

ESG Report - HMHC

Score: 83

Environmental

Houghton Mifflin Harcourt is a learning company that provides curriculum and learning services for *grades K-12* in the United States. As most of the revenues come from the sale of physical books, the use of paper is still prominent and has a negative effect on the environment. Deforestation is one of the main causes of global warming and half the company’s revenues are still from physical books; however, it is focused on making the shift towards digital learning. They reported in Fall 2021 that 11% of their billings were now coming from online subscriptions. The company has a paper policy that states its main goals when it comes to the sourcing of the materials used in its products and the company consistently beats the goals outlined below.

Exhibit 1: Environmental Goals

Goal	Target	Actual
Percentage of HMH purchased paper used for education products made with no less than 10% recycled fiber	90%	99%
Percentage of paper procured domestically for trade products certified by the FSC	75%	87%
Percentage of paper procured internationally for trade products certified by the FSC	80%	86%

Source: Company ESG Report, Tonus Capital

The company’s Boston headquarters are certified LEED Gold as it has implemented many energy efficient practices including high-efficiency fluorescent bulbs, motion sensor lighting, energy efficient HVAC and heating, and LED light fixtures in parking lots. When the company has unsold and excess books, the preferred method of disposal is through donations. In 2020, the company donated over 1 million books to 228 organizations, which is great as it benefits individuals who may not normally have access to these books. Additionally, 96% of waste generated at HMH distribution centres and warehouses is recycled. Another important source of pollution for the company is the international transportation of the products. In 2020, the company saved 332,000 lbs. of CO2 by better managing international transportation methods and the company’s focus on sustainable practice greatly reduced its footprint and saved 36,338 tons of paper (388,860 trees), 69,650,000 gallons of water, and 196,894,000 lbs. of CO2.

We believe that the company is doing a great job at reducing its impact; however, it does not disclose enough information for us to draw any conclusions HMHC provides figures on how much it saved, but the company does not provide figures about how much it used. If it continues to focus on the digital side of the business, the company’s environmental impact will surely diminish. We are pushing the company to disclose more in its annual fillings.

Social

Philanthropy

Employees at HMHC are very involved in the various communities wherein the company operates. In 2020, the company’s employees logged more than 3700 volunteer hours, donated over 1 million books, and participated in the first-ever virtual volunteer week. Amid the pandemic, the company put together over 1200 success kits for students in Boston, made the online services free, and donated thousands of masks and gloves to various organizations. The company also supports Austin Voices for Education, City Year, and the City of Boston Scholarship.

Through HMH Books for Equity, the company donated 100k books to various organizations including Save the Children, First Book, Reach Out and Read, Book’em, Too Small to Fail, World Central Kitchen, Food Bank of the Rockies, and the Children’s Hospital of New Orleans. In line with the company’s commitment to the BLM movement, half of these books were written by black authors.

Diversity

The company has made a commitment to increasing diversity within the entirety of the organization. As of 2020, HMHC's domestic workforce is 67% female and 77% white. Furthermore, the workforce is 9% Hispanic, 8% black, and 5% Asian. Although there is strong gender diversity, there is a lack of racial diversity as most of the workforce is white. At the management level, 38% of roles are held by women. Considering most of the workforce is female, women are underrepresented in management roles. 77% of executive management is white, 15% is black, and 8% is Hispanic. The lack of diversity is stronger at the higher levels and the company must attempt to address and close this gap.

We believe HMHC's elevated level of philanthropic activities and its focus on increasing diversity throughout the organization makes the company socially responsible; however, the company must focus on increasing diversity at the executive level. We have discussed the issue with senior management and given HMM's mission of educating children, we believe a proper diversity, reflecting today's society, is paramount.

Governance

Board

HMHC's board of directors consists of 9 individuals from various backgrounds. Of the nine individuals, two are female and two are members of minority groups. Although this diversity is strong, it is not industry leading. The board independence is much stronger than the industry median and the chairman of the board is independent, which demonstrates the strong focus on the separation of powers. The board members' average age is slightly higher than the industry median, although the average tenure demonstrates the company's balance between having experienced board members while also bringing in fresh perspectives. The director attendance rate at meetings is in line with the industry median and we would like to see an increase in this metric.

