

OTC Markets

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# How ESG / Sustainability can boost your company's valuation

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# PRESENTED BY

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## **Christopher Nicholson**

ACF Equity Research – Managing Director / Head of Research

Christopher is a financial analyst, repeat entrepreneur, professionally qualified equestrian. Amongst others, I trained as a financial analyst at Global US based fund manager Legg Mason Investors, was head of Technology and Media Equity Research at Bryan Garnier, a pan-European investment bank. For 11 years I broadcasted as an expert guest and wrote regularly in the leading international media including Bloomberg TV, the BBC and the Financial Times.

I studied Biochemistry at Kings, London, England and then Economics at the London School of Economics. I can conduct business in English and French, I speak German and have basic knowledge of Spanish and Italian. My free time, which I make sure I carve out, is in part each day spent on my passion – riding, competing with and caring for my horse(s). In my view, I am only able to do these things because of the quality of the team I work with at ACF.



## **Renas Sidahmed**

ACF Equity Research – Sales & Strategy / Staff Analyst

Renas is an awarding winning macro-economic and financial analyst, linguist, mathematician, professional dancer and chef. I worked for 4 years with the IMF; 2.5 years with the International Finance Corporation (IFC) and eight months with the World Bank in Washington DC.

Over this time, I met with senior politicians with varied global and local interests in both wealthy and less developed economies. My sector expertise includes natural resources (particularly oil & gas) healthcare, manufacturing, infrastructure and investment portfolio management.

Before joining ACF Equity Research, I worked with Japan's second largest brokerage, Mitsubishi Bank, in the London office. I speak six languages including English (native), Italian, French and Arabic and obtained an MBA in Rome and a Mathematics degree from a sister Ivy League – Smith College. I joined ACF because of its entrepreneurial, female friendly City culture, overarching global values and excellent growth prospects.



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# ACF EQUITY RESEARCH

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## Accuracy – Clarity - Foresight

- An independent investment research company
- Specialises in the highest specification / quality of equity research for corporate clients
- **Effectiveness – No.1** - independent metrics show ACF beats leading North American and UK/EU competitors
- Global foot print
- Institutional grade investment research to a wider investor audience
- International and forward thinking culture
- **Mission – maximise the effectiveness of capital markets for all**



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# WHAT IS ESG / SUSTAINABILITY?

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ESG - Environmental, Social & Governance

- Evolution of the 1980s CSRs policies – Corporate Social Responsibility [statement] - broader with metrics
- A discipline that improves your valuation
- Sustainability - Impact investing – Are your company's efforts sustainable?



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# WHAT IS ESG?

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## ESG - Environmental, Social & Governance

- Set of measurable metrics used to screen companies by 'socially conscious investors'
  - e.g. (**E**) resource conservation, emissions, (**S**) equal pay, health and safety, (**G**) how is the board run, what rules do you play by
- Requires commitment and action and invites verification = accountability & credibility
- Provides access to capital
  - e.g. sustainable funds, green loans – and NOW – regular plain vanilla funds, FO, SHNWI and Retail



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# WHY ESG / SUSTAINABILITY IS RELEVANT

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## The Key Drivers – Economic and Regulatory

- Companies with ESG policies have higher valuations compared to companies that do not
- 93% of the world's largest companies (by revenue) already report on ESG – the 93 are dominated by US
- Regulation is catching up with the economics



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# WHY ESG / SUSTAINABILITY IS RELEVANT

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## Exchanges will Follow European Example – The Precedent

- MiFID II - Most significant piece of legislation with respect to capital markets and nano to mid-caps
- MiFID II - A European piece of legislation with a global impact
- MiFID II - Not a legal requirement outside of EU but it has changed global capital markets business models
- Global effect on research production, PM/FM income statement, broker/IB business model

## MiFID II – Next Impact

- ESG / Sustainability driver created by MiFID II – we expect all other regions to follow this example
  - UK/EU 2021 expectation is all listed companies must have an ESG policy with metrics
  - Governments and policy makers globally do not want to be on the wrong side of history
  - Millennials do not want to work for companies that do not do good



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# EXCLUDING YOURSELF FROM US\$ 30.7TRN IN 2021

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## Why is ESG / Sustainability important?

