



# ESG: Implications for Corporates & Investors

Citi | Banking, Capital Markets and Advisory

October 2019



Environmental



Social



Governance

Strictly Private and Confidential



# What is ESG?

## Environmental



### Environmental factors include:

- the contribution to climate change through greenhouse gas emissions
- waste management / water pollution
- energy efficiency & use of natural resources
- environmental opportunities (investment in “clean & green”)

## Social



### Social factors include:

- human rights & labour standards in the supply chain
- product safety & quality
- adherence to workplace health and safety
- integration into the local community
- access to finance and development

## Governance



### Governance factors include:

- corporate governance – Board, pay, ownership etc.
- corporate behaviour – corruption, tax transparency, anti-competitive practices, ethics

# ESG in Focus – Gaining Significant Media Attention

## Environmental

### BP oil spill confirmed as 'world's worst'

*"The BP oil spill in the Gulf of Mexico is the world's biggest accidental oil leak, with government scientists estimating that 4.9m barrels of oil gushed from the Macondo well"*

**FT**

### Monsters To Nestlé: Single-Use Plastics Hurt People And Profits'

*"Environmental activists teamed up with giant puppets this week to deliver a message to Nestlé S.A., the world's largest food company and a major producer of single-use plastics"*

**Forbes**

### 'Ryanair is the new coal': airline enters EU's top 10 emitters list

*"Ryanair has become the first non-coal company to join Europe's top 10 carbon emitters. Their greenhouse gas emissions in 2018 were up 6.9% on last year and 49% over the last 5 years"*

**theguardian**

## Social

### YouTube and Netflix to face violence crackdown in US

*"America's Congress is to consider a crackdown on YouTube and Netflix with new rules to prevent children being exposed to violence, sex and other inappropriate content"*

**THE TIMES**

### Apple recalls UK wall plug adapters over electric shock fears

*"Apple is recalling a number of wall plug adapters due to safety concerns. It warned it could leave people at risk of getting a shock if they touched the exposed metal components"*

**The Telegraph**

### Australian clothing brands won't commit to garment workers' safety

*"Five years after the Rana Plaza disaster, brands including Myer and Just Jeans still haven't signed an agreement to improve workers' conditions"*

**theguardian**

## Governance

### Unilever's Dutch relocation details anger UK investors

*"UK investors have reacted angrily to details of Unilever's plans to move its HQ to the Netherlands after they announced they would leave the FTSE 100"*

**FT**

### Starbucks' EU unit paid 2.8% in UK tax last year

*"Starbucks' European business paid \$5.9m of tax in the UK on profits of \$213m, after a payment from another part of the group boosted profits."*

**FT**

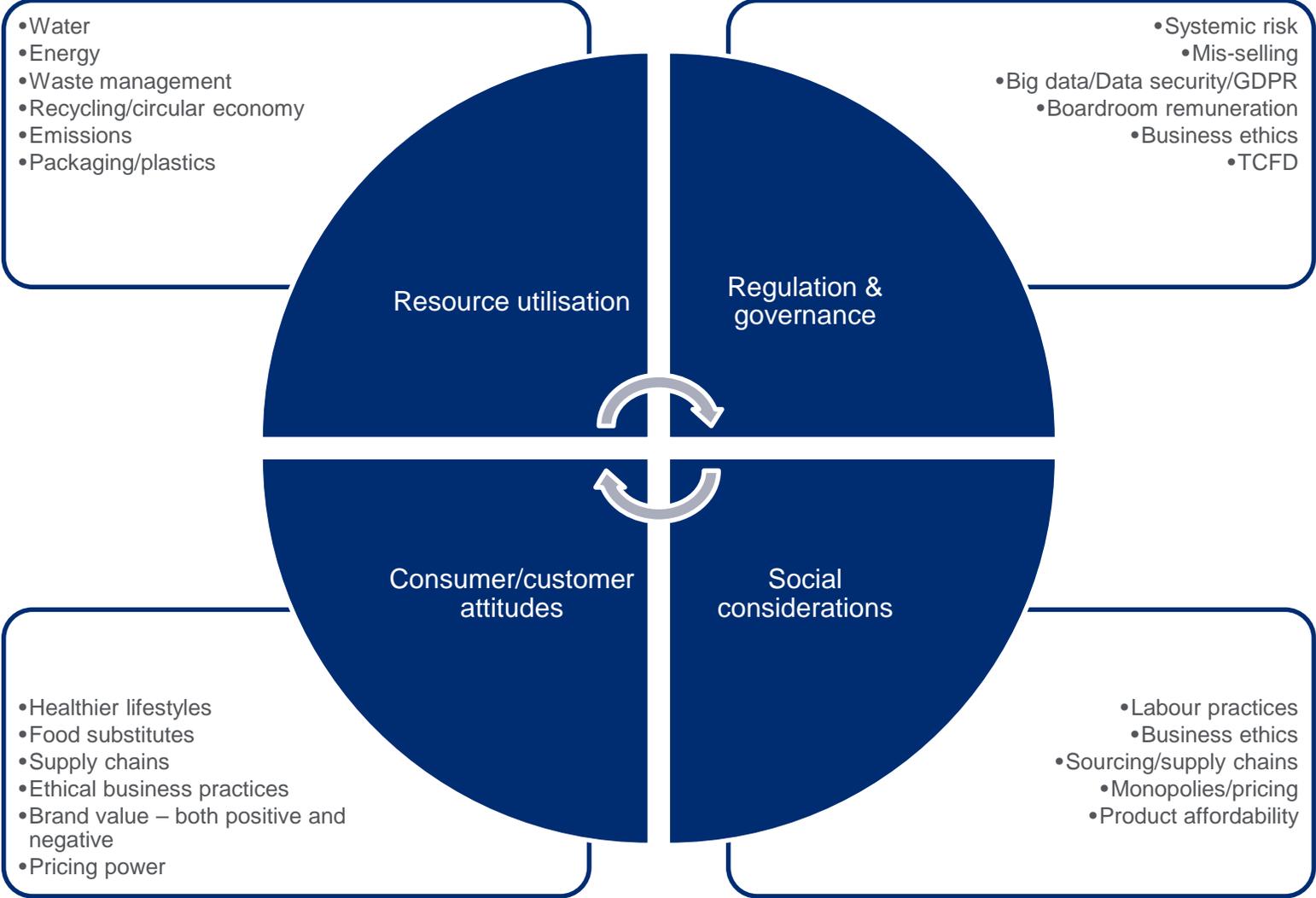
### Persimmon boss to leave after 'distraction' over pay