Exhibit 2: Board and Executive Diversity

	HMHC	Industry
Presence of Women on the Executive Team	45%	N/A
Presence of Minorities on the Executive Team	27%	N/A
Presence of Women on the BOD	22%	32%
Presence of Minorities on the BOD	22%	N/A
Board Independence	89%	76%
Meeting Attendance Rate	75%	75%
Average Age of Members	62 years	61 years
Average Tenure	7 years	N/A

Source: Proxy Statement, Tonus Capital

Compensation

The executive compensation at HMHC is comprised of the base salary, the annual cash bonus, and the long-term equity incentive plan. In 2020, the base salary accounted for 19% of the CEO's compensation and 27% of the other executives' compensation. The remainder of compensation comes from the cash bonus and equity incentives. In 2020, 10% of the target bonus was paid as a result of the company's poor financial performance and inability to meet targets. The annual cash bonus is dependent on the adjusted cash EBITDA and the number of billings. The long-term equity incentive plan takes into account the management team's ability to achieve 3-year billing and adjusted cash EBITDA targets. It is important to note that the entire executive team took pay cuts during the first four months of the COVID-19 pandemic. The median employee salary in 2020 was \$79,770 and the CEO compensation totaled \$3,577,827. These numbers provide a CEO-to-employee pay ratio of 45 which is very reasonable.

We believe that the pay-for-performance philosophy at HMHC is well integrated into the compensation structure. We believe that the executive compensation is fair and well-aligned with the creation of shareholder value.

Ownership

The total insider ownership of HMHC common stock is approximately 0.8%. This figure is very low and ownership across the executives and directors is underwhelming. The company has a strong minimum share ownership requirement policy; however, almost half do not meet the required amount. Since the inception of the insider buying program, the executives have not made many share purchases and the company employees have surprisingly bought more shares than the executives. It is important to note that Daniel Allen, a former board member, purchased a stake in the company after his private equity firm liquidated its position, which demonstrates his high conviction in the company.

We recommend that the company insiders increase their positions in the company's stock as the current levels of ownership do not represent strong alignment with the shareholders.

Exhibit 3: Progress Towards Minimum Share Ownership - Senior Leadership

Name	Position/Title	Age	Tenure	Current Holdings (USD)	Minimum Ownership Req.
John J. Lynch Jr.	President, CEO, & Director	62 years	4 years	4,477,000	4,500,000
Lawrence K. Fish	Director and Chairman	76 years	10 years	2,948,000	402,000
Jean-Claude Brizard	Director	57 years	< 1 year	0	240,000
Gordon Crovitz	Director	62 years	9 years	760,166	234,000
Jean Desravines	Director	49 years	3 years	199,815	276,000
Jill Greenthal	Director	64 years	9 years	523,083	285,000
John Killian	Director	66 years	10 years	540,551	318,000
John McKernan	Director	72 years	9 years	334,719	306,000
Tracey Weber	Director	54 years	5 years	1,045,000	276,000
Joseph Abbott Jr.	CFO	44 years	5 years	1,683,000	1,650,000
William Bayers	EVP & General Counsel	66 years	14 years	806,674	1,350,000
Michael Evans	EVP & CRO	59 years	2 years	301,037	1,575,000
James O'Neill	EVP & General Manager	48 years	4 years	826,012	1,350,000

Source: Proxy Statement, FactSet, Tonus Capital

Exhibit 4: ESG Checklist and Score

TONUS CAPITAL ESG QUESTIONS

Environmental	Yes	No	N/A
Are the company's operations dangerous for the environment?		X	
If so, is the company's management doing something to mitigate the risk?			
Is the demand for the company's products/services likely to be impacted by climate change regulations?		X	
Is the company focused on decreasing emissions and its overall environmental footprint?	X		
Does the company disclose emissions data?	X		
Social	Yes	No	N/A
Have there been any labor relation issues in the past 10 years?		X	
Has the labor safety and lost time injury rate improved over time?			X
Does the company have operations in a country with a history of poor labor practices?		X	
Has the company or any of its officers been involved in scandals and/or fraudulent activities		X	
Governance	Yes	No	N/A
Are there high levels of insider ownership at the management and board level?		X	
Does the board have a high level of independence?	X		
Is the compensation structure aligned with the creation of shareholder value?	X		
Is the compensation structure reasonable?	X		
Is the level of diversity of the board of directors and management team greater than 30%?		X	

Score	83%
Positive	10
Negative	2

TCI Focus Area

- 1) Increased diversity of workforce and senior management team for a better reflection of gender and minorities
- 2) Greater disclosure on the CO2 emissions of the company and its target for the future
- 3) Increased ownership by directors of the company, ideally with purchases on the open market