

*Leaders Do Better: The Relationship between
the Environmental and Financial
Performance of Companies*

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The Relationship between the Environmental and Financial Performance of Companies:

Contents:

- Why Environmental Performance Is Relevant to Managers/Investors/Government Officials*
- Quantitative Rating Models*
- Results for a Variety of Industries/Indexes*
- Conclusions for Managers/Investors/Officials*

Why Environmental Performance Is Relevant:

The Global Impact of Environmental/Social Issues:

- Over 80% of UK pension managers planning to use some sort of environmental/social investment strategy***
- In France, the number of SRI funds has grown from 4 to over 25 over the past 5 years***
- In the USA, SRI fund assets have grown from \$695b in 1997 to \$2.16T in 2003 (11.3% of mutual fund assets)***
- 95 investment groups representing nearly \$10T in global assets under management have written letters to CEO's of 500 largest companies asking about their carbon risk.***

Why Environmental Performance Is Relevant:

Global Impact of Environmental/Social Issues (Cont.):

- *In Japan, 7 new environmental funds raised \$2.5b of assets in 2 years- one fund raised \$250m in 6 weeks*
- *Dow Jones launched a Global Sustainability Index based upon their Dow Jones Global Index.
(the 200 firms in the Index have, on average, higher ROE, ROI, ROA and expected earnings, than DJGI companies)*
- *Several leading global financial institutions provide environmental ratings to all their equity analysts*
- *Post-Enron, a good environmental image is starting to be recognized as a major intangible asset for companies*

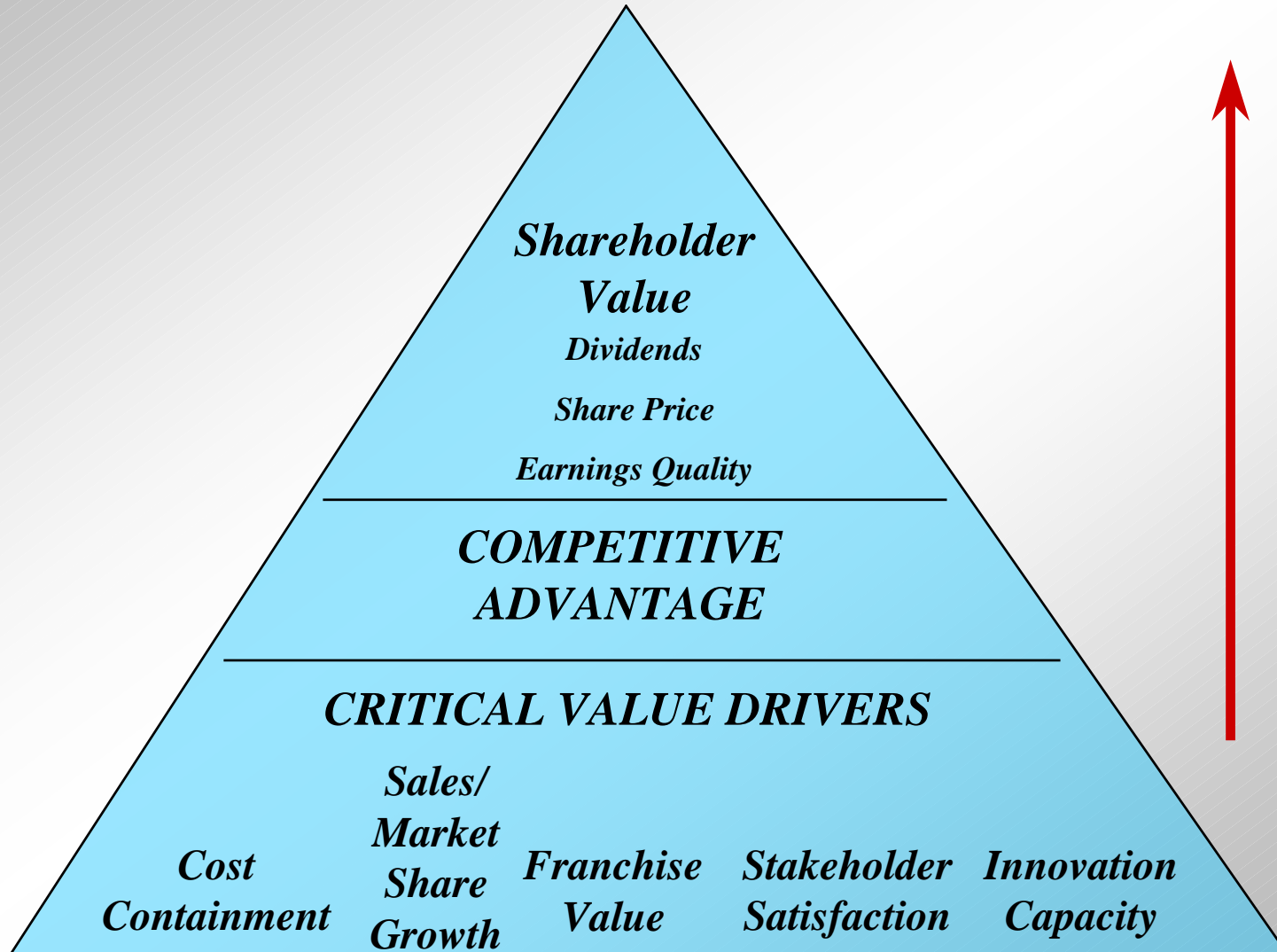
Why Environmental Performance Is Relevant:

The Drive to Efficiency and Shareholder Value:

- *The financial markets have favored companies that are efficient and create value for shareholders on a consistent, sustainable basis (i.e., not Enron!)*
- *Many recent corporate re-structurings have been driven by a desire to meet these expectations*
- *However, “fiduciary responsibility” was said to prevent asset managers from looking at environmental information; now, they may be in violation of their fiduciary responsibility if they don’t....*

Why Environmental Performance Is Relevant:

ENVIRONMENTAL PERFORMANCE DRIVES SHAREHOLDER VALUE



ENVIRONMENTAL OUT-PERFORMANCE

Quantitative Indicators of Environmental Performance:

- *Management and eco-efficiency performance have correlated well with financial results, but social data has not (yet), and it may take 3-5 years until we have enough social data to find possible correlations, if any*
- *However, management and investors that ignore social issues, do so at their own risk, especially with rapidly-changing global investor demographics & stakeholder concerns and issues like climate change*
- *Experience says asset managers tend to financial issues & clients decide which social issues are key*

EcoValue'21: Quantifying Environmental Performance:

EcoValue'21 analyzes 60+ key variables using over 20 data sources:

Historical Contingent Liabilities:

- Superfund
- State and hazardous waste sites
- RCRA
- Toxic torts

Financial Risk Efficiency Capacity

- Balance sheet strength
- Insurance cover adequacy

Operating Risk Exposure:

- Toxic emissions
- Product risk liabilities
- Hazardous waste disposal
- Waste discharges
- Supply chain management risk

**EcoVALUE '21
RATING**

Managerial Efficiency Capacity

- Strategic corporate governance capability
- Environmental management systems strength
- Environmental audit/accounting capacity
- Supply chain management
- Training capacity and intensity
- Generic environmental management protocols
- Relationships with stakeholders
- Industry-specific protocols

Eco-Efficiency and Sustainability Risk:

- Energy intensity and efficiency
- Raw materials & natural efficiency and intensity
- Product life-cycle durability/ recyclability
- Exposure to shifts in consumer values

Strategic Profit Opportunities

- ability to profit from environmentally-driven industry and market trends

The Innovest Rating

Sample Ratings

Rating Matrix

Ticker	Company	Score	Rating	Rank
7203	Toyota Motor	1556	AAA	1
7267	Honda Motor	1529	AAA	2
VOW	Volkswagen Group	1454	AA	3
RNO	Renault SA	1304	A	4
UG	PSA Peugeot Citroen	1280	A	5
7201	Nissan Motor	1266	BBB	6
FIA	Fiat SPA	1266	BBB	7
F	Ford Motor Company	1258	BBB	8
DCX	Daimler Chrysler	1244	BBB	9
BMW	Bayerische Motoren Werke	1157	BB	10
GM	General Motors	1136	BB	11

The Link Between Environmental & Financial Performance: The Innovest Model as a Tool

- *A 1998 PWC study said 54% of investors felt that environmental performance was particularly valuable in making investment decisions. Why? - Sustainable earnings/long-term shareholder value-creation are key components of strong management.*
- *The Innovest Model quantifies hidden value potential not currently captured by traditional Wall Street research models.*
- *The current “Environmental Premium”: 1-4% for diversified portfolios, 5-25+% in high environmental-impact sectors.*
- *Bottom line: environmental performance can strengthen - or harm - shareholder value, and thus investor returns.*

