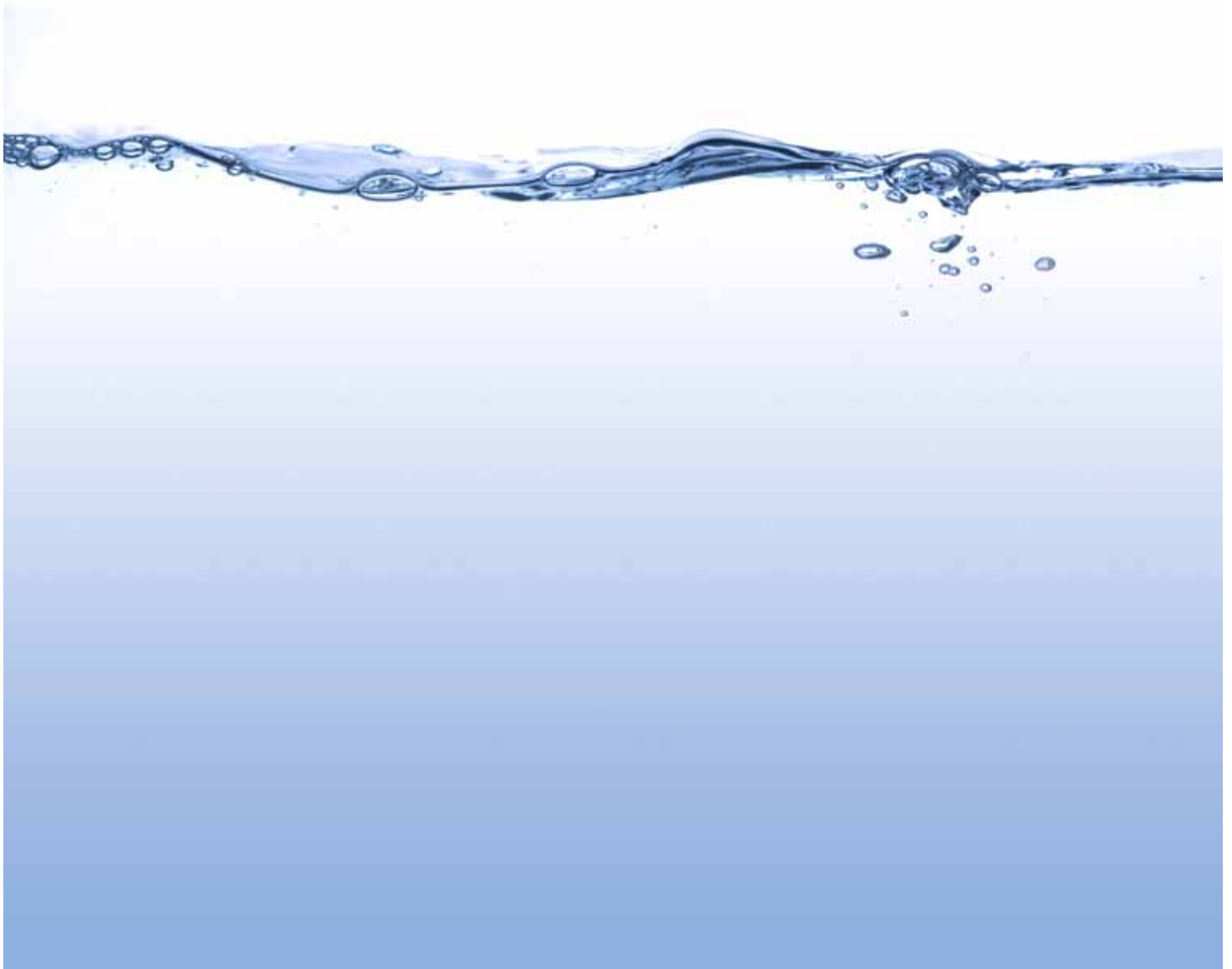


ESG Research Australia Awards 2010

Recognising excellence in ESG research and service



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The winning ESG research and service providers

Best piece of ESG research by an individual analyst or team

Good Ethics & Culture = Good Investment Returns

Andrew Gray

Goldman Sachs JBWere

Highly commended

Australian Carbon Pollution Reduction Scheme: De-carbonising the CPRS

Timothy King, Brendan Fitzpatrick

Deutsche Bank

Water Challenges for ASX100 Companies: Adapting to Increasing Water-Related Risk

Elaine Prior

Citi

Best ESG broking firm

Citi

Summary

From being a fringe consideration a few years ago to becoming a key part of today's investment process, the integration of Environmental, Social and Governance (ESG) considerations into mainstream investment processes has been swift.

Catalysed by the global financial crisis, many investment managers are quickly adapting to include ESG into their investment decisions. In the rush, the industry is struggling to keep up with itself. While investment managers are wanting to integrate ESG alongside traditional financial measures, there is still not adequate ESG research that allows investment managers to do it effectively.

To encourage brokers to provide ESG research, HESTA, UniSuper and VicSuper initiated ESG Research Australia in 2009¹. A number of superannuation funds and fund managers have subsequently joined ESG Research Australia to work towards the common objective of increasing the quantity, quality and scope of ESG research produced on Australian companies.

The ESG Research Australia Research Awards were created to recognise excellence in ESG research. There are two award categories:

- Best piece of ESG research by an analyst or team
- Best ESG broking firm

All ESG Research Australia members were invited to submit ESG research produced by brokers in 2009 that they believed added value to their investment processes. A judging panel was formed from a sub-group of ESG Research Australia signatories from the superannuation and funds management industry. This judging panel then assessed the research against a set of predetermined criteria.

ESG Research Australia members also voted on an award for the best broker service. This was voted on by investment managers and superannuation funds that directly manage Australian equities investments.

Together, the awards are designed to recognise and promote the important role that brokers can play in identifying and assessing the impact of ESG matters on investments and investment returns.

The focus on ESG research comes at an important time for the investment management industry as we emerge from the global financial crisis and when managing and responding to economic issues such as climate change are still firmly on the international agenda. Many investors have been adversely impacted by the global financial crisis and have been given a very stark lesson in risk and the value of sustainability. This has dramatically changed investors' priorities, and the days of a blasé attitude to risk and governance are over. There is a renewed - and overdue - focus on companies' approach to ESG issues. There is a particular focus on good corporate governance, with investors no longer tolerating poor management behaviour or bad governance practices.

Investors are now demanding responsible, sustainable investing and fund managers are having to react quickly to this change. The speed with which this has come about has caught some investment managers napping. Keen to be seen to be doing *something*, some of them have responded by taking a 'box-ticking' approach to ESG to appease investors.

But this was only ever going to be a short-term measure and their time has already passed.

Responsible investment now needs to be an integral part of mainstream investment processes and to realise this, investment managers need quality research. Brokers have responded to this demand and the quality of ESG research has improved dramatically in recent times, as evidenced by the high quality research submitted for the ESG Research Australia Awards. Goldman Sachs JBWere and Citi pioneered ESG research in Australia, with many brokerage houses now following suit. There's still a long way to go and much work to be done, but the initial research is already playing a vital role in the education of the whole industry.

The scope of issues covered by broker research is broadening and several ESG research pieces were recognised by the judging panel for their originality, especially the Goldman Sachs JBWere paper *Australia's Hidden Resource: The Economic Case for Increasing Female Participation*. Tim Macready, of Christian Super said, "This paper covered an exceptional idea. It needs further research linked to the company level but it was a very well researched paper and a highly original, interesting piece of work."

Rigour was another judging criteria and the Deutsche Bank paper, *Australian Carbon Pollution Reduction Scheme: De-carbonising the CPRS*, was commended on this front. Don Hamson of Plato Investment Management said, "This paper is very comprehensive and detailed. While not as innovative or original as some of the other papers, it provided a level of detail that others couldn't match."

