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Forsyth Barr’s C&ESG Ratings of NZ corporates

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NZX Firm

FORSYTH BARR

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NEW ZEALAND QUANTITATIVE RESEARCH
5 DECEMBER 2023

Carbon & ESG Ratings of NZ Companies
Charting the Course of Change

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Despite economic uncertainty, geopolitical tensions, and a local election, NZ companies have continued to advance Carbon, Environmental, Social, and Governance (C&ESG) practices over 2023. The necessity for strong C&ESG credentials is clear and supported by a range of established drivers, including NZ's new Climate Disclosure Standards (CDS). Companies are making robust commitments, strengthening policies and embedding widespread action into business-as-usual (BAU) conduct. Even with a heightened focus on greenwashing, momentum continues to build.

We update our C&ESG analysis of NZ companies. Last year we released our inaugural C&ESG ratings for NZ companies under our equity research coverage. Our ratings act as C&ESG due diligence on NZ companies and support our fundamental investment research. The data we collect provides: (1) insight into how a company is preparing for a low-carbon future, (2) a measure of a company's competitive positioning, (3) a supplement for a screen of quality, and (4) a way to identify areas of risk beyond traditional financial analysis that may warrant further investigation.

This helps us better appraise companies and build confidence in the potential for long-term success. In creating our ratings we collected over 8,300 C&ESG-related data points and turned them into an overall score that classifies companies as a *Leader*, *Fast Follower*, *Explorer* or *Beginner*. Our full methodology is publicly available (refer to the separate Forsyth Barr 2023 C&ESG Rating Methodology document) as are the individual scorecards for each of the 58 companies we assessed. This transparency is crucial as we tackle the well-known challenges of ESG ratings. These 58 companies account for ~99% of the NZX's total market capitalisation and contribute ~11% of NZ's total greenhouse gas (GHG) emissions.

The findings of our 2023 project yield two overarching conclusions:

- **Companies are very engaged on this agenda, but external motivations such as regulation and affirmation by investors that sustainability is important are essential to ensure focus is retained. Especially in times of economic uncertainty and geopolitical tensions.** Sustainability practices are now BAU for the majority of companies that Forsyth Barr covers. Most companies now collect and report on a wide range of C&ESG data. With evidence of the growing number of companies meeting several of our criteria, we believe this framework is actively driving companies to improve their C&ESG practices. We emphasise the importance of the investor voice in ESG-related conversations.
- **The easy wins have been tackled.** We see tension between companies that are in the early days, with their sustainability agendas quickly jumping up the leaderboard, and with those that are a few years in, striving to achieve ongoing, tangible results. Except for a small group of *Leaders* we are yet to see commitments and measurement turning into positive outcomes for the environment and society.

The top three performers are Meridian Energy (MEL), Tourism Holdings (THL), and Precinct Properties (PCT). MEL sits at the top of the table for the second year running. This is a particularly commendable effort given that the framework has undergone a significant evolution as we have built on our insights from last year. We are intentionally moving from a focus on inputs and policy to one of actions and outcomes. Delegat Group (DGL) is the biggest improver, jumping two categories from *Beginner* to *Fast Follower*, skipping *Explorer* altogether. Other notable improvers include Property for Industry (PFI), Winton (WIN), Infratil (IFT), and Serko (SKO).

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Last data update:
31/08/2023

Company ticker:
CEN

A
Leader

	Grade	Score	Utilities Sector Average	New Zealand Average	Utilities Sector Weights
Carbon	A+	89%	75%	55%	20%
Environment	B-	54%	58%	46%	20%
Social	A+	84%	85%	71%	20%
Governance	A-	70%	63%	60%	40%
Total	A	74%	69%	60%	

Forsyth Barr Commentary

CEN remains in the Leader category this year and is fourth place in the market, ranking with an ambition to be a decarbonisation leader. CEN again scores well in the 'C', 'S', and 'G' categories. It misses out on a perfect 'C' score because it is not yet operating at net zero and is yet to have a fully developed climate transition plan. The 'S' score is high due to CEN's impressive health and safety record and human rights policy, as well as its disclosure of key diversity metrics. On the 'G' side, CEN scores relatively strongly across the board. The area of most potential improvement for CEN is in the 'E' category, where it lacks a waste management policy as well as a commitment to the circular economy.