*"The boss of Persimmon Jeff Fairburn has been forced out after a row over his £75m pay award. Persimmon said the issue was having a "negative impact" on the firm's reputation"*

**BBC**

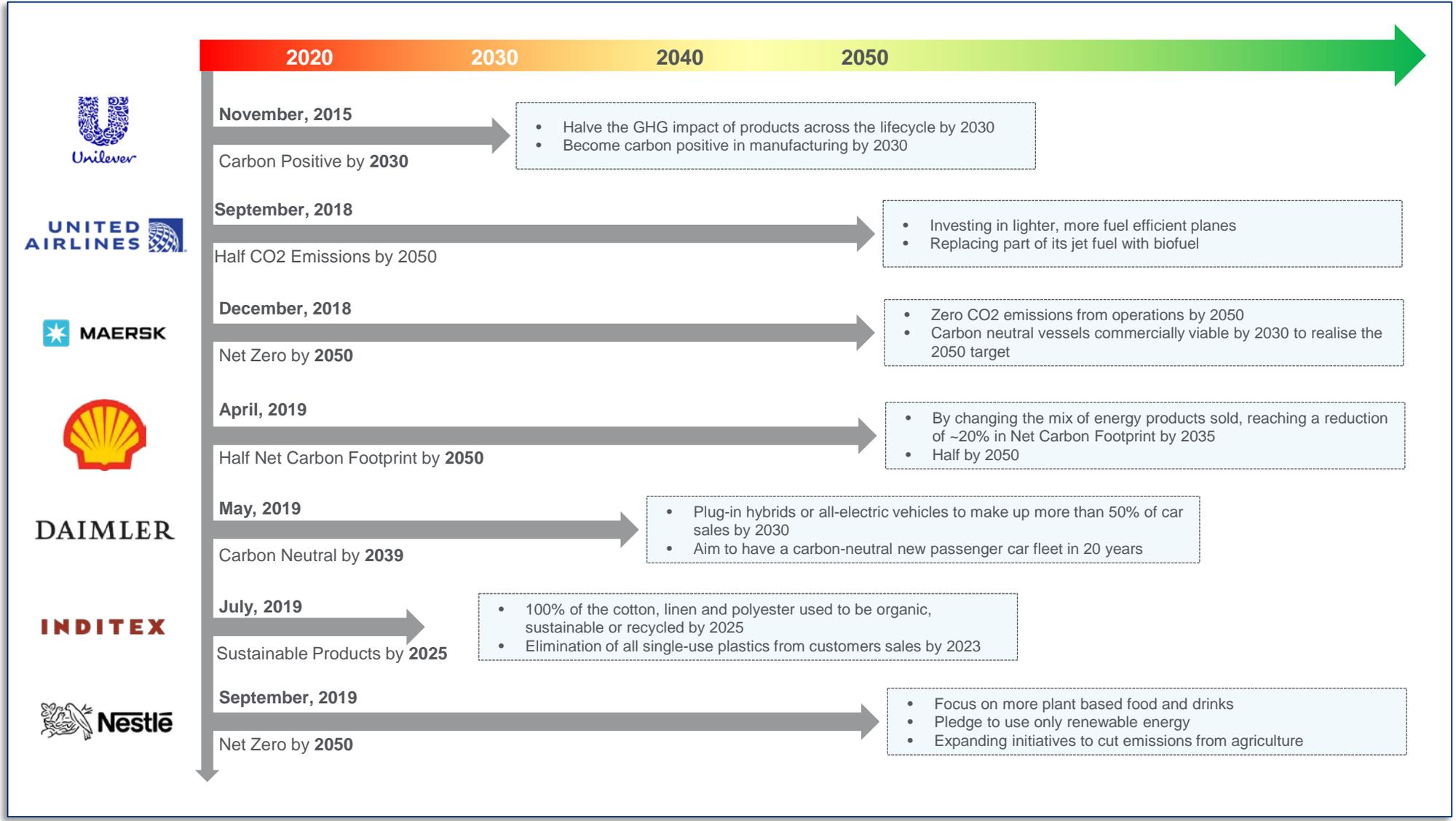
# ESG Issues are NOT 'non-financial'

ESG issues pervade every element of a corporate's activities, from operational considerations, through geographic positioning, to at its most fundamental level, strategic alignment and industrial focus. Hence it is not true to say that ESG issues are 'non-financial' – they might better be described as 'pre-financial' issues.

