

Green is Good

As January draws to a close the February ASX reporting season beckons. While legislation covers mandatory disclosure requirements, the informational thirst of institutional and sophisticated investors rarely ends there. This brings us to discretionary disclosure items. For example, during the prior reporting season the focus of investors was largely on the strength of company balance sheets and thus, debt maturity profile information was in high demand. But much has changed in the market over the past nine months. Credit markets have eased, economic data releases have indicated improving conditions and the general mood of investors has shifted to optimism. Evidence of this lies in the All Ordinaries Index which has experienced a “hockey stick” recovery and now sits 57% higher than at the end of March last year.

Accordingly, the areas of focus for sophisticated investors and their informational desires will also have shifted and the emphasis on balance sheet issues will have made way for those pertinent to the income statement. Notably, operating leverage (especially), currency exposure and interest rate leverage will all be front of mind and companies should be mindful of this when compiling their investment presentations to accompany upcoming earnings reports. While catering for this is not difficult, there is another area of investor interest which is not so easy to address – the Carbon Pollution Reduction Scheme.

But wait a moment, wasn't this legislation put to death by the ascent of Abbott, Minchin, Joyce and co? Maybe for now, but since the bill was voted down we have seen some consensus reached at Copenhagen and I think the general view amongst the public is that the implementation of some form of emissions control legislation is inevitable. Even fund managers, who typically warm little to the “green” cause, acknowledge this.

But what should companies be expected to do given the lack of certainty and clarity around this issue and the likely form of any impending legislation? I recently spoke with a number of leading institutional investors on this matter and the message was clear, the potential impact of any emissions

control legislation is already an important consideration in their stock selection process. Hence, companies must at the very least demonstrate that they are actively considering the potential impact of any emissions control legislation and where appropriate, planning strategically to mitigate any negative impact it may present.

So what can companies do to address emissions control on a more practical level, say at the February reporting season? Investors are likely to be interested as to whether companies are currently measuring their emissions and if so, what their level of emissions actually are. Furthermore, investors will be interested in finding out what management's plans and targets are for reducing emissions over time and how they plan to be able to actually achieve this. I expect that going forward, a company's level of emissions will be reported periodically in conjunction with its earnings releases.

One could argue that the impact of any emissions trading legislation on company earnings will be relatively minor given the significant concessions which have been proposed. Thus, its importance to fund managers should not be great. However, I think this misses a key point being the rise in importance of environmental, social and governance issues (ESG), not to mention the growth in ethical and sustainability

funds. The public's increasing demand for improved corporate citizenry on ESG issues has been duly noted by major superannuation funds and asset consultants. These groups are now in turn, putting increasing pressure on fund managers to significantly increase their level of analysis on a company's performance on ESG issues and to actively take this into account as part of their stock selection process. The power of superannuation funds and asset consultants cannot be understated given they have the responsibility of allocating funds between managers. Hence, when they speak, fund managers listen. The implications of this are both clear and important, if a company cannot demonstrate good practice on ESG issues (of which emissions control is a key part) then it will be increasingly difficult for fund managers to be able to justify investing in them.

David Greer, Executive Director