Carbon		Metric	Data	Score	Weight	Group Score	Group Wgt
GHG Emissions	C1.1	Is scope 1 and 2 CO_2e (tonnes) tracked, measured and publicly reported by the company? If so, for how long has the data been collected?	5 years	1.00	20.00%	100.00%	33.33%
	C1.2	If five years of data, are scope 1+2 emissions increasing, stable or decreasing?	-31.03%	1.00	20.00%		
	C1.3	If five years of data, is carbon intensity increasing, stable or decreasing?	-29.76%	1.00	20.00%		
	C1.4	Has the company identified and publicly disclosed its most material scope 3 emission sources?	Yes	1.00	20.00%		
	C1.5	Is scope 3 CO_2e (tonnes) tracked, measured and publicly reported by the company? If so, for how long has the data been collected?	5 years	1.00	20.00%		
Emissions Management	C2.1	Does the company have an emissions reduction target or net zero commitment in place?	Yes	1.00	16.67%	66.67%	33.33%
	C2.2	If so, is the target an absolute and/or intensity measure?	Absolute	1.00	16.67%		
	C2.3	If so, has the target been verified/approved by the SBTi (or similar) as a science-based target?	Yes	1.00	16.67%		
	C2.4	Is there a clearly defined climate transition plan in place outlining the strategy to meet targets? If so, does the plan include decarbonisation efforts as well as specifying the role of existing/future climate solutions (i.e. technologies and products that will enable the economy to decarbonise)?	No	0.00	16.67%		
	C2.5	Is the company already operating at net zero and if so, how are offsets used to help meet targets?	No	0.00	16.67%		
	C2.6	Are there any material projects underway that will enable actual emissions reductions of more than -10% of total scope 1 and 2 emissions?	Yes	Unscored	0.00%		
	C2.7	Has the company introduced the concept of a 'just transition' into their climate ambitions?	Yes	1.00	16.67%		
Risk & Opportunity Management	C3.1	Has a physical risk and transition risk assessment been undertaken?	Both	1.00	33.33%	100.00%	33.33%
	C3.2	Has the company outlined how its assessment of climate-related risks and opportunities serves as an input to capital deployment and funding decisions?	Yes	1.00	33.33%		
	C3.3	Does the company own any proven or probable fossil fuel reserves?	No	1.00	33.33%		
C - Total							A+ (88.89%)

Environmental		Metric	Data	Score	Weight	Group Score	Group Wgt
Environmental Management Systems	E1.1	Does the company have an ISO 14001, EMS, Toitū Envirocare carbonzero or equivalent certification on all applicable sites?	Yes	1.00	33.33%	66.67%	33.33%
	E1.2	Has the company made commitments to new build or retrofit to meet level 4, 5 or 6 of the Green Star (or equivalent Homestar if relevant) standard in owned or leased buildings?	No	0.00	33.33%		
	E1.3	Has there been an environmental fine or breach (including any resource consent discharge breaches such as nutrient discharges) in the last three years?	No	1.00	33.33%		
Waste & Water	E2.1	Is there a commitment to reduce waste in place?	No	0.00	25.00%	62.50%	33.33%
	E2.2	If there is five years of data, is total waste to landfill increasing, stable or decreasing?	-16.60%	1.00	25.00%		
	E2.3	Is there a target for achieving water use reduction or water consumption efficiency?	Yes	1.00	25.00%		
	E2.4	If there is five years of data, is total water use increasing, stable or decreasing?	-4.00%	0.50	25.00%		
Biodiversity & Circular Economy	E3.1	Is there a commitment by the company to preserve and protect biodiversity and/or natural ecosystems?	Yes	1.00	33.33%	33.33%	33.33%
	E3.2	Does the company voluntarily report against the TNFD framework?	No	0.00	33.33%		
	E3.3	Is the company actively engaged in implementing circular economy principles into their business model?	No	0.00	33.33%		
E - Total							B- (54.17%)

Why did we develop our own C&ESG scores?