How E. P. Models are Used by Financial Institutions

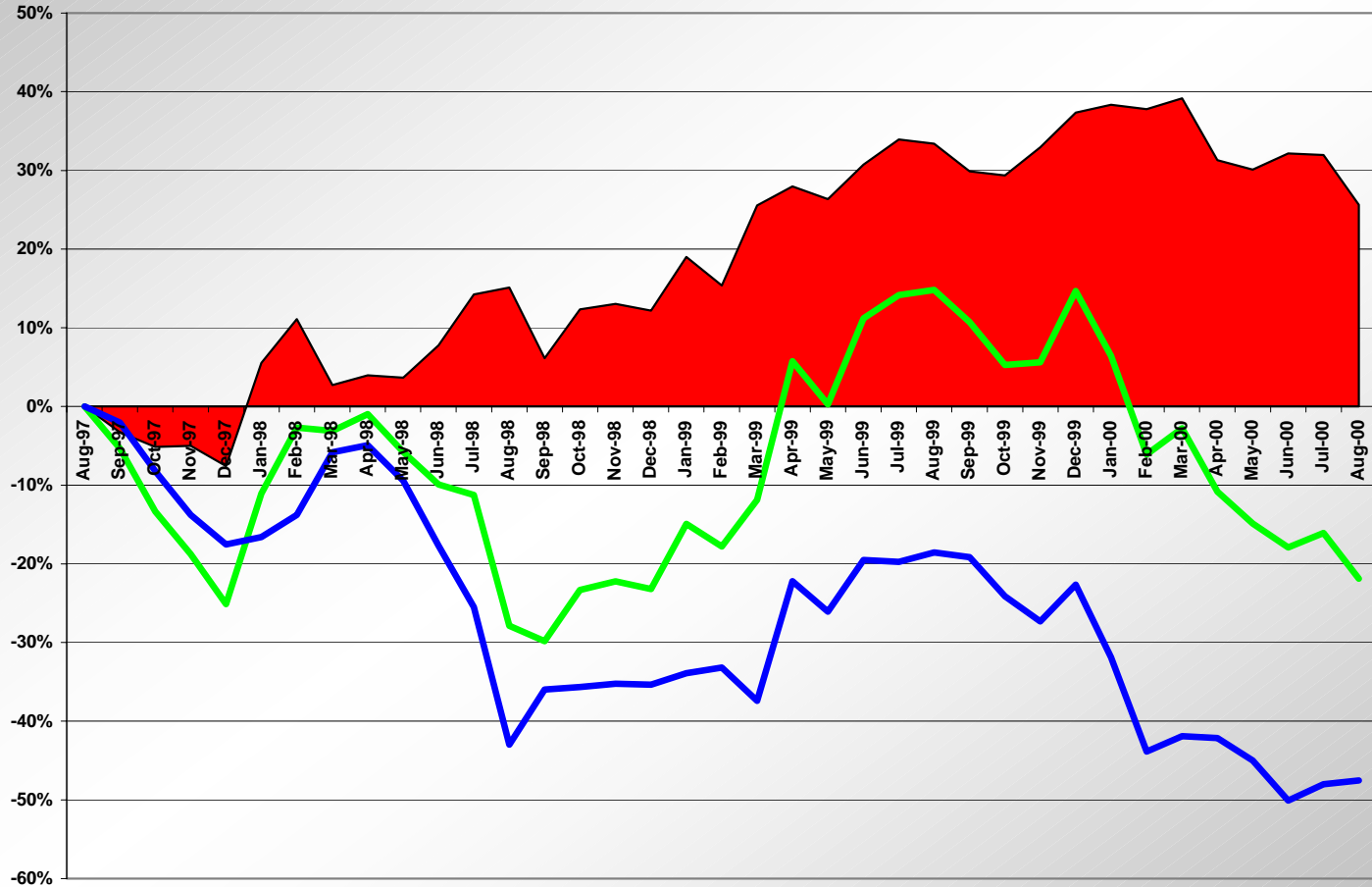
Used as a Screen with a Variety of Investment Strategies:

- *Enhanced S&P 500 Index Funds*
 - *Contra Costa County, State Street Global Advisors*
- *Active Investment Strategies*
 - *T. Rowe Price/Daiwa Global Eco-Fund - June 2001*
 - *ABP (Dutch pension fund) US/Euro Ethical Funds*
- *Can be applied to value, growth, technology, etc., approaches*

Other Environmental Investment Approaches:

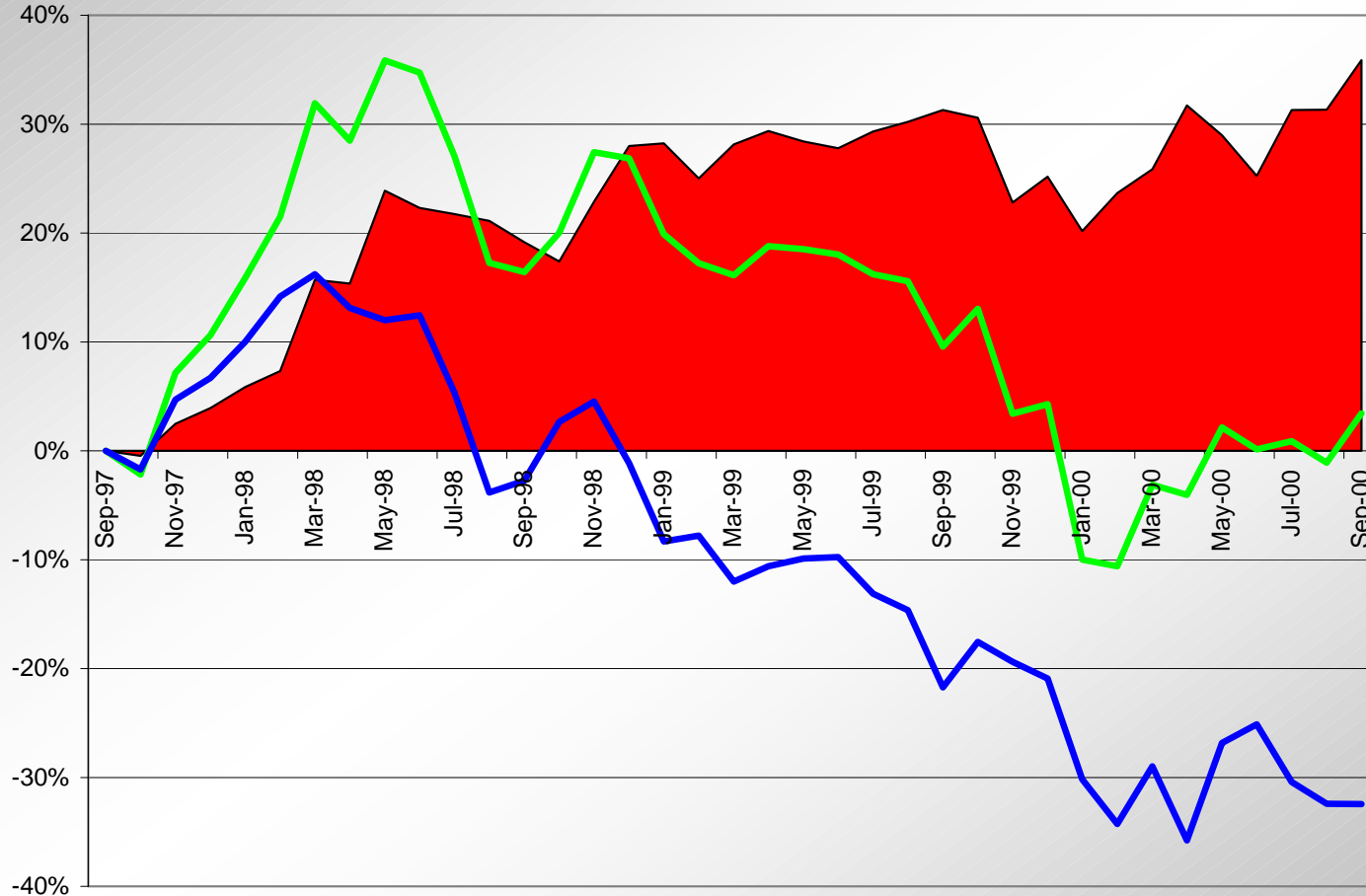
- *Sustainable Asset Management (SAM) sustainability approach.*
- *Trucost PLC environmental economics approach.*
- *Core Ratings- Environmental risk analysis model approach.*
- *Traditional SRI approaches (negative screening).*

Innovest Sample Results: Steel Sector- 3 Years



	A-97	S-97	O-97	N-97	D-97	J-98	F-98	M-98	A-98	M-98	J-98	J-98	A-98	S-98	O-98	N-98	D-98	J-99	F-99	M-99	A-99	M-99	J-99	J-99	A-99	S-99	O-99	N-99	D-99	J-00	F-00	M-00	A-00	M-00	J-00	J-00	A-00
Difference	0%	-3%	-5%	-5%	-8%	6%	11%	3%	4%	4%	8%	14%	15%	6%	12%	13%	12%	19%	15%	26%	28%	26%	31%	34%	33%	30%	29%	33%	37%	38%	38%	39%	31%	30%	32%	32%	26%
Top Half Average	0%	-5%	-13%	-19%	-25%	-11%	-3%	-1%	-6%	-10%	-11%	-28%	-30%	-23%	-22%	-23%	-15%	-18%	-12%	6%	0%	11%	14%	15%	11%	5%	6%	15%	6%	-6%	-3%	-11%	-15%	-18%	-16%	-22%	
Bottom Half Average	0%	-2%	-8%	-14%	-18%	-17%	-14%	-6%	-5%	-9%	-18%	-25%	-43%	-36%	-36%	-35%	-35%	-34%	-33%	-37%	-22%	-26%	-20%	-20%	-19%	-19%	-24%	-27%	-23%	-32%	-44%	-42%	-42%	-45%	-50%	-48%	-48%

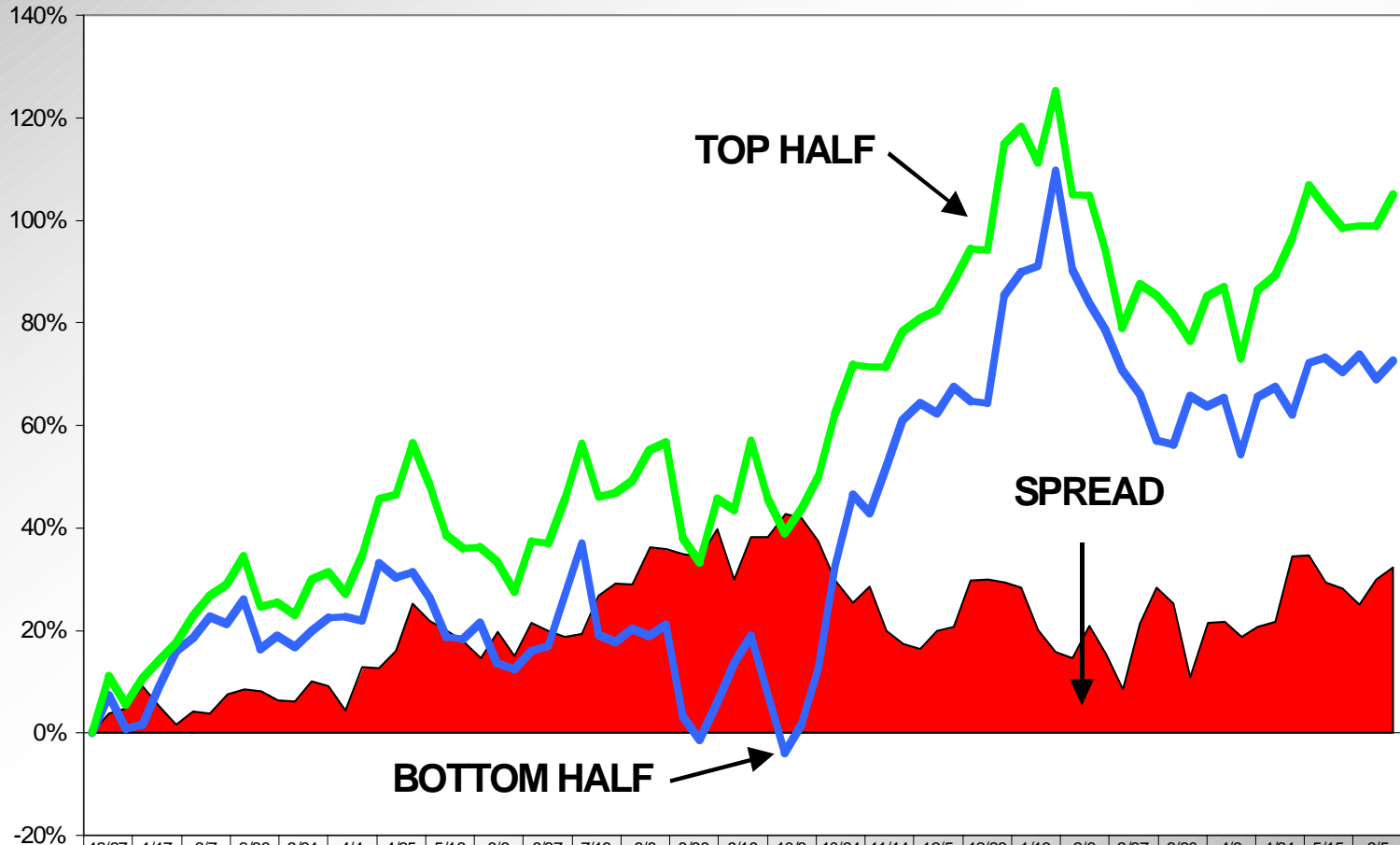
Innovest Sample Results: Food Sector- 3 Years



	S-97	O-97	N-97	D-97	J-98	F-98	M-98	A-98	M-98	J-98	J-98	A-98	S-98	O-98	N-98	D-98	J-99	F-99	M-99	A-99	M-99	J-99	J-99	A-99	S-99	O-99	N-99	D-99	J-00	F-00	M-00	A-00	M-00	J-00	J-00	A-00	S-00
Difference	0.0%	-0.5	2.5%	3.9%	5.9%	7.3%	15.7	15.4	23.9	22.3	21.7	21.1	19.2	17.4	22.9	28.0	28.2	25.0	28.1	29.4	28.4	27.8	29.3	30.2	31.3	30.6	22.8	25.2	20.2	23.7	25.9	31.7	29.0	25.3	31.3	31.3	35.9
Top Half Average	0.00	-2.16	7.18	10.6	15.8	21.4	31.9	28.4	35.8	34.7	27.0	17.2	16.4	20.0	27.4	26.8	19.9	17.2	16.1	18.7	18.5	18.0	16.2	15.5	9.56	13.0	3.41	4.26	-9.98	-10.6	-3.10	-4.05	2.14	0.13	0.88	-1.08	3.44
Bottom Half Average	0.00	-1.69	4.70	6.70	10.0	14.1	16.2	13.1	11.9	12.4	5.32	-3.83	-2.75	2.64	4.53	-1.13	-8.33	-7.78	-12.0	-10.5	-9.89	-9.77	-13.1	-14.6	-21.7	-17.5	-19.3	-20.9	-30.1	-34.2	-28.9	-35.7	-26.8	-25.1	-30.4	-32.4	-32.4

