EDMOND DE ROTHSCHILD

THE SRI CHRONICLES

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EDITORIAL

JEAN-PHILIPPE DESMARTIN
Head of the Responsible Investment Team

Sustainable Finance and Responsible Investment Chair

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SOME HOPE IN A CRUDE WORLD?

Reading our chronicles has convinced you, we hope, of the lack of complacency in terms of sustainability in a number of sectors with high ESG intensity, such as fossil fuels, cement and air transport. With the start of the summer, and as for many European citizens, the holidays mean making use of their personal vehicles, we would like to mention a light of hope flickering in a complicated sector - especially since the "diesel gate" of September 2015 - the European automotive industry.

Between 2019 and 2022, all the leading European manufacturers saw their climate targets validated by the independent and demanding SBTi (*). The switchover from thermal to electric is real, and we can see it in very concrete terms in the present and future decline in GHG (**) emissions of vehicles sold between now and 2030 and beyond. Progress has also been made on key issues such as recycling, alternatives to rare earths for electric batteries and the reinforcement of the used vehicles markets. Lastly, a major point is that all manufacturers are taking on the heavy social burden of this transition to electric vehicles. For the VW manufacturer alone, we are talking about 100,000 jobs at stake.

Of course, nothing is perfect. Breaking with an inverse structural trend, the average weight of vehicles sold in recent years in Europe has increased (SUVs for example). Many industry players continue with lobbying that is not always positive in terms of environmental and social challenges. The deployment of infrastructure remains a major issue for electric vehicles, not to mention the hydrogen transport sector in the long term. Moreover, outside of Europe, momentum is less visible. And let us not forget the importance of using public transport, rail transport in particular.

We would like to wish you an enjoyable summer by highlighting this encouraging trend towards sustainable mobility. Enjoy reading!

(*) Science Based Targets initiative

(**) Greenhouse gas

NEWS

INDEPENDENCE AND THE ENERGY TRANSITION MAKE A GOOD COMBINATION

With the ongoing war in Ukraine, the reduction in Europe's dependence on fossil fuels, while meeting the decarbonisation targets, is a priority. Combining the transition and energy independence seems to be more relevant and necessary than ever, in our opinion.

URGENCY TO ACT NOW

"Three years to take action and keep a liveable future" is the alarm bell rung by the IPCC[1]. Melting ice, the advance of the deserts and heat domes... Climate change is already being felt and global temperatures could rise by up to +4 °C in 2100. This level of warming would impact all the pillars of our societies, making the world "uninsurable" for example. By 2050, an estimated 1 billion people in coastal regions will be threatened by rising water levels and $10 trillion in the value of infrastructure threatened by exceptional flooding.

THE BEST ENERGY IS THE ONE THAT IS NOT CONSUMED

The economic value of energy efficiency, which can be implemented quickly, is rather simple to understand. It makes it possible to reconcile independence, purchasing power and the fight against climate change. The solutions lie not only in technological advances, but also in behaviour and constraints. Good news, there are numerous levers for action: insulation, sustainable mobility, optimisation of electrical distribution networks, heat pumps, etc.

ACCELERATE THE USE OF RENEWABLE ENERGY

The transition to a low-carbon economy also requires greater use of renewable energy solutions: wind, solar, hydro, geothermal, biomass, biomethane, green hydrogen, etc. Solutions that require the development and reinforcement of locally installed renewable energy networks, helping to strengthen the economic and social fabric of certain neglected regions. Things have already started moving. In the previous decade (2010-2020), 83% of the world's new installed electricity generation capacity was renewable.

COMPANIES AND INVESTORS HAVE INCREASINGLY RELIABLE TOOLS

Precise measurement tools for carbon emissions scopes 1 and 2[2] have been developed over the past 20 years and there is real progress in taking Scope 3[3] into account ("the elephant in the room", because it accounts for around 80% of total emissions). Scope 4[4] represents the "new frontier" because it makes it possible to measure the avoided CO2 and therefore value investment in climate solutions. Investors are increasingly better equipped to measure and manage their portfolio and therefore take climate action.

> SCOPE 4 REPRESENTS THE "NEW FRONTIER"

FOR A JUST TRANSITION

Investors participate in the movement towards a sustainable economy, by assuming the complexity of the environmental, social and economic balances of the "just transition". The transition is complex because it calls into question decades of development based on fossil fuels. It will only succeed if social constraints are anticipated and integrated. For example, we are talking about 100,000 jobs at play for the VW manufacturer alone for its transition from thermal to electric.

1. IPCC, Intergovernmental Panel on Climate Change, Sixth Assessment Report, February 2022.
2. Scope 1 concerns direct emissions, and Scope 2 indirect emissions related to energy.
3. Scope 3 encompasses other indirect emissions.
4. Scope 4 concerns avoided emissions.

SHAREHOLDER ENGAGEMENT ON ENVIRONMENTAL, SOCIAL AND GOVERNANCE PERFORMANCE

TAMAS BARKO

graduated with a Research Master in Finance and a PhD from Tilburg University in the Netherlands. He is specialized in data management, analytics and machine learning.

MARTJIN CREMERS

is a professor of Finance and Law in University of Notre Dame, Mendoza, USA. His research and teaching areas are investment management, corporate finance, corporate governance, corporate law, business ethics and Catholic social thought.

LUC RENNEBOOG

is Professor of Corporate Finance at Tilburg University and a research fellow of the CentER for Economic Research (Tilburg). Renneboog graduated from the University of Leuven with a BSc/MSc in commercial engineering and with a BA in philosophy, from the University of Chicago with an MBA, and from the London Business School (University of London) with a PhD in Financial Economics. His research focuses on corporate governance, M&A, ESG, and the economics of art.

This article, accepted for publication, studies investor activism promoting environmental, social and governance (ESG) performance. Based on the proprietary dataset of a large international, socially responsible activist fund engaging in 847 ESG processes with 660 companies around the globe, this study gives a full panorama of the challenges, success factors and effects of investor activism. A decade (2005-2014) of dialogue and engagement with companies are examined, whether successful or not. Every contact had a specific ESG objective, and either pushed CSR performance or revealed grey areas. The three authors investigate the engagement effects on corporate results, ESG ratings and stocks performance. Dialogue with companies about ESG has never been so useful, or has it?

PRESENTATION OF THE DATASET AND COMPANIES TARGETED

The dataset, provided by a large European asset manager with more than $250 billion in total AUMs, concerns investor activism on a majority of environmental (42,3%) and social (43,3%) issues. Governance represents only 14,4% of the cases. Identified ESG matters are revealed by the asset manager's research, external providers' analysis, and a keen eye on recent crises and controversies. Investor activism often takes place behind the scenes, in private email exchanges. Before engaging dialogue with a company, the asset manager sets an ESG objective. This target can be a "reorganization" oriented engagement, thus having an input in management and organisations. In this sample, a majority of cases (51,5%) are of this type. The target can also be a "transparency" oriented engagement, aiming at a better ESG disclosure and reporting (48,5% in this sample). Looking at the panel, the study finds that firms with low ESG scores in low risk countries are the most likely to be targeted. This suggests that investor activism concentrates on companies with room for improvement on ESG performance. In addition, firms targeted generally have a higher stocks market performance than their peers, and have an important analyst coverage – with the exception of companies engaged on governance issues, that have a dispersed ownership structure and lower potential growth opportunities.

INVESTOR ACTIVIM'S MULTIPLE EFFECTS

The paper puts forward the effects of investor activism depending on the company. A vast majority of firms welcome the dialogue and engagement initiative. Indeed, two thirds of the companies are "initially receptive and participate in an initial discussion", according to the paper. First, target companies with low ESG ratings see their ratings improve during the activism period. This suggests that the engaged companies take into account the investor's remarks, thus improving its ESG performance, disclosing pertinent information and strengthening its ESG transparency. On the other hand, target companies with high ESG ratings see the ratings decline during the activism period. This suggests that the engagement process raises ESG concerns, shedding light on controversies and revealing areas of weakness that had not been taken into account yet. Surprisingly, changes in ESG ratings already occur by engaging with the company- not only after the engagement process is over. Whether successful or not, ESG engagement processes always unveil something. Thereby, investor activism has positive and negative repercussions on ESG ratings. Second, the study shows that accounting performance does not significantly change following a successful engagement – except for sales that tend to grow after the engagement. Third, the authors find that engaged firms outperform non-engaged firms. Targeted firms in lowest ESG quartile outperform peers by 7,5% in the year following engagement in terms of financial returns. Furthermore, successfully engaged firm outperform unsuccessfully engaged firms by a financial return of 6,8% over the year following the engagement. Indeed, successful engagements – and in particular reorganization oriented engagements, that require operational changes – are rewarded by a net share price increase.

FACTORS OF ENGAGEMENT SUCCESS

Investor activism in this panel has a 60% success rate. Engagement is considered successful if the targeted company shows the desired change in operations or reporting. In other words, success occurs when the target company complies with investor's ex-ante demands. This definition of success set by the activist is questionable as setting easy targets could lead to overstated success rates. If the targeted change does not occur in less than two years, the engagement file is usually closed by the activist investors as "unsuccessful". In this sample, successful engagements occur within 20 months on average. The study shows that success is more likely to occur in transparency oriented engagement, in comparison with reorganisation oriented engagement. Indeed, the latter can be harder to achieve – but may lead to more value enhancement. Another finding of the study is that activism with companies with a higher ESG score prior to engagement are more likely to succeed. Indeed, companies that were already attentive to ESG and already have the necessary ESG skills and know-how are more likely to succeed in implementing ESG changes and recommendations. The authors also put forward the fact that a successful engagement is less likely in firms with a large controlling shareholder. Finally, engagement processes are more likely to be successful when the firms have lower sales growth, as the companies are more under pressure from investors. In the same way, large cash reserves tend to make the successful engagement less likely – as the target firm can fence off investor pressure.

CONCLUSION

Dialogue and engagement are a cornerstone of responsible finance and this study shows that responsible finance, ESG engagement and strong performance go hand in hand. Investor activism has historically been criticized for being a tool for publicity and a marketing façade. This paper, covering engagement processes worldwide, on environmental, social and governance pillars, shows the extent of the asset manager's commitment and its multiple effects on company operational and stocks performance. ESG engagement is upmost beneficial for companies with low ESG scores that see their ratings improve during the process. On the other hand, companies with strong ESG performance often see their ESG ratings decline during the process- unveiling yet undisclosed controversies or sources of concern. Globally engaged companies outperform their peers. Efforts made by successfully engaged companies are rewarded as well, as they outperform unsuccessfully engaged peers.

Globally, ESG investor activism is beneficial to portfolio managers and also to targeted companies that get an unique opportunity to align their CSR strategy to the best practices of the market. Successfully engaged companies that integrate ESG operational changes outperform their peers, which strengthens our convictions about the importance of dialogue and engagement being key for a responsible investor.

Barko, T., Cremers, M. & Renneboog, L. *Shareholder Engagement on Environmental, Social, and Governance Performance*. J Bus Ethics (2021). *Shareholder Engagement on Environmental, Social, and Governance Performance* by Tamas Barko, Martijn Cremers, Luc Renneboog :: SSRN

COMPANY MEETINGS

HELLOFRESH

@HelloFresh

Created in 2011, HelloFresh is an innovative player in the home catering sector and provides meal kits.

HelloFresh has a unique position in the food distribution market with its innovative business model and its healthy food offer. The group has attracted over 7 million customers in 17 countries. Each week, on the Hellofresh platform, the customer chooses from a wide range of tasty recipes and gets the ingredients delivered at home. The German company, driven by strong growth, counted nearly 15,000 employees by the end of 2021, with the majority of its revenue coming from the United States. The company is taking action against food waste, and is committed to reduce its carbon footprint intensity. In addition, HelloFresh's atypical delivery model ensures good working conditions by industry standards. Finally, supply chain management and product quality is a reputational matter for the group, which regularly launches responsible consumption initiatives.

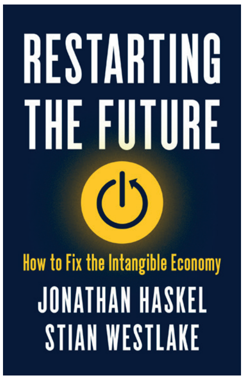
Source of data: Edmond de Rothschild Asset Management (France).

The information about the companies cannot be assimilated to an opinion of Edmond de Rothschild Asset Management (France) on the expected evolution of the securities and on the foreseeable evolution of the price of the financial instruments they issue. This information cannot be interpreted as a recommendation to buy or sell such securities.

RECOMMENDED READING

SOMETHING TANGIBLE ON INTANGIBLE ASSETS

Intangible assets - brands data, human capital, intellectual property, software, customer capital - now account for more than 80% of the financial value of companies, such as GAFA, in our services and digital economies. These intangible assets are also at the centre of the achievement of sustainability goals, with education being the best symbol of this. Jonathan Haskel, professor of economics at Imperial College, has come out with a new book on intangibles, following his "*Capitalism without Capital*" in 2017. "*Restarting the Future*" allows us to better understand, see and touch these assets that are "invisible" in accounting, through concrete examples linked to the deep transformation of growth models.



Restarting the future
By Jonathan Haskel and Stian Westlake

$742 Bn

The total amount invested in fossil fuels by global banks in 2021.

Source: Financial Time ; 31 March 2022.

83%

Shares of Renewables Net Annual Additions in Power Generating Capacity in 2020.

Source: REN21, Renewables 2021 Global Status Report.

SAY ON CLIMATE: A DOUBLE-EDGED OPPORTUNITY

The AGM season focused on remuneration and climate. Just as "Say on Pay" lets shareholders to vote on executive compensation, "Say on Climate" allows them to express their opinion on the climate strategy, or, in the broader sense, the environmental strategy.

This year they were able to vote in France on the strategies of EDF and Engie, as well as Amundi and Carrefour, among others. However, while we value the approach of transparency and dialogue, the resolutions are still too disparate for shareholders to be able to vote with serenity on the topic.

Furthermore, it would be useful to know what would happen in the event of a vote against a Say on Climate resolution, so as not to fall into the same pitfalls as those encountered by its Say on Pay counterpart (apparently no follow-up effect after the rejection of Mr Tavares's remuneration at Stellantis, for example).

"We have an agreement in principle. The question is, do we all have the same principles."

DIALOGUE AND ENGAGEMENT WITH TOTALENERGIES

Edmond de Rothschild Asset Management values an open and constructive commitment. As such, we have participated in dialogues with the TotalEnergies group for many years, both individually and collectively. Since 2020, we have asked management to set and publish greenhouse gas (GHG) emission reduction targets in line with the target of the Paris Climate Agreement.

As this dialogue was unsuccessful, 11 investors, including Edmond de Rothschild Asset Management, finally decided to jointly file a shareholder resolution asking the company to set short, medium and long-term targets in line with the Paris Climate Agreement trajectory. Indeed, the ambitions of TotalEnergies in terms of GHG reduction in the short and medium term are not aligned with a scenario of global warming of 1.5 °C.

Although the company accepted an identical resolution in 2020, this year it refused to put it on the agenda of the meeting, which we consider represents a denial of our shareholder rights. Note that similar resolutions have been accepted by rival oil majors, both European and US.

For 2023 we hope for a clarification of the rules in the Paris marketplace on the filing of resolutions at the initiative of shareholders.

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EDMOND DE ROTHSCHILD ASSET MANAGEMENT (FRANCE)
47, rue du Faubourg Saint-Honoré, 75401 Paris Cedex 08
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AMF Registration No. GP 04000015 - 332.652.536 R.C.S. Paris
www.edram.fr

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