- ACF forecasts that there will be US\$ 30.7 trillion in ESG filtered funds by YE21
- BlackRock says US\$ 400trn by 2030
- Global de facto primary filter
- Communicating sustainability to the markets
- Boosting your valuation by implementing an ESG / sustainability policy





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# ESG INTEGRATION AS A PRIMARY FILTER

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## Global FMs and institutions pushing the ESG agenda

- CFA - Chartered Financial Analyst program
- TCFD – Task Force on Climate-related Financial Disclosures
- UN PRI – United Nations Principles for Responsible Investment
- SASB – Sustainability Accounting Standards Board
- EU SFM – EU Sustainable Forest Management
- Canada SFI - Canada Sustainable Forest Initiative
- France Article 173 – ESG reporting requirements imposed on institutional investors

## How ESG investing / filtering is used

- It can exclude companies that are not aligned with the sustainable agenda of the various investor classes
- It can be used to filter out companies that are performing well financially and provide investment returns
  - $EVA \text{ (Economic Value Added)} = \text{net operating profit after taxes (NOPAT)} - (\text{WACC} * \text{Capital Invested})$
  - $EVA \text{ margin} = EVA \$ / \text{Sales } \$$
  - $EVA \text{ spread} = EVA \$ / \text{Capital } \$$
  - $ROIC \text{ (Return on Invested Capital)} = \text{NOPAT} / \text{Capital Invested}$



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# FORMAL VS. INFORMAL FILTERING

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## Formal ESG filtering

- The top global FMs /PMs based in the US have already put these policies in place
- US PMs rule out opportunities that do not have an ESG policy
- It is no longer just the giants – everyone is filtering from mid tier through to small PMs to sophisticated and unsophisticated retail

## Informal ESG filtering

- The problem - firms don't know they have been filtered this way.
- Tactic is used and preferred so that FMs can test policies and their Rol before going public
- Nevertheless, the principles and ideas are the same as formal filtering



# THE OUTPERFORMANCE OF ESG FUNDS

Exhibit 1 - S&P 500 ESG vs. S&P 500, 2018-2021



- Having an ESG policy gives access to a fund
- ESG rating is based on a weighted calculations score
- Indices provide a benchmark for companies that are executing sustainable business practices
- ESG index ratings:  
e.g. MSCI ESG Leaders Index, S&P 500 ESG Index

Sources: ACF Equity Research; SPGlobal.

Exhibit 2 – MSCI ESG Rating Scale



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# BOOSTING YOUR COMPANY'S VALUATION

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## ESG and financial performance

### **The Numbers Drivers**

- An ESG policy provides far greater access to capital and lowers a company's cost of capital
- ESG reduces your cost of capital by introducing better discipline - leads to a lower cost of capital (WACC)
- ESG improves margins
- ESG increases revenue opportunities

### **The Emotional Drivers**

- By not addressing human capital management issues, this will cause a decrease in employee productivity
- Millennials believe that if companies care about sustainability they will have improved long term success
- Increased interest in ESG = higher demand for stock = higher performance stock = higher valuation



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# BOOSTING YOUR COMPANY'S VALUATION

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ESG - higher profitability, higher ROIC, lower volatility = higher valuation

- How does ESG create economic value add (another way of expressing total profitability of a company)?
  - The higher the ESG performance - the higher the EVA margin
  - Low-ESG performing companies have higher volatility and lower return on assets (RoA)
  - Companies with an ESG policy tend to have higher valuation multiples: P/E, P/FCF, P/B
  - High-ESG performing companies return more capital to investors
  - High ESG performance is worth ~6% outperformance to portfolio managers

EVA Margin variations explained – the exceptions

- 2013 – 2015: A dive in EVA M% because of the manufacturing recession and rise of online retailers
- 2017 – 2019: EVA M% rallied thanks to the financial and energy sectors recouping lost or negative margins



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# ESG - LOW HANGING FRUIT FOR SMALL COMPANIES

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Implementing a policy now in order to increase investor interest

- Start with what you have – show the direction of travel
- There is no need for a lot of audited metrics or to rearrange the entire auditing system
- Nano to small-caps are not required to produce the same metrics as mega-caps
- Metrics can be taken from report and accounts and management accounts
- Therefore, there is no need to consider major investments in your financial reporting systems early on
- Getting on the bandwagon and publishing a few metrics = making sure your company is on the right path
- Waiting until the regulation becomes a forcing action will be seen as cynical and on the wrong side of history
- Show investors that you are actively focusing on ESG and get that message out into the markets
- If you are on the OTCQX/QB you are already a step forward in governance – G of ESG



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# ESG – WHAT YOU CAN DO TO GET STARTED

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## Starting the journey

- Set the trajectory - you do not have to do everything at once
- Set out the three areas of policy statement with targets
- Do you have a process and set of rules by which you run the board and executive decision making?
- I don't emit much carbon – great - so say that and show how low your carbon footprint is.
- My company does not create environmental pollutants
- My Company has two execs on payroll everyone else is a consultant
- Talk about how you treat your consultants
- Take advantage of the OTCQX/QB to distribute research on your ESG increase valuation
- Talk to ACF we can help and it won't cost you \$200k



# CONTACT

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## Christopher Nicholson

Managing Director / Head of Research

+44 (0) 79 77 07 32 91

[cnicholson@acfequityresearch.com](mailto:cnicholson@acfequityresearch.com)



## Renas Sidahmed

Sales & Strategy / Staff Analyst

+1 646 480 0806

[rsidahmed@acfequityresearch.com](mailto:rsidahmed@acfequityresearch.com)

