., generating new sources of revenue) — and identify potential ESG risks and opportunities for further investigation. Issues range from broad sector considerations to company-specific items and are informed by the SASB Standards' identification of potentially material ESG issues in addition to our own knowledge and experience. On the following pages, we provide a case study of Fabrinet (NYSE: FN).

ESG INTEGRATION CASE STUDY

FABRINET

COMPANY OVERVIEW

A rare pureplay in the Electronics Manufacturing Services (EMS) industry, Fabrinet is the industry leader in manufacturing optical communications equipment, with greater than 50% market share. Focusing on low volume, complex products, the company generated over $1.8 billion in revenue in 2021, 76% of which is related to optical components used in the communications industry.

Fabrinet manufactures optical amplifiers, lasers, prisms, and lenses — critical components in technology that make modern communication possible. The company benefits from secular tailwinds in connectivity and 5G. Furthermore, as an EMS company, Fabrinet benefits from Original Equipment Manufacturers (OEM) increasingly outsourcing the manufacturing of electronic components.

ANALYSIS

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After an initial review of Fabrinet, we noted their dominant market position, strong growth profile, and record of stable financial returns. Analysts also observed above average profitability, the latter largely thanks to 80% of its manufacturing being in Thailand. The company's significant geographic exposure to Thailand emerged as the most important area for further research.

Analysts reviewed a variety of third-party resources and conducted their own primary research. They sought to answer three key questions:

- What are the risks associated with manufacturing in Thailand?
- What has the company done to mitigate the risks?
- To what extent might the risks, if they do occur, affect the company's financial results?

RISK ASSESSMENT

Potential risks and opportunities for technology companies commonly include quality control, waste management, labor conditions, and material sourcing. In the case of Fabrinet, our research indicated the company's geographical exposure to Thailand — and its exposure to flooding specifically — as the most important risk factor to assess. The analysts explored other risks as well, which were deemed to be immaterial or managed risks.

Flooding in Thailand is a regular natural disaster occuring annually. As a result of climate change, however, the severity and frequency of flood events are increasing. In 2011, major flooding affected numerous companies operating across Thailand. The flooding forced Fabrinet to permanently close a facility and shut down another for a month. As a result, the company incurred more than $100 million in expenses (20% of revenues that year) associated with the disaster, although about 80% was recuperated through insurance and government grants.

Examined in the context of today's market, with the heightened demand for fiber optic components, a future facility shutdown could result in greater financial impact and longer-term market share loss. Exacerbating this existing risk exposure, Fabrinet has since moved most of its manufacturing capacity to Bangkok — a city with even higher flood risk than its previous location.

INVESTMENT DECISION

Boston Trust Walden makes active investment decisions based on our assessment of financial quality, the sustainability of the business model, and valuation. Our analysis of ESG factors informed our view of Fabrinet's operational strengths and weaknesses. Despite strong fundamentals, the high geographic exposure to Thailand created operational physical risk that raised serious concerns about the company's sustainability. Further, Fabrinet's public disclosures did not indicate the company had taken steps to mitigate this known risk. Instead, the company chose to relocate manufacturing to Bangkok, effectively increasing the risk of potential flooding. With this ESG risk incorporated into our analysis, we determined the company's valuation was unattractive. Ultimately, our Securities Research Committee concurred with the analysts' recommendation to not add Fabrinet to the firm's approved list.

In summary, ESG factors affect corporate performance and ESG analysis played a crucial role in our assessment of Fabrinet. We believe it is prudent to recognize the financial materiality of ESG factors, and are committed to doing so as we seek to invest client assets in a set of securities positioned to minimize risk and produce sustainable returns.

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