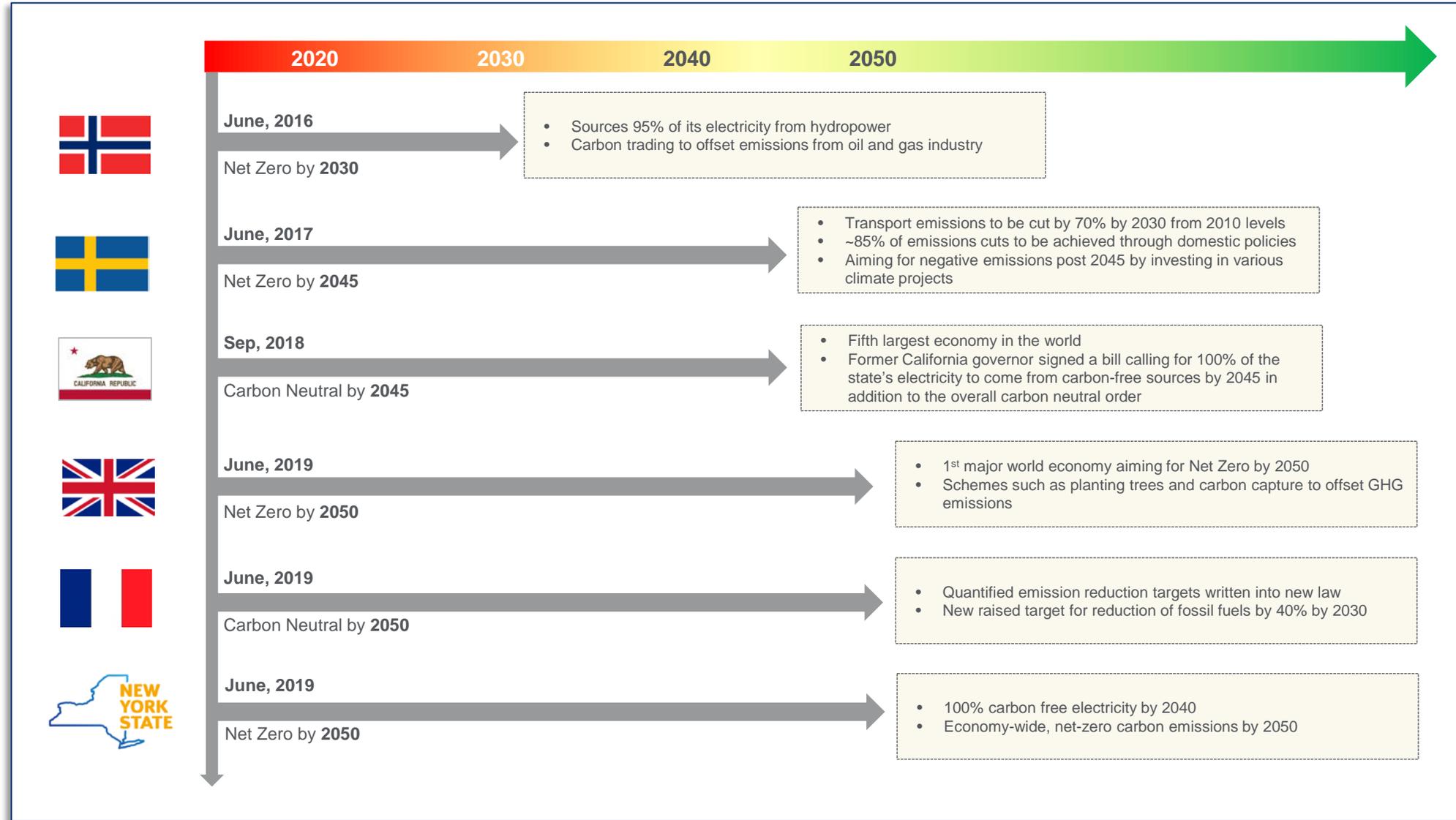


Source: Citi Global Insights

# Triggering Industrial Transformations & Innovations in All Sectors with New Long Term Targets Set by Companies ...



# ... And by Federal & State Governments



# Dedicated ESG investment body - PRI



## United Nations Principles for Responsible Investment

- Formed in 2005 by the United Nations
- The world's largest proponent of responsible investment
- Works to understand the investment implications of ESG factors and looks to support investors to incorporate these factors into their investment and ownership decisions
- **Investors are encouraged to become a PRI signatory**

## The 6 Principles for Responsible Investment

The creation of 6 voluntary and aspiration principles that provide investors with a list of possible actions for incorporating ESG issues into investment practice.