Despite positive developments in the field of ESG research, the judging panel felt that it still needs to be written in a form and style consistent with other types of more traditional research. As David Paradise of Paradise Investment Management says, "There is still a lot of work to do. We haven't yet been able to put ESG into a share price and say 'this is worth 20 cents per share', but I think it will come. Goldman Sachs JBWere is at the forefront of building ESG into the share price, and the others are catching up."

One obstacle for quality broker research is the ability to remain objective. Brokers are sometimes reluctant to be critical of a company's ESG performance and companies are peculiarly sensitive to criticism on the ESG performance.

"We never see a lot of negativity on management from brokers because they don't want to close the door on communications. What I'd like to see is brokers on the front foot in being critical," one panel member observed.

Another commented, "Brokers need to be a bit bolder and a bit braver. Brokers are not keen to name and shame potential clients. There is tension there. If we saw more brokers being more bold, it would make being critical easier."

Another challenge of ESG research is ensuring brokers are able to communicate and translate its relevance to the investment process. "Much ESG research is interesting, but not necessarily translatable. Useability is most important," said Don Hamson from Plato.

Richard Fuller, from HESTA, believes that useability is not necessarily the top priority. "Useability is at war with originality. We need research at both ends of the spectrum," he said.

¹ ESG Research Australia was modelled on a similar project, the Enhanced Analytics Initiative, which has since merged with the United Nations Principles for Responsible Investment

Sector-specific research is an area that needs developing to increase usefulness for analysts in various sectors. Amanda McCluskey from Colonial First State Global Asset Management wants to see a 'company first' approach and commends Citi's paper *Thirsty Thoughts* on the beverages sector. "The Thirsty Thoughts paper was notable in that it examined the sector. It took a company-first approach rather than focusing on ESG thematic," said McCluskey.

As shown in the chart opposite, more than half of the papers submitted for consideration covered environmental issues, with governance the least popular topic. Graeme Rough, UCA Fund Management, wants an increased focus on the 'G' of ESG. "Governance drives the environmental and social approach. We want to see more on ownership and board quality and a fresh look at traditionally-held views," said Rough.

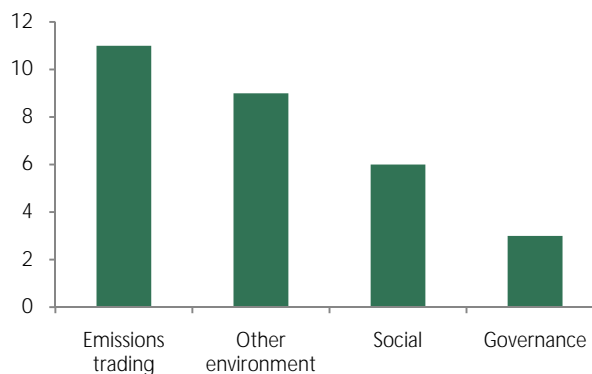
ESG research has come a long way, but it is still a relatively niche area. Of the 29 papers submitted for the award, 16 were from Citi's Elaine Prior, and 11 examined emissions trading. A broader approach was sought by the panel with a more balanced focus on environmental, social and governance issues, while encompassing both short and longer term issues and adopting a clear focus on useability.

Suggestions from the panel of areas for potential research from sell side researchers included:

- consumer and public health
- supply chain stewardship issues
- related party transactions and the independence of the Board
- consumer debts for the financial services and retail sector
- executive remuneration
- board quality, and
- geo-political and security risk.

The judging panel agreed the most important goal for the industry was to see ESG research fully integrated into mainstream investment and driving broker recommendations. Azhar Abidi from Industry Funds Management summed up the views of the committee. "At the moment there are two tiers; ESG research and mainstream research. We won't understand materiality until it's fully integrated and ESG issues are put into context of other financial drivers," said Abidi.

Categories of submitted research



Judges' comments

Best piece of ESG research by an individual analyst or team

Papers were nominated by members of ESG Research Australia from Goldman Sachs JBWere, Deutsche Bank, JP Morgan, Macquarie, UBS, Merrill Lynch and Citi. The judging panel assessed the papers using the criteria of usability, rigour, reliability, and originality.

Andrew Gray's paper, *Good ethics & culture = good investment returns*, was voted the winning paper by the panel for its relevance and the evidence it provided to validate the theory and that ESG issues materially impact share price performance.

Hamson noted that Gray's was the only research that clearly demonstrates that ESG factors meaningfully impact future returns.

Helen Bloustein from VicSuper highly regarded Andrew Gray's paper, noting it provided a clear statement of rationale. "It provides a good background and definition of indicators. It shows how impacts can be different for different sectors," said Bloustein.

Rough voted for the paper on its useability, "It is more of a portfolio management tool that allows ranking. It's delivered in a clear and consistent framework and covers more ESG factors than any other paper."

The *Australian Carbon Pollution Reduction Scheme: De-carbonising the CPRS* paper from Deutsche Bank was highly commended by the judging panel. This paper undertook a detailed analysis of the impact of the Carbon Pollution Reduction Scheme (CPRS) as it currently stands in the Carbon Pollution Reduction Scheme Bill (2009) in light of the political uncertainty surrounding the passage of the CPRS and amendments proposed by the Coalition.

The CPRS paper was highly regarded for its thoroughness and useability. "While the paper is not as innovative or original as some of the others, it is comprehensive and detailed," said Abidi.

The paper was commended for its thorough exploration of the subject as a whole. Hamson said, "The writers have pulled it all together in one piece of research. From a quantitative perspective we can translate it to make better investment decisions."

McCluskey scored the paper highly from a research valuation point of view. "The CPRS is the most potentially material issue of all Australian ESG issues and this paper goes down to the level of valuation," said McCluskey.

Elaine Prior, from Citi, was also highly commended for her research paper *Water Challenges for ASX100 Companies: Adapting to Increasing Water-Related Risk* which examines a selection of the most 'water-exposed' ASX100 companies. The paper addresses availability and security of supply, how companies use water, and how they are adapting to new water challenges.

Bloustein rated Elaine Prior's paper for its clear appraisal of a complex topic and the fact that the paper lent itself to be used and understood by the whole market. Fuller added, "This research topic is tough because the data being disclosed by companies is all over the place. Elaine should be commended for bringing it all together to produce a useful piece of research."

Elaine Prior was also recognised for her broader contribution to ESG research. "Elaine has educated people on broader ESG issues. Through talking about issues she has improved people's knowledge. The subject of ESG has been a learning curve for many people and Elaine has led the way in education, bringing people up from no knowledge to some knowledge," said Hamson.

The 'Best ESG broking firm award' was voted on by all ESG Research Australia members that are Investment Managers from superannuation funds that directly manage Australian equities investments. The award is for the broking firm that rated highest for overall service and for the provision of ESG research on Australian equities.

The firm voted best broking firm for 2009 was Citi. Comments from ESG Research Australia members in relation to Citi's service included:

"Strong dedicated, issues-based research on ESG themes and issues have been produced by Elaine Prior"

"Broader global perspectives are provided by Citi's global research team"

"Citi's broader research team has supported the ESG effort through industry- and stock-based research"

"While a number of organisations produce research on ESG, none have marketed it as much as Elaine Prior at Citi"

"Citi has the most comprehensive and in-depth coverage of ESG issues, extending it beyond carbon to water and health and safety. It is also taking the first steps towards to integrating it with sectoral work"

"No other broking house can match the body of research produced by Elaine Prior"

Firms that also ranked highly were Goldman Sachs JBWere and Macquarie.

One member commented, "Goldman Sachs JBWere has made the conscious effort to present and distribute both stock-specific and market-level research regarding ESG issues. The firm has a dedicated representative in Andrew Gray who understands the potential importance and relevance of ESG issues and how they relate to equity markets. Over the past year, Goldman Sachs JBWere has provided an ESG service that has included, in addition to a number of research reports, an introduction to ESG data providers as well as the organisation of conferences on ESG topics."

Another member added, "From a quantitative perspective, Goldman Sachs JBWere provide ratings that could be directly input into a process. Furthermore, Goldman Sachs JBWere are the only broker to provide evidence that their ESG ratings are actually associated with share price performance."

Macquarie was also recognised by members, with one commenting, "Macquarie has adopted a refreshingly straightforward and lucid approach to matters of ESG. Aimee Kaye appears to pursue a very pragmatic view of living in a world with ESG."

Paper synopsis

Best piece of research

Good Ethics & Culture = Good Investment Returns

Andrew Gray, Goldman Sachs JBWere

This paper examined the link between ethics and culture factors and investment performance by utilising the Regnan database for individual ethics and culture company ratings. This report was produced as a component of Goldman Sachs JBWere's efforts to document the linkages between ESG and share price performance.

The report found significant correlation between ethics and culture factors and high risk stocks during the equity bear market from late 2007. Of particular interest, a substantial portion of the stocks examined that rated poorly in terms of ethics and culture factors, were also found to exhibit the most noteworthy underperformance during the period. These correlations were used as supporting evidence to suggest that a causal relationship may exist between inferior ethics and culture of a company and higher risks to investors, especially during times of extreme risk aversion.

The research found that a less obvious correlation existed after the market began its initial recovery in March 2009, concluding that the factors of ethics and culture attributed less to a stock's performance when investors in a market were less risk averse.

Highly commended

Australian Carbon Pollution Reduction Scheme: De-carbonising the CPRS

Timothy King, Brendan Fitzpatrick, Deutsche Bank

This paper proposed that the CPRS would impose a new layer of costs for all Australian companies, through the cost of buying permits to cover direct emissions, and indirectly through higher indirect costs such as electricity. The report analysed the key elements of the CPRS in detail, with a discounted cash flow analysis of the carbon liability for the top 25 emitters (who represent 94% of the emissions by the ASX 100).

The paper found that the valuation impacts of the CPRS were less than what might be expected, with the most notable exceptions being Virgin Blue and Caltex. Overall, the report concluded that the valuation impacts would be relatively benign for most companies due to the expected allocation of free permits to energy intensive trade exposed businesses and their ability to pass on additional costs.

Water Challenges for ASX100 Companies: Adapting to Increasing Water-Related Risk

Elaine Prior, Citi

This paper looked at a selection of the most 'water-exposed' ASX100 companies and addressed the security of supply, exposure to water pricing, how companies use water, and how they are adapting to growing water challenges. The field of investigation was seen to be particularly topical in light of modern changes to the dynamics of Australian water supply. As part of the ten year, \$12.9bn Australian Water Plan, yield tests of Australian water sources have led to the implementation of sustainable extraction limits on various surface and groundwater systems within Australia. These developments are likely to have substantial impacts on a range of Australian listed companies.

The enquiry identified a set of risks that ASX companies may be exposed to through water supply as having the ability to impact production continuity, cost margins and their licence to operate. These risks included scarcity, management of excess, management of disposal quality and potential environmental impacts. The sectors that were found to be most exposed to increased costs of water supply were irrigators, metal and mining companies and power generators. Materially, the cost of increased water pricing was seen to be of less concern for water-consuming companies than the prospect of uncertainty of supply. The paper argued that the former could be improved through efficiency incentives and investments in water saving technologies.

Award criteria

Best piece of ESG research by an individual analyst or team

The following four criteria were considered by the ESG Research Australia judging panel in assessing research produced by the sell side for their clients and asset owners.

Usability

The panel looked to test the ease with which analysts could incorporate the research into their stock analysis by gauging its practicality and whether there is a framework underlying the analysis. Ideally, the research should contribute to the further integration of ESG into investment analysis. The panel looked for:

- analysis of ESG impacts on company-specific investment value drivers
- integration into securities valuation, and
- companies' integration of ESG analysis into securities recommendations

Rigour

The panel examined whether the research was rigorous, including the approach taken in the analysis and to the development of a framework to assess the issues. The panel also looked for the issues to be clearly identified in a timely manner. Clarity of thought and expression was also important. Data was required to be expressed in a way that allowed key issues to be incorporated into company valuations.