Innovest Sample Results: 1998- Computers Sector

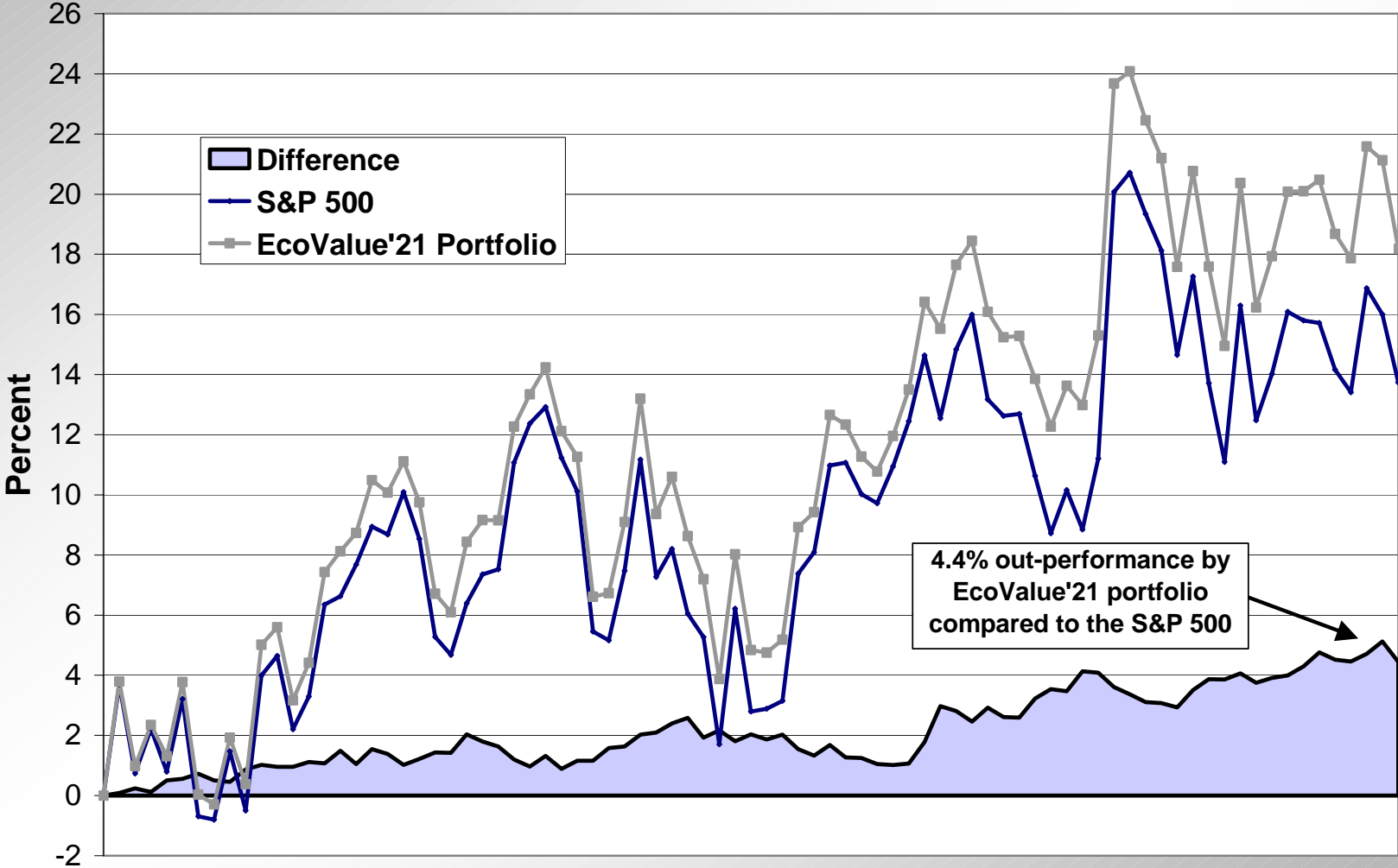
EcoValue '21 - Computer Subset
1-98 to 6-99 Stock Performance
Top Half vs. Bottom Half



	12/27	1/17	2/7	2/28	3/21	4/4	4/25	5/16	6/6	6/27	7/18	8/8	8/29	9/19	10/3	10/24	11/14	12/5	12/26	1/16	2/6	2/27	3/20	4/3	4/24	5/15	6/5
Difference	0.0%	9.1%	4.2%	8.5%	6.2%	9.0%	12.7%	21.9%	14.7%	21.5%	19.4%	28.9%	34.9%	29.9%	38.2%	37.4%	28.6%	16.3%	29.7%	28.3%	14.7%	8.4%	25.3%	21.5%	20.7%	34.6%	25.1%
Top Half Average	0.0%	10.6%	22.8%	34.4%	23.0%	31.4%	45.7%	48.3%	36.2%	37.3%	56.3%	49.0%	38.0%	43.5%	45.6%	49.9%	71.4%	80.7%	94.4%	118.2	105.0	79.0%	81.6%	85.1%	86.3%	106.8	98.8%
Bottom Half Average	0.0%	1.5%	18.5%	25.8%	16.8%	22.3%	33.0%	26.5%	21.4%	15.9%	37.0%	20.1%	3.1%	13.6%	7.4%	12.5%	42.9%	64.3%	64.7%	89.9%	90.2%	70.6%	56.3%	63.6%	65.5%	72.2%	73.7%