The principles were designed by investors for investors. Signing the PRI commits investors to contribute to developing a more sustainable financial system:

- 1 We will **incorporate ESG issues into investment analysis** and decision-making processes
- 2 We will be **active owners and incorporate ESG issues into our ownership** policies and practices
- 3 We will **seek appropriate disclosure on ESG issues** by the entities in which we invest
- 4 We will **promote acceptance and implementation of the Principles** within the investment industry
- 5 We will work together to **enhance our effectiveness in implementing the Principles**
- 6 We will each **report on our activities and progress towards implementing the Principles**

Investors that are already PRI signatories include those with dedicated ESG funds...

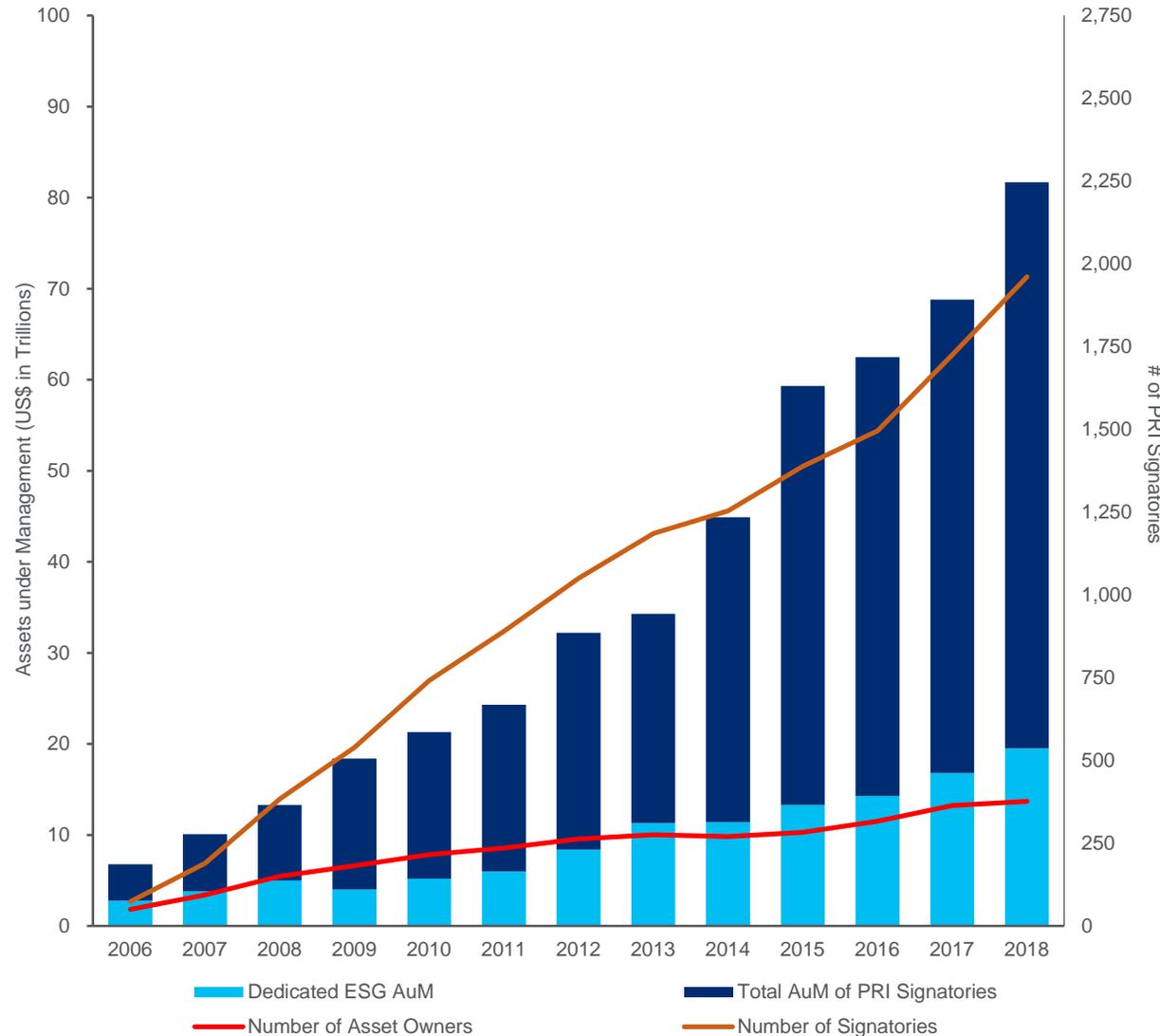
	<b>TIAA</b> CREF Social Choice Equity Fund
	<b>NEWTON</b> Sustainable Global Equity Fund
	<b>Janus Henderson</b> Global Sustainable Global Equity Fund
	<b>Premier</b> Ethical Fund
	<b>WELLINGTON</b> Global Impact Fund

...and generalist global investors that also look to incorporate ESG factors into their investment thesis


# ESG going truly mainstream – with 19% YoY growth over 2018

## ESG market size

Global AuM & number of PRI signatories<sup>(1)</sup>



- ESG-linked AuM (linked to PRI signatories) currently stands at more than \$83trn globally
  - Includes classic generalist funds who adopt some form of ESG angle – typically “screening out” poorly rated companies
  - Around half of these assets managed in Europe and more than a third in the U.S
- Dedicated ESG funds are expected to have c.\$25trn under management
- ESG-themed ETFs have also surged since 2016, with 120 funds around the world