- Currently, different ESG rating agencies provide diverging ESG ratings
    - Unique methodology; different attributes, measures, motivations and data sources
- We have chosen which ESG data we want to collect and created a scoring system that we understand
    - Transparent, relevant and future focused
    - We put emphasis on what we think is important
- We tried to tackle the key criticisms of ratings
    - Disaggregated the score
    - Full transparency on the methodology and findings via company scorecards

Building this analysis into our usual fundamental analysis gives us a well-rounded, holistic lens that considers a company's financial health as well as an assessment of how well it is planning for a low carbon, more sustainability focused economy.

Why split Carbon out?

We have split Carbon out from Environment because:

- It is such a significant factor on its own; allows separate analysis
- It can dominate what goes into an ‘E’ score; we do not want to lose sight of the importance of the other environmental matters
- We want to give appropriate weight to the carbon transition currently underway
- You can have a separate carbon score or merge it with the E score

Objectives

Our objectives in developing C&ESG scores. We want to know that companies are:

- Adhering to best practice C&ESG standards
- Managing and navigating C&ESG related risks and opportunities
- Positioning themselves for a low carbon, more sustainable future
- Thinking about their impact on the world
- Adapting to the ever-increasing demands of different stakeholders

Our C&ESG scores are a measure of a company's competitive positioning on C&ESG, they supplement a screen for quality and they help to identify areas of risk beyond traditional financial analysis that warrants further investigation. In a nut shell, they help us to better appraise companies and build confidence in the potential of their long-term success.

How to use the C&ESG ratings

For investors:

- As a quantitative feed into financial screening tools (ESG integration)
- As an engagement tool to drive better discussions with company management on ESG issues
- Premium/discount to cost of equity

The scorecards:

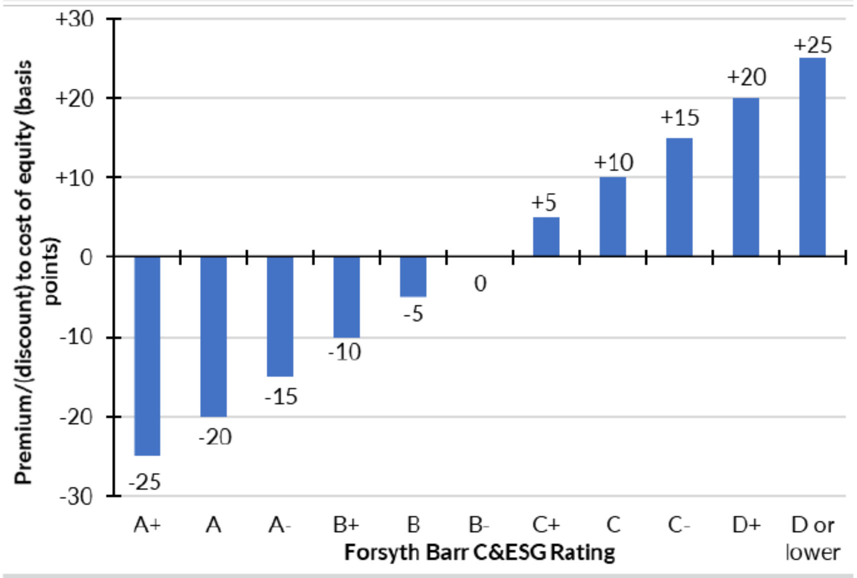
- Add investor C&ESG DD on NZ companies
- Help identify key C&ESG risks and opportunities for companies
- Identify which companies are managing C&ESG risks well and which are positioning themselves for a low carbon, more sustainability-focused future

For corporates:

- Provide insights on what is really important to investors
- Enable a company to see how it compares to its peers and the NZ market
- See their strengths and weaknesses and plan out a programme for improving C&ESG performance

Forsyth Barr has integrated C&ESG scores into cost of capital

… on an overall neutral basis. Companies scoring A+ benefit from a -25 bps reduction in their cost of equity. In contrast, companies scoring D or lower receive a +25 bps increase in their cost of equity.



Source: Forsyth Barr analysis

Our impact

Impacts of C&ESG ratings report
Improving practices
Requests from companies for specific feedback
Requests from companies for examples of good performance
Direct engagement with companies
Use by other influencing organisations
Use of ratings by institutional investors
Board awareness of the ratings
Companies releasing a press release or mentioning their score in public disclosures
Companies requesting advice on which ESG surveys to respond to or the best way to disclose ESG information to many stakeholders

Changes for 2024…

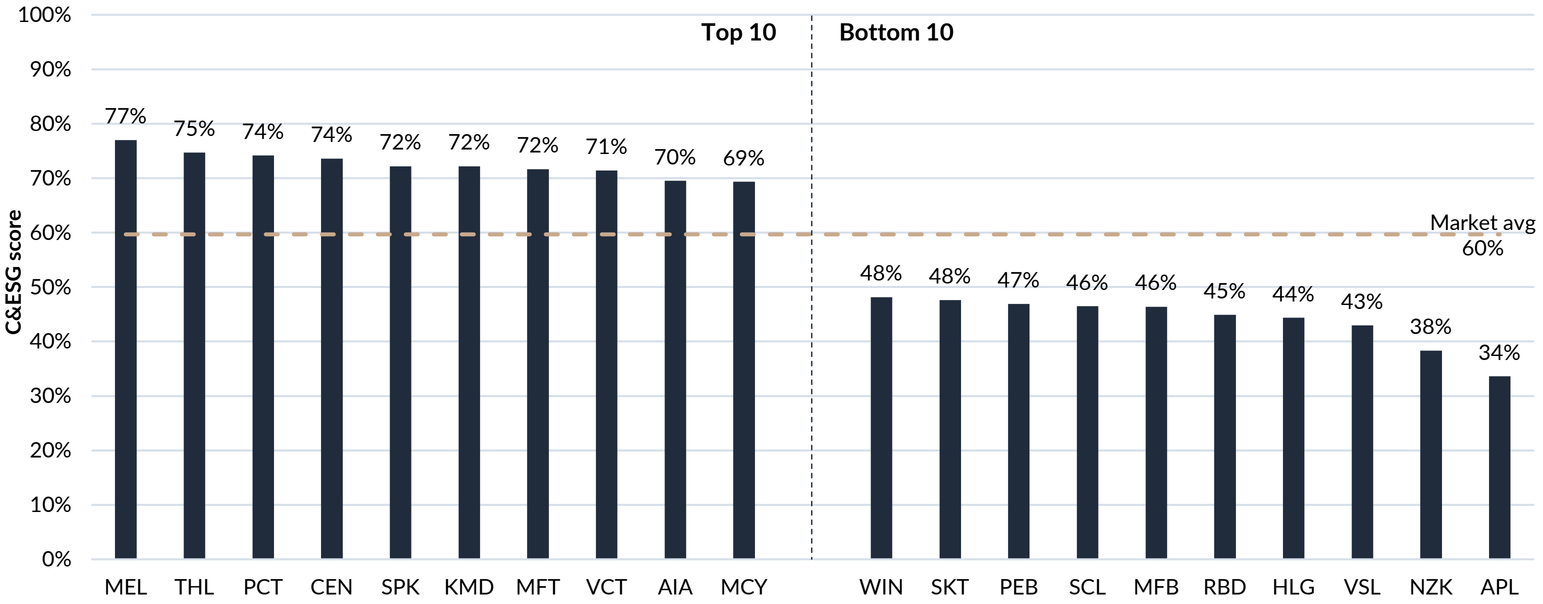
- Continue to raise the bar as our insights deepen and we find better ways to assess the quality of responses
- Continue to intentionally move from a focus on inputs and policy to one of outcomes and action
- Continue to reduce the number of questions
- Draw out insights on companies that are choosing to focus on fewer but more material elements of C&ESG versus those doing everything
- Specifically:
    - Improve the water metrics
    - 43/58 companies have linked remuneration to improving ESG performance – but is it driving the right performance?

2023 Results

Findings

- NZ companies are genuinely engaged on the topic of improving sustainability.
- Sustainability practices are now BAU but we are yet to see commitments and measurement turning into real outcomes for the majority of the market.
- We see a tension between those that are in the early days with their sustainability agendas and those that are a few years in and have already tackled the low hanging fruit.
- Fear of greenwashing allegations is causing a tightening of wording in disclosures and driving better accountability mechanisms.
- Companies are committed to reducing their emissions but clarity on how and the pathways to achieve reductions are still opaque.
- Four companies hold the lever on driving real change in terms of scope 1 and 2 emissions reduction (AIR, GNE, FSF, FBU). But, with increasingly frequent and severe climate events affecting the very fabric of New Zealand life, all mitigation and adaptation efforts are needed to build resilience for an uncertain future. All companies have an obligation to act.
- Controversies have contributed to the scores being lower this year – notably: SKC, FBU, ATM (carry over from 2022).

Top and bottom performers - 2023



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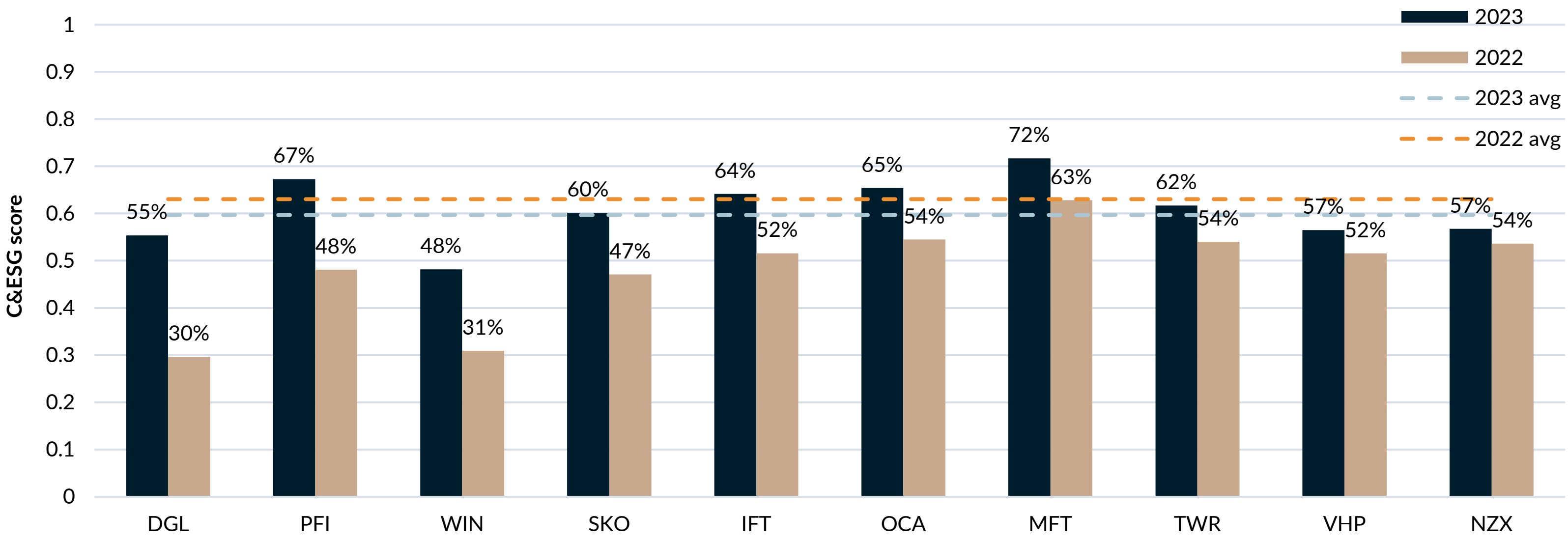
Most improved - 2023