Reliability

The panel looked to test the investment relevance of sector and issue analysis, specifically:

- the significance of top-down and thematic analysis for decision-making
- identification of sector themes and impacts, and
- differentiation of long- and short-term horizon impacts

Originality

The panel looked to see if the research contained any new information and insights, although the general topic may have covered an existing issue. This would include an assessment of the reasoning applied in the analysis and transparency of research outputs. The panel also looked to see if the research was sufficiently differentiated from other material available in the market place.

Best ESG broking firm

Best ESG Broking Firm as voted by investment managers is awarded by ESG Research Australia to the broking firm rated highest for overall service and provision of ESG research on Australian equities.

This award is based on investment managers' opinions as to which broking firm is providing, in their view, the most valuable ESG research and support. Different investment managers will have different views on what is most valuable, and so this award recognises the variety of ways in which ESG can be incorporated into the investment process. The award is intentionally subjective in nature as it reflects investment managers' opinions of value and service in ESG.

The award encapsulates the views of all investment managers that are ESG Research Australia members. The broad and representative cross-section of investment managers helps to acknowledge the broking firm with the best ESG capabilities and service.

The award reflects the remuneration, via brokerage directed through a panel system or specific research tags, paid by ESG Research Australia investment manager members for ESG research services received over the relevant year of the award.

Officially submitted research

All members of ESG Research Australia were invited to submit research they thought was worthy of consideration by the research assessment committee. The following pieces were submitted (in alphabetical order):

- Alternative Energy Momentum Building: Companies at Citi's Inaugural Australian Investment Conference (Elaine Prior, Citi)
- Australia's Hidden Resource: The Economic Case for Increasing Female Participation (Tim Toohey, David Colosimo, Andrew Boak, GSJBW)
- Australian Carbon Pollution Reduction Scheme: De-carbonising the CPRS (Timothy King, Brendan Fitzpatrick, Deutsche Bank)
- Australian Carbon Trading Update: Political Debate and Lobbying Intensify (Elaine Prior, Citi)
- Australian Coal Mining Under CPRS: Assessing Emissions Trading Impact – Are Mines at Risk? (Elaine Prior, Citi)
- Australian Emissions Bill Fails: What next? (Elaine Prior, Citi)
- BHP Billiton Sustainability Briefing: Focus on Carbon, Safety & Water (Elaine Prior, Citi)
- Bluescope Steel, Onesteel & CPRS: Quantifying Carbon Pollution Reduction Scheme Impacts (Elaine Prior, Citi)
- Carbon Emissions: It's Tough at the COP: After the Confusion, Uncertainty.... (Mark Lewis, Isabelle Curien, Deutsche Bank)
- Carbon Pollution Reduction Scheme Negotiated Amendments But Will It Get Through The Senate? (Andrew Gray, GSJBW)
- Carbon Pollution Reduction Scheme: Financial Impact on ASX100 Companies & More (Elaine Prior, Citi)
- Cement emissions not in the clear just yet (Ben Chan, Merrill Lynch)
- Does Corporate Governance Add Value? GMI Performance in Australia (Vyas Balasubramanian, Oliver Antrobus, UBS)
- ESG – Basic Industrials - No Incentive = Not Important (Alistair Reid, Andrew Scott, Thomas Reif, Thomas G Beadle, JP Morgan)
- ESG – Regulating Diversity (Aimee Kaye, Macquarie)
- ESG – Remuneration rigour (Aimee Kaye, Macquarie)
- ESG Exploration - Human Capital (Ian Myles, Aimee Kaye, Macquarie)
- Good Ethics & Culture = Good Investment Returns (Andrew Gray, GSJBW)
- Good Governance = Good Investment Returns; Long Term Returns Are Strong, And It Was "GFC Safe" (Andrew Gray, GSJBW)
- Metals & Mining: Coal and Carbon – A Load of Hot Air? (Craig Sainsbury, Clarke Wilkins, Elaine Prior, Citi)
- Oil & Gas Sector: A review of the potential impact of an Emissions Trading Scheme (Mark Greenwood, Benjamin Wilson, Dale Koender, JP Morgan)
- Opportunities in Water Solutions: Water Update 4: Several Companies May Benefit, Leverage is Low (Elaine Prior, Citi)
- Safety Spotlight: ASX100 Companies & More: Injury and Fatalities Data Presented and Interpreted (Elaine Prior, Citi)
- Safety Spotlight: BHP Pilbara Iron Ore: Five Fatalities Including Three LEI Contractors in Ten Months (Elaine Prior, Citi)
- Thirsty Thoughts: Edition 15: Assessing ESG Risks at FGL, LNN and CCL (Andy Bowley, Craig Woolford, Tim Mitchell, Elaine Prior, Citi)
- Water Challenges for ASX100 Companies: Adapting to Increasing Water-Related Risk (Elaine Prior, Citi)
- Water Challenges for ASX100 Companies: Update No 1: Includes Beverage Company Data (Elaine Prior, Citi)
- Water Worries: Record Low Murray Inflows: Water Update 3: OneSteel, Newcrest, Rio Tinto, Foster's & AGL (Elaine Prior, Citi)
- Weaning Cars off Oil – an Accelerating Trend (Elaine Prior, Citi)

About ESG Research Australia

ESG Research Australia is an association of Australian superannuation funds, fund managers and asset consultants which has the single objective of increasing the amount and quality of broker and other equity research in Australia that includes consideration of ESG issues. ESG Research Australia is an association incorporated under Australian law (incorporated 2009) and is governed by an Executive Committee comprised of fund managers and superannuation funds and is currently Chaired by Rob Fowler from HESTA Super Fund. Membership currently represents 42 institutions managing over \$100 billion in Australian equities, including some of Australia's largest fund managers and superannuation funds.

The judging panel

The Judging Panel for the award *Best Piece of ESG Research by an Individual Analyst or Team* comprised of:

Amanda McCluskey, Head of Sustainability & Responsible Investment; Colonial First State Global Asset Management (Chair)

Azhar Abidi, Director, Sustainability and Responsible Investment; Industry Funds Management

Dinusha Peiris

Don Hamson, Managing Director; Plato Investment Management Limited

Graeme Rough, Executive Director & Chief Executive Officer; UCA Funds Management

Helen Bloustein, Executive Manager Sustainability & Education; VicSuper

Richard Fuller, Investments Analyst (PRI); HESTA Super Fund

Sam Dyson, Portfolio Manager; Maple-Brown Abbott

Talieh Bentley, Manager, Governance and Sustainable Investment; UniSuper

Tim Macready, Chief Investment Officer; Christian Super

With additional feedback from David Paradise, Portfolio Manager; Paradise Investment Management

ESG Research Australia members

Fund managers	Super funds
Acadian Asset Management (Australia) Ltd	AustralianSuper Pty Ltd
Ankura Capital	CareSuper
Ausbil Dexia Limited	Catholic Superannuation & Retirement Fund
Aviva Investors Australia Limited	Catholic Superannuation Fund
BlackRock	Cbus
Colonial First State Global Asset Management	Christian Super
Eley Griffiths Group Pty Ltd	Health Super
Fortis Investment Partners Pty Ltd	HESTA Super Fund
Goldman Sachs JBWere Investment Management Pty Ltd	Non-Government Schools Superannuation Fund
Greencape Capital	Statewide Superannuation Trust
Hyperion Asset Management Limited	Unisuper Management Pty Ltd
Industry Fund Management	VicSuper
ING Investment Management	Vision Super
Investors Mutual Limited	Asset consultants
JF Capital Partners Ltd	Frontier Investment Consulting
Maple-Brown Abbott	Mercer Investment Consulting
Northcape Capital Pty Ltd	
Northward Capital	
Orbis Australia	
Paradise Investments	
Perennial Growth Management	
Plato Investment Management Ltd	
PM Capital Limited	
Queensland Investment Corporation	
Renaissance Smaller Companies	
Tyndall Investment Management	
UCA Funds Management	

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