Innovest Results: Enhanced S&P Index Fund

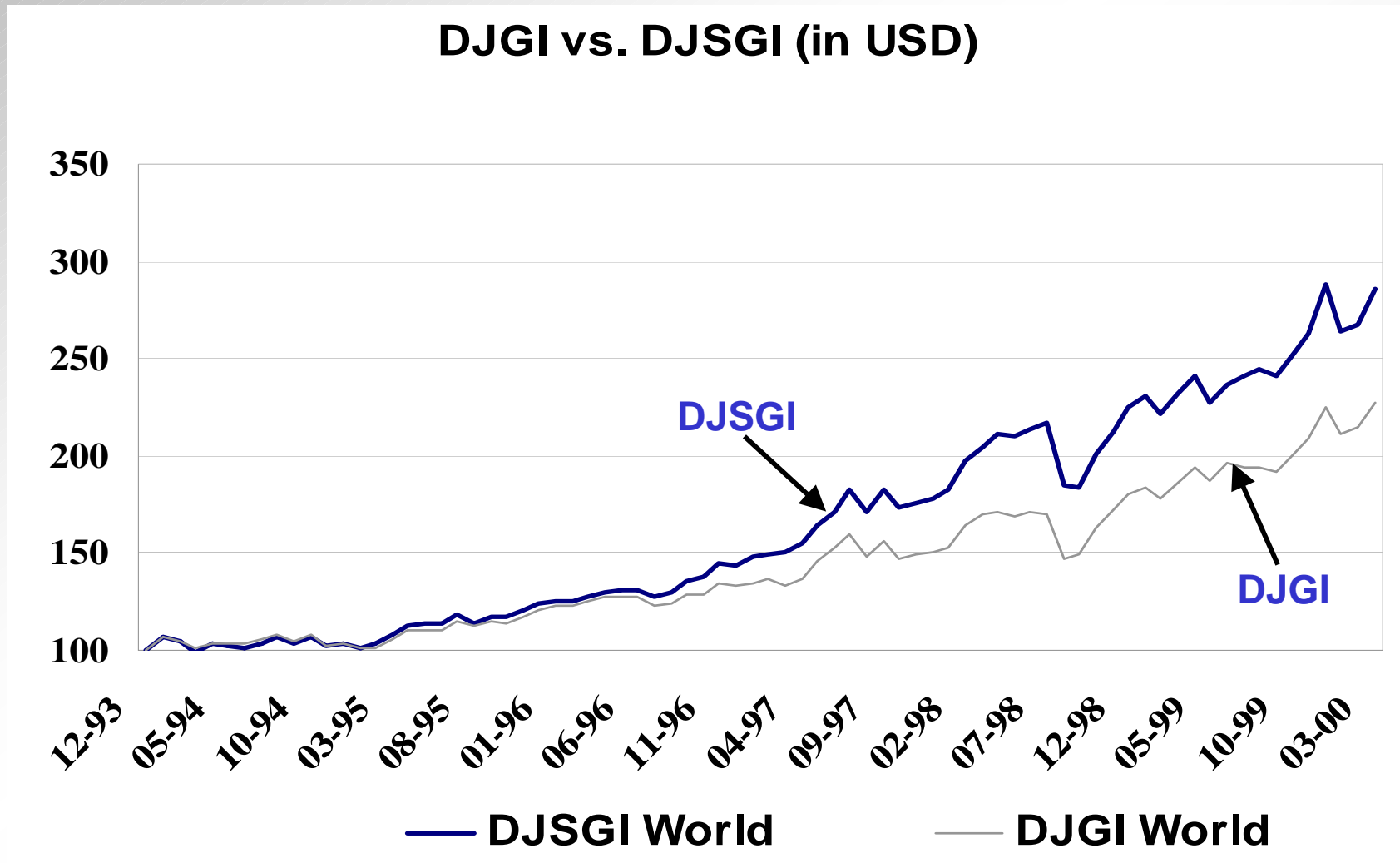
EcoValue'21 Portfolio
Relative Performance Since 12/31/98 through 6/30/00 vs. S&P 500



SAM/DJSG I Performance

DJSGI World Index

(December 1993 – March 2000, US Dollar, Price Index)



The Next Big Investment Issue- Climate Change Risks

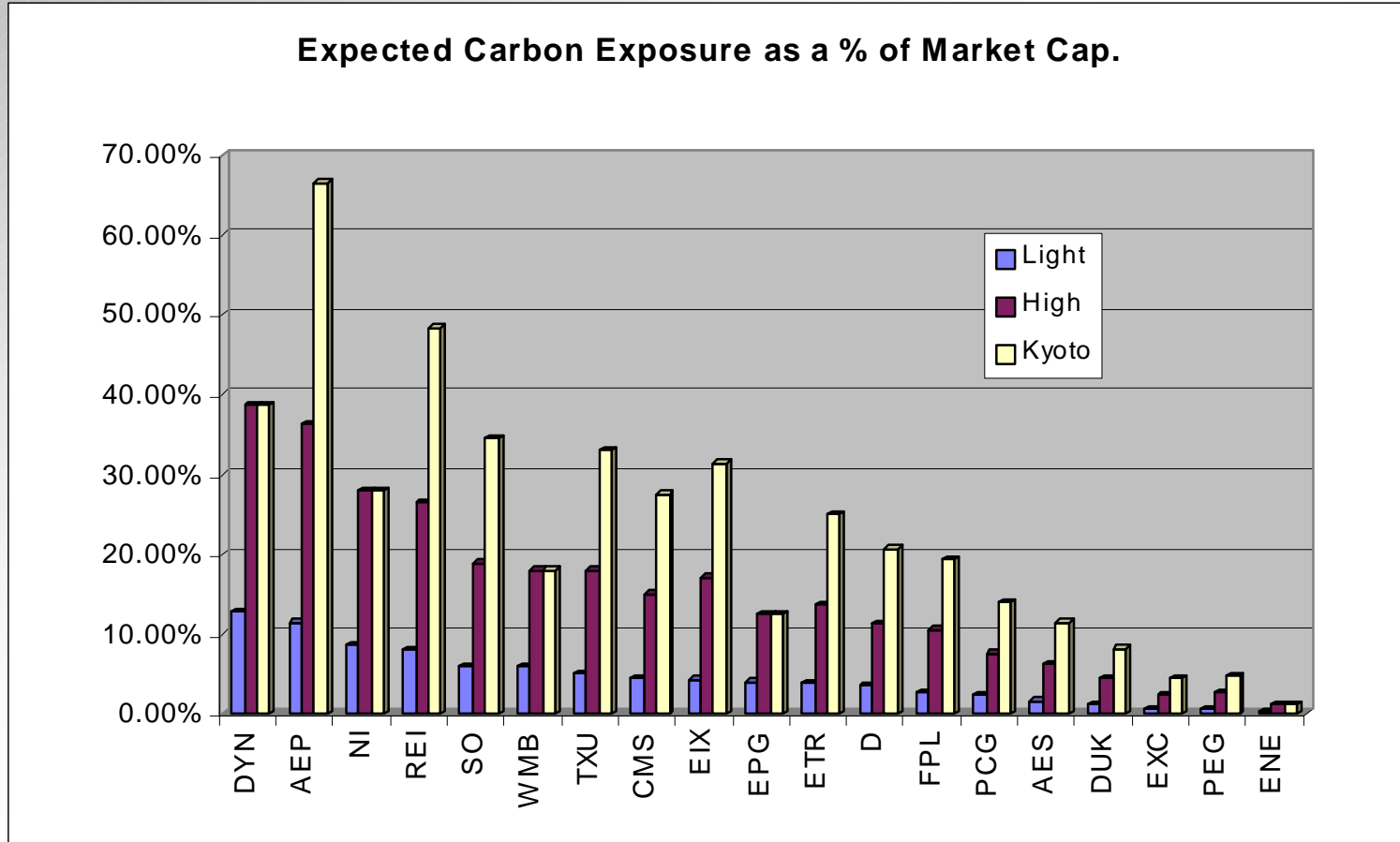
Climate Change will have real financial impacts:

- **Health Insurance-** “Climate change will lead to a resurgence in infectious disease unseen since the 19th century”
 - **Paul Epstein, Harvard Medical School**
- **Property Insurance-** “World-wide economic losses due to natural disasters appear to be doubling every ten years, and have reached \$1 trillion over the past 15 years”
 - **Munich Re**
- **Impact on Government Expenditures-** “UK government losses from floods and coastal erosion will double in next decade”
 - **UK Department of Trade & Industry**

Climate Change will have real financial impacts:

- - **Impact on Competitive Advantage- “STMicroelectronics will have a \$100m /yr. cost advantage over our U.S. competitors because of energy-efficiency improvements we are making to meet Kyoto Protocol requirements”
- Pasquale Pistorio, CEO, STM**
- **Impacts on Legacy Liabilities- Representatives of 50 state Attorney Generals (including 16 AG’s) met at Columbia University Law School last week to discuss Legal Issues of Climate Change.
Discussion centered around “...will carbon emissions be the next asbestos, tobacco, or Superfund financial problem for corporations/insurers and governments?”**

Why Investors Interested: Climate Change Financial Impact



Source: Value At Risk, CERES/Innovest, 2002

Implications for Managers/Investors/Officials:

Using E.P. Ratings to Create Competitive Advantage:

- Need to integrate environmental issues into marketing, sales, R&D, & business strategy, not just operations
- Must increase disclosure to stakeholders/regulators about:
 - The inputs (materials, energy, etc.) to products and services
 - Infrastructure operations impacts, global & local
 - Product/service end use impact
- Positives and negatives need to be discussed
- Innovation & good management are critical to success

Implications for Managers/Investors/Officials:

Using E.P. Ratings to Create Competitive Advantage:

- Institutional investors are starting to consider ratings in corporate governance reviews, in voting proxies and in screening of portfolios; retail investors also interested.
- Connecticut is the first state in the USA to legally require their state pension funds to consider social and environmental issues in their fund investment strategy.
- Some government economic development agencies are trying to attract only highly-rated companies to their communities.

Implications for Managers/Investors/Officials:

Using E.P. Ratings to Create Competitive Advantage:

- Managers must be aware that stakeholder issues (social concerns, corporate governance, ethical issues, etc.) are rapidly rising in importance among investors
- Regulators are starting to look at the implications of E.P. performance ratings for performance track awards, prioritization of inspections, etc. (e.g., Multi-State EMS Working Group, various states, EPA, DOE, DOJ)
- Goals are Sustainable Profits, Lower Risk of surprises for investors, maintenance of firm Reputation/Brand

Maximizing Business Value- Conclusions:

- **Environmental performance serves as a proxy for good management quality, and thus for sustainable earnings quality and long-term value-creation for companies.**
- **By measuring eco-efficiency & management quality, environmental rating models can distinguish the differences in a meaningful manner.**
- **Environmentally or socially-oriented investors care about these issues now; pure financial investors starting to follow.**
- **If business managers/government officials ignore these issues, their firms or citizens will be at a competitive disadvantage.**

Three Final Quick Thoughts:

1) *“ In the 19th century, we were making money with money, in the 21st century, I believe and hope that we will use values to create value.”*

- Oliver Le Grand , Chairman of a French bank)

2) *“ No Place To Hide for the Irresponsible Business”*

- Headline, Financial Times, 09/29/03

3) *“ To IRR* is human, to ERR** divine.”*

- Woody Tasch, Chairman, Investors' Circle

** IRR= internal rate of return*

*** ERR= external rate of return*