*“Sustainable investing will be a core component for how everyone invests in the future. I expect that the ESG category will grow from the current \$25 trillion to \$400 trillion in 2028.”*

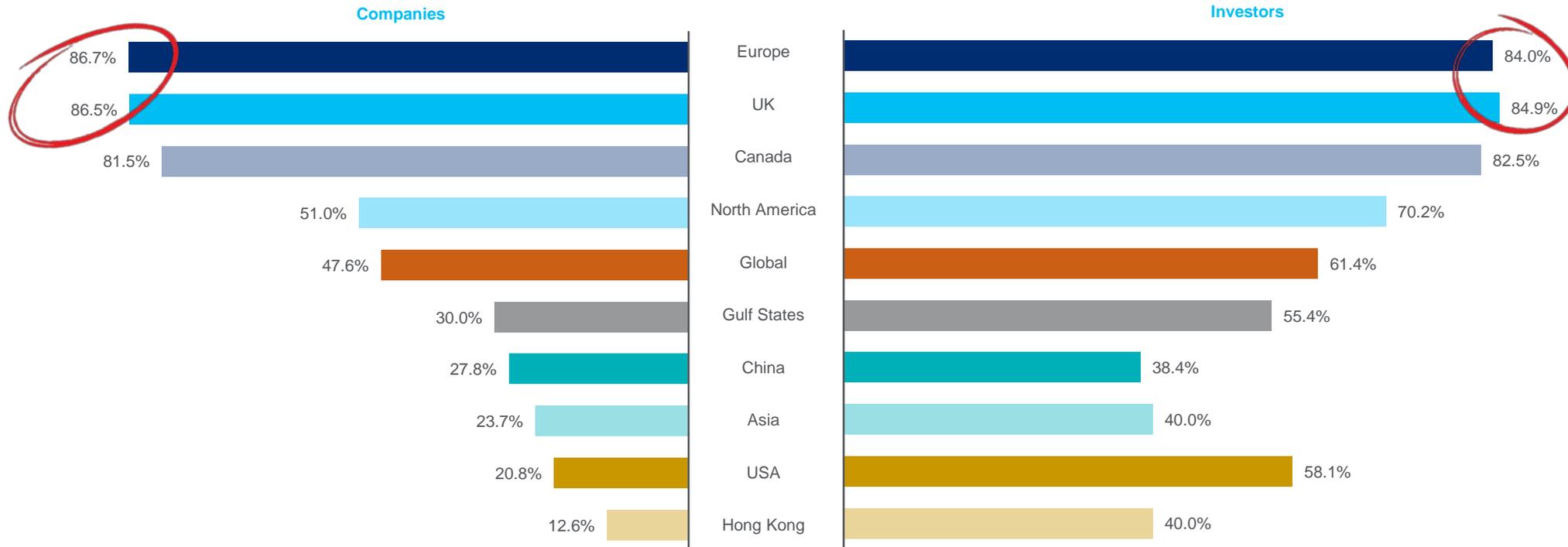
**BLACKROCK**

Source: PRI.  
 Note: (1) investors who have publically signed the Principles for Responsible Investment list – publicly demonstrating commitment to responsible investment.



# Europe and UK at the forefront of ESG

## Proportion of companies and investors with ESG strategies



- Investors are the leading change agents in ESG strategies – applying pressure on companies to improve: 61% of all investors now have an ESG strategy compared to 48% of companies
- UK investors are at the forefront of the change – leading UK and European corporates to have the greatest take-up of ESG strategies
- Despite 58% of US investors adopting an ESG strategy, US companies lag the global average with only 21% take-up

*“That is why it is time to change our view on ESG investing. It is not just the smart thing to do, not just expedient. For our clients and as responsible corporate citizens, regardless of which way the political pendulum is swinging, **it is our duty to bring ESG considerations into sharper focus and bring them to the front of ours and our clients’ minds.** It is time to change our perspective.”*

