NEW ZEALAND ESG RESEARCH
8 DECEMBER 2022

Transitioning New Zealand Business
Forsyth Barr's Inaugural Carbon & ESG Ratings

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Carbon, Environmental, Social and Governance (CESG) information has become a dominant focus for business leaders, investors, consumers and regulators over recent years. Whether in the form of ratings, regulations or banking covenants, CESG information is already widely used in decision-making. But a lack of confidence in CESG data still exists, causing hesitancy and uncertainty at a time when bold decisions are needed.

Greater standardisation, robustness and accountability of CESG information is needed to enable the big decisions that will make deep inroads and fast track the transition to a more sustainability-focussed economy. As demand for CESG information grows, so does the importance of transparent and reliable data to enable accurate assessment. Given the complexity and quantum of data required to make informed decisions, investors, financial institutions and other stakeholders are increasingly relying on externally sourced ESG assessments and rankings.

Current external ESG ratings of New Zealand companies do not give us the insights stakeholders need. There is not enough granular detail with appropriate geographical nuance for the New Zealand market. The data is predominantly backward-looking, whereas we need a focus on the future. Further, existing ratings do not cover an adequate range of New Zealand companies. Finally, there is a lack of transparency regarding the methodology used and a valid argument that ratings contradict each other.

Forsyth Barr's CESG ratings have been designed to solve the gap in resources. In a year long investigation, we've undertaken detailed due diligence and analysis of the 57 New Zealand companies that we cover, collected over 6,500 pieces of CESG data and turned it into an overall score that classifies companies as *Leader*, *Fast Follower*, *Explorer* or *Beginner*. Our full methodology is available (refer to the separate Forsyth Barr CESG Rating Methodology document) as are the individual scorecards of each of the 57 companies we assessed. This transparency is important as we tackle the well known challenges of ESG ratings and assess how New Zealand is positioning itself for a sustainability-focussed future.

From ESG to CESG: A key change we have made from the external ESG service providers is to split Carbon (C) metrics out from the Environment (E) category. We have found that, historically, carbon related metrics can dominate the constituents of an 'E' rating. We did not want to lose sight of the importance of the other 'E' matters, while giving appropriate weight to the low carbon transition currently underway.

Our findings highlight that corporates are moving on the sustainability agenda and it is a quickly evolving space — but there is a lot more work to do. There is a significant gap between the *Leaders* and *Beginners*. The majority of companies fall into the *Fast Follower* and *Explorer* categories. And for those delayed in getting underway, there is increasing urgency to take meaningful action.

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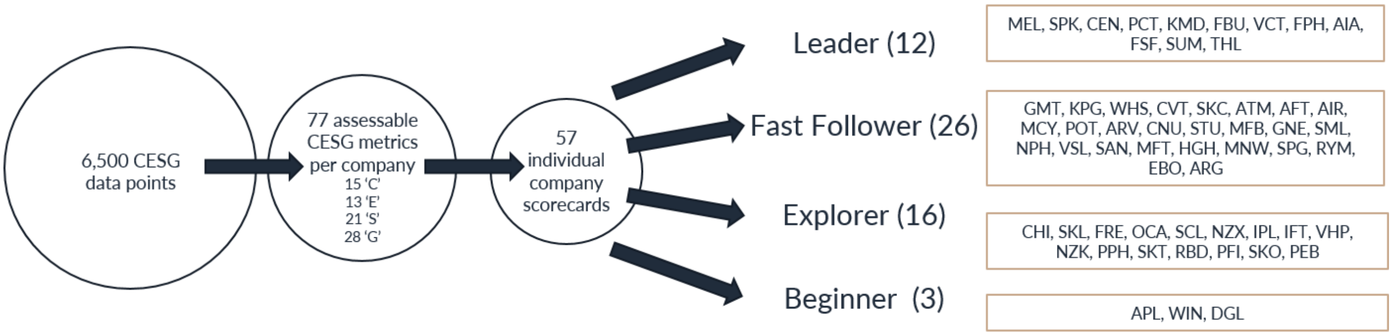
Executive summary

It has been a particularly interesting year for the ESG market with war, market volatility, the cost of living crisis and the lingering effects of a pandemic causing heightened and polarising attention. The evolution of the industry continues at speed with a focus on Net Zero, green-washing and legislation driving improved ESG related disclosure in New Zealand and across the globe.

Internationally, ESG criticism has been in the headlines, particularly in the US where a number of States are arguing that ESG investing breaches their laws on fiduciary duties. Also under the spotlight are some of the Net Zero alliances that have proven extraordinarily popular in the last two years. Despite the criticism, **ESG products are attracting capital at a faster rate than their non-ESG counterparts**, even during the challenging market environment of this year.

We have undertaken detailed due diligence and analysis of the 57 New Zealand companies we cover. In a year-long investigation we collected over 6,500 pieces of CESG data, analysed it and turned it into an overall score that classifies companies as a *Leader*, *Fast Follower*, *Explorer* or *Beginner*. Our full methodology is available (refer to the separate Forsyth Barr CESG Rating Methodology document) as are the individual scorecards of each of the 57 companies we assessed.



The ratings help to build confidence in the potential of a company's long-term success, and the scorecards help to identify areas of risk beyond traditional financial analysis that warrant further investigation. The information we have gathered enables an assessment of how companies are adhering to best practice CESG standards and how they are navigating risks and opportunities associated with CESG themes. It provides insights on how companies are positioning themselves for a low carbon, more sustainability-focussed future and how they are thinking about their impact on the environment and society. It also enables an assessment of how companies are adapting to the ever increasing demands of different stakeholders.

We find that corporates are moving on the sustainability agenda and it is a quickