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focus

ESG: Charting the course of change

Forsyth Barr has updated its Carbon, Environmental, Social, and Governance (C&ESG) ratings for New Zealand companies. One year on and we find companies are making robust commitments, strengthening policies, and making sustainability practices business-as-usual, despite geopolitical tensions and volatile market conditions.

FORSYTH BARR

...The transition to a more sustainability-focussed economy is underway...

The transition to a more sustainability-focussed economy is underway. From an investment perspective, understanding how companies are navigating the transition can help us assess how well they are preparing for a low-carbon future. The transition provides both risks and opportunities for companies. With growing regulation and changing consumer and investor preferences, company executives must successfully manage a business from a strategic and operational perspective, while also thinking long term about managing the necessary transition.

We have converted C&ESG data into a useful benchmark. In creating our ratings we collected over 8,300 pieces of C&ESG data across 58 of New Zealand's largest listed companies. We turned the data into an overall score for each company, classifying them as a Leader, Fast Follower, Explorer, or Beginner. Our full methodology is available (refer to the separate *Forsyth Barr 2023 C&ESG Rating Methodology* document) as are individual *scorecards* for each of the companies we assessed. This enables advisers and clients to look at how portfolio companies are performing on important C&ESG metrics.

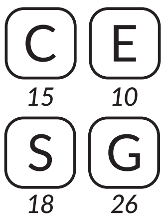
Our findings

Overall, we found that NZ companies are genuinely engaged on the topic of improving sustainability practices. At a global level, navigating the net-zero economy became relatively complicated last year amid intensifying geopolitical tensions, which fuelled higher energy prices. In addition, a backlash against ESG in the US, supply chain pressures, elevated interest rates, higher input costs (alongside muted economic growth) collectively represented a considerable challenge for companies wanting to build on and extend their sustainability commitments.

In New Zealand, we found that the majority of companies are proactively embracing the trend, but not all. There are still a few reluctant participants driven by compliance alone. That said, the overarching picture is that there are no signs of a back down on sustainability commitments in NZ.

8300+ C&ESG data points

69 assessable C&ESG metrics per company



58 individual company scorecards

Leaders (11)	MEL, THL, PCT, CEN, SPK, KMD, MFT, VCT, AIA, MCY, SUM
Fast Followers (33)	CVT, FPH, GMT, PFI, GNE, STU, KPG, FBU, AFT, OCA, IFT, NPH, AIR, FSF, CNU, SPG, ARV, TWR, SKO, SML, CHI, ARG, SAN, NZX, SKC, MNW, ATM, DGL, SKL, VHP, IPL, WHS, FRW
Explorers (13)	POT, EBO, RYM, HGH, WIN, SKT, PEB, MFB, SCL, RBD, HLG, VSL, NZK
Beginners (1)	APL

...diversity leads to better corporate governance...

However, while sustainability practices are now largely becoming part of business-as-usual, we are **yet to see evidence that commitments and measurement are turning into real outcomes** for the majority of the market. For example, 44 companies have commitments to reduce their greenhouse gas emissions but of the 33 companies that have been reporting this data for more than five years, only 12 companies are showing a decline in absolute emissions. We also observe that disclosure on how companies are planning to meet their targets is still very opaque.

Within the group of leaders, **we identified some clear standout behaviours.** 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 — a particularly commendable effort. These companies are seeking to differentiate themselves with a concerted focus on evolving their practices to have a positive impact on the environment. These companies also offer thoughtful employee value propositions, showing they understand the benefits of attracting and retaining talent.

They are also adherring to best practice corporate governance standards and linking the remuneration of executives to improving ESG practices. Delegat Group (DGL) was the biggest improver over the year.

Despite the progress we have seen in one year, there are **a number of areas where improvement across the market is required.** Building robust data collection methods is one area. Gender diversity on boards is another. Diversity is important as it brings a broad range of perspectives, experiences, and expertise to decision-making. There is research to show that diversity leads to better corporate governance and company performance*. In addition, it helps to contribute to a more inclusive and equitable society. Gender diversity on boards has been improving over recent years but our research shows that 34% of boards still comprise greater than two-thirds of one gender. Another area of key concern is that 47% of companies have had the same auditor for more than 10 years. We view relationships of greater than 10 years to be at risk of compromising the independence of the auditor.

*Effect of Board Diversity on Corporate Governance Structure and Operating Performance: Evidence from the UK Listed Firms, James Oladapo Alabede, 2016

...C&ESG scores help us look beyond traditional financial metrics...

In conclusion

This piece of research has become important to Forsyth Barr as we gain interesting insights into how New Zealand companies are transitioning to a more sustainability focussed future. It is important that we have a voice on this subject, reinforcing to companies that this agenda is of value to investors. C&ESG scores help us look beyond traditional financial metrics, they supplement a screen for quality and they help to identify areas of risk beyond traditional financial analysis that may warrant further investigation. In a nut shell, they help us to better appraise companies and build confidence in the potential for long-term success.

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If at any time you want to discuss investment options and opportunities, your Forsyth Barr Investment Adviser is available to provide you advice and assistance.

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