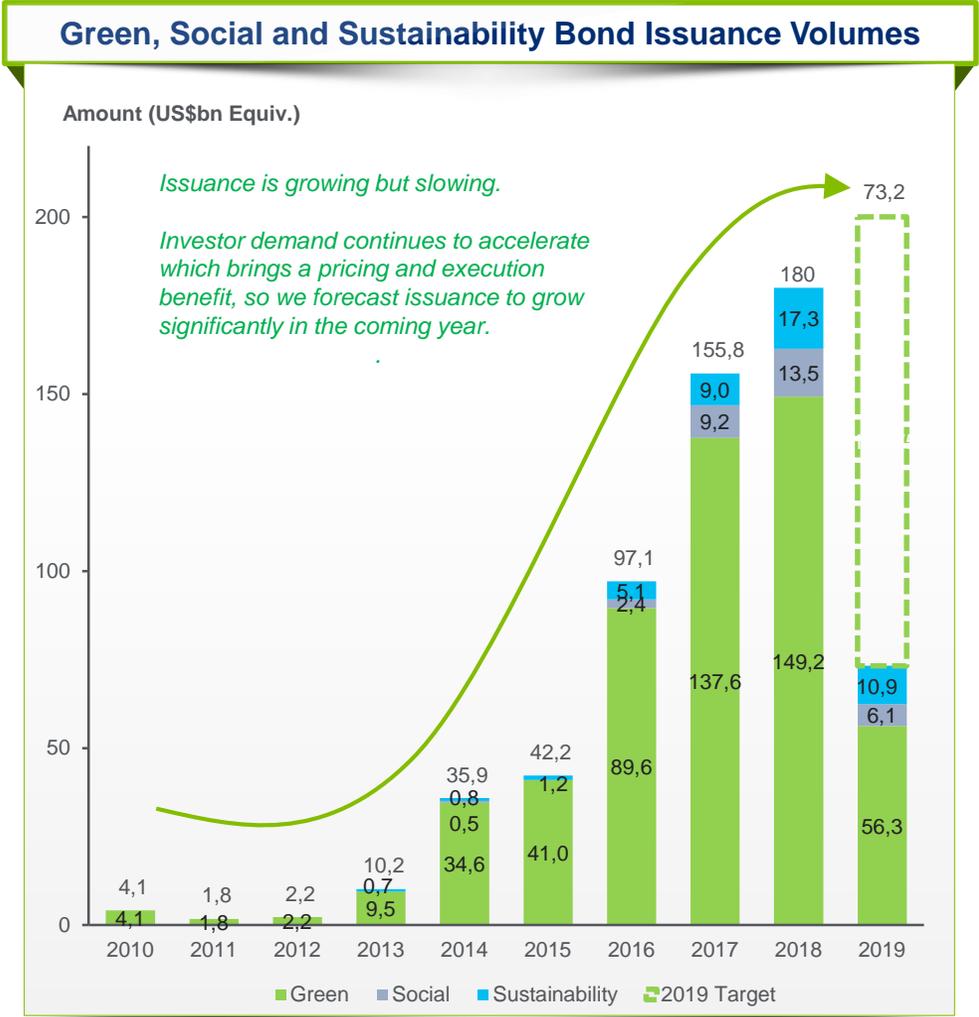


# Examples of ESG strategies in action

Strategy	Company	Investor approach	Fund
Screening		Exclusion of Tobacco and Defence stocks from investment through negative screening	<p>“BNP Paribas Asset Management is one of the first global asset managers to <b>exclude tobacco from its mainstream investments</b>. We <b>recognise the important role that long term capital plays in tackling major global issues</b> and we are taking into account growing international concerns about the risks posed by tobacco.”</p>  <p>“We apply ESG standards to our responsible investing (RI) and ESG integrated open ended funds, as a result of these ESG standards, <b>the coal and tar sands producers, tobacco and defence sectors are excluded from our funds.</b>”</p> 
Best-in-class		Active investment into companies with strong ESG ratings	<p>“We evaluate all issuers from an ESG perspective in addition to fundamentals and <b>emphasize those we consider to be “best-in-class.”</b> As a result, <b>issuers that incorporate sound ESG practices and with highest impact potential are more likely to be held in our ESG portfolios.</b>”</p> 
Engagement		<p>AGM voting to reject remuneration policy</p> <p>Consistent engagement to improve board independence &amp; subsequent AGM vote</p>	<p>“The company put its three-year binding <b>remuneration policy</b> to the vote. We <b>decided to vote against its introduction given our concerns around the increased quantum</b> and lack of relative metrics (where previously a portion of executive pay was dependent on the company’s performance versus its peers).”</p>  <p>“Since November 2017, we <b>escalated our engagement efforts by attending the company’s 2018 and 2019 AGMs</b>. We <b>engaged with the chair of the board (twice)</b>, some of the other independent directors, and executive management. At the 2019 AGM, we voted against the chair of the board.”</p> 
Thematic investment		Specific investment into clean companies	<p>“The Pictet Global Environmental Opportunities Fund <b>mainly invests in equities of companies in clean energy and water, agriculture, forestry and other areas of the environmental value chain.</b>”</p> 

# The Green, Social and Sustainability bond market

The Green, Social and Sustainability bond market continues to develop, however the pace of growth seem to be slowing. Investor interest in socially responsible fixed income is growing faster than issuance volumes.



### Total Outstanding Green, Social and Sustainability Bonds \$410 Billion

Type of Bond (US\$bn Equiv.)	2017	2018
Green Bond	US\$265.5bn	US\$407.3bn
Social Bond	US\$11.4bn	US\$24.3bn
Sustainability Bond	US\$16.3bn	US\$33.1bn
<b>Total</b>	<b>US\$293.2bn</b>	<b>US\$464.7bn</b>

### Projections for 2019FY SRI Bond Issuance

Source	2019 Projection
Citi	US\$200bn+
Climate Bonds Initiative	US\$300bn

Source: Citi, Dealogic, US Green Municipal volumes taken from Bloomberg, 18 April 2019.

# Why companies should care?

Reduce pressure on management and **increase success of passing motions** at AGMs

*"We view ESG practices as a proxy for management quality."*

Schroders

ESG improvements can also **protect companies from negative environmental trends** & costs

*"It's not just 'what's my company's impact on climate,' it's 'what's climate's impact on my company.'"*

S&P Global  
Ratings

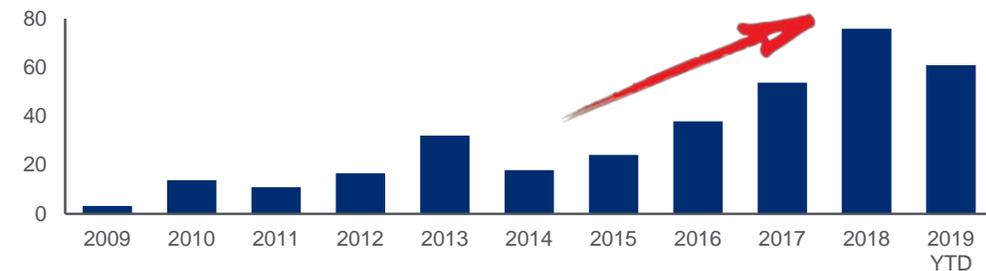
**Less likely to be the subject of regulatory change** or negative press – reducing potential share price volatility

*"On the risk side, quite simply those more compliant companies are less likely to be penalised by government policy or by trading partners who are keen to ensure they maintain highest possible standards in their supply chains."*

Fidelity

**Help to make activist approaches become less likely** – with ESG campaigns increasingly in focus

Number of US Activism Campaigns with an ESG Demand



Provides **access to Green Bonds** – funding to improve the sustainable management of businesses

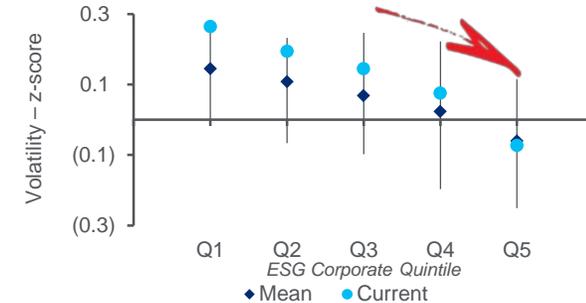
Investors scrambled to get in on Verizon's \$1B green bond deal

**It is ethically and morally right!**

# How does it benefit companies?

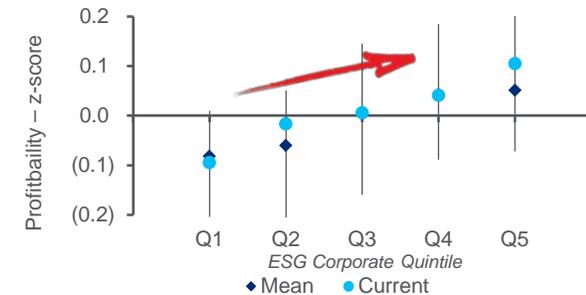
## Lowers risk

- Companies with **strong ESG characteristics typically have above-average risk control standards** and better supply chain management
- Due to better risk control standards, **high ESG-rated companies suffer less frequently from incidents** such as corruption
- **Leads to less stock-specific downside risk and volatility** for a company's share price
- Over the last 10 years high-rate firms saw fewer negative incidents



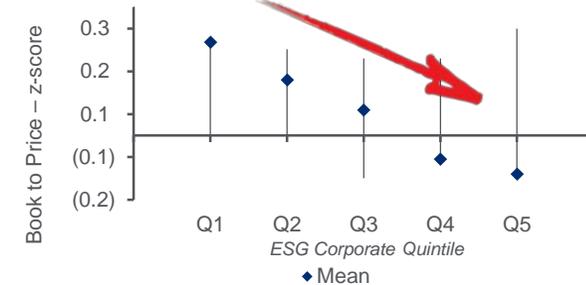
## Improved financial performance

- **High-rated ESG companies are more competitive than peers** – due to more efficient use of resources, better human capital development or stronger management
- Upper quintile ESG companies on average are **better at developing long-term business plans** and management incentives
- These firms **use their competitive advantages to generate higher levels of profitability**



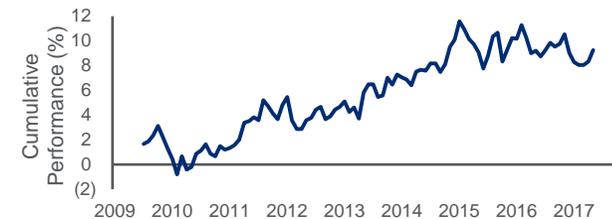
## Improve valuation

- Strong ESG companies see **lower systematic risk (market / macro), which is captured through a company's cost of capital**
- Meanwhile, better-rated firms **see lower firm-specific risk which can impact a company's future cash flows**
- In a DCF model, companies with a lower cost of capital and improved cash flows will have a higher valuation
- A **higher valuation means lower book-to-price** as the chart maps



## Greater returns & shareholder demand

- Companies in the highest ESG quintile saw a **stronger financial performance** than the bottom quintile
- Leading to **better cumulative returns and greater ability to return capital** to shareholders