What the leaders are doing well

- Already well prepared to meet the Climate Disclosure Standards.
- Absolute emissions are starting to trend down.
- Improving disclosure on the most material scope 3 emissions sources.
- Committed to circular economy principles.
- Seek to differentiate the company with a concerted focus on employee value proposition, diversity and inclusion, mental health & wellbeing (recognising the benefits of attracting and retaining talent).
- ESG strategies are predominantly integrated into business models.
- Remuneration is linked to improving ESG performance – but we need additional information on whether its driving the right performance.
- External assurance on sustainability disclosures (wider than GHG inventories).

However, none of the leaders are perfect on all the criteria. Therefore a greater focus on assessing outcomes becomes important as we evolve our framework going forward.

Areas for improvement

- Disclosure is improving but there are still too few companies that have actually managed to reduce actual emissions.
    - Only 12 companies have five years of data and are decreasing their scope 1 and 2 emissions.
- Data collection is improving causing problems for companies with comparing year on year changes.
    - A large cohort of companies have considerably increasing scope 3 emissions inventories as the breadth of what companies are including in their scope 3 emissions grows; large increase in waste to landfill.
- Only 21 companies reported payment of KiwiSaver continuing through both paid and unpaid parental leave.
- Only 4 companies are accredited living wage employers: GNE, HGH, TWR, VCT.
- Only 3 companies committed to TNFD: AIR, GNE, MEL.
- Employee turnover has been increasing for 7/9 companies that have been reporting this data for 5 years or more.
    - The remaining two companies have had their turnover remain steady; no companies have reported decreasing turnover over the last five years.
- Auditor tenure: 27/58 companies have had the same auditor for greater than 10 years - risk of compromising the independence of the auditor remains.
- Only 38 companies have sufficient gender diversity on their boards (i.e. < 2/3 either gender).
    - Only three companies have majority female boards (CEN, MEL, NZX) and MEL and CEN are ranked overall (1st and 4th).

What the C&ESG ratings tell us

Maturity level	C&ESG Score	Description
Leader	A	• Full sustainability strategy in operation for multiple years, often having been updated and refined over time • Detailed and full set of C&ESG metrics collected • Predominantly meeting best practice standards • Recognises key C&ESG risks and opportunities and is managing them • Well versed on stakeholder demands and how they are evolving • Understands its potential positive and negative impacts on the environment, economy, and people, including human rights • Transition to become a ‘sustainable’ company is well underway • Well prepared for the upcoming CDS • Actual GHG emissions are stabilising or trending down.
Fast Follower	B	• Earlier stage sustainability strategy • Partial collection of C&ESG metrics, potentially with a heavier focus on one of the C, E, S, or G categories • Sometimes meets best practice standards • Has a handle on key C&ESG risks and opportunities and has started measuring C&ESG performance but is not yet seeing deep progress on sustainability results • The transition to become a ‘sustainable’ company is more a vision than a reality.
Explorer	C	• Earlier stage of adopting or implementing a sustainability strategy • Few C&ESG metrics collected with a short history • On the journey towards meeting some best practice standards.
Beginner	D	• First sustainability strategy under discussion or not yet existent • Reporting few C&ESG metrics • Really only at the very beginning of the C&ESG journey.

Source: Forsyth Barr Analysis