# ESG Focus Driven by Industry

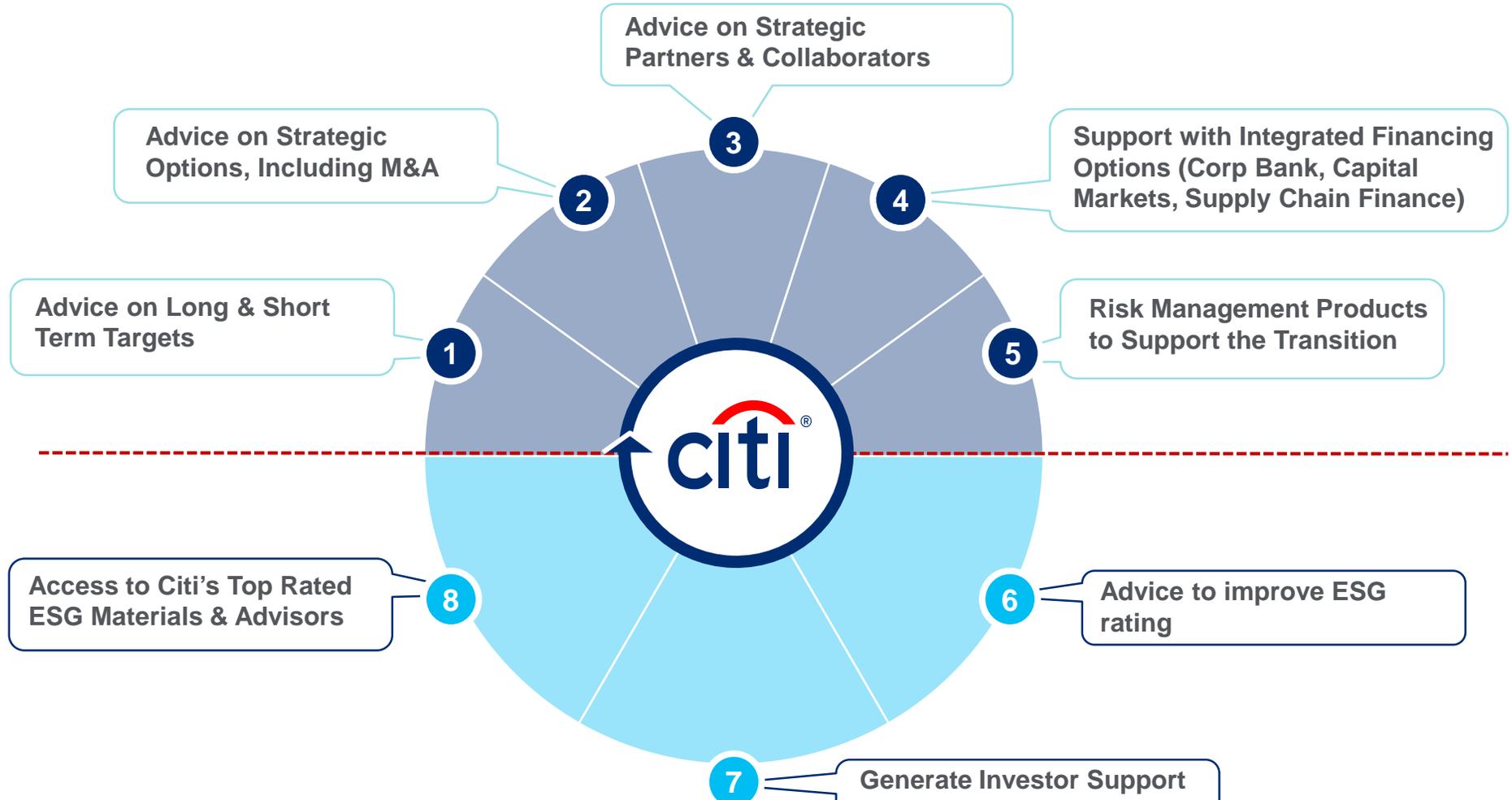
Citi has analysed the level of exposure to E, S, and G issues faced by each industry; understanding that exposure is critical to creating a focused strategy to help improve your ESG rating and screen better to investors.

	Paper & Packaging, Forestry	Real Estate	Hotels & Leisure	Chemicals	Building & construction	Cap goods	Food retail	Metals & Mining	Food manufacturing/HPC	Oil & gas	General Retail	Transport	Telecommunication	Business services/logistics	Utilities	Technology	Beverages	Luxury	Autos	Consumer staples	Aerospace & defence	Insurance	Media	Pharmaceuticals	Tobacco	Div Fins	Banks
<b>Social</b>																											
Food & hunger																											
Education																											
Gender equality																											
Communities																											
Future of work – AI & automation																											
Inequalities																											
Supply chains																											
Good health and wellbeing																											
Cyber Security/Big data/GDPR																											
Health & safety/injury																											
Labour issues																											
<b>Environmental/Physical</b>																											
Climate chg/emissions/efficiency/Clean & aff. energy																											
Energy storage, energy transition																											
Environmental impact																											
Circular economy																											
Waste management																											
Water																											
Sustainable Cities & Urbanisation																											
Infrastructure																											
<b>Governance</b>																											
Business ethics																											
Peace justice & strong institutions - politics																											
Bribery & Corruption																											
Regulation																											
Reporting, disclosure & transparency																											
Executive remuneration																											

NB: Darker shaded areas represent key issues as identified by Citi Research sector analysts in publications.

# Citi's Integrated Model

## Strategic & Financial Advisory



## Investor Support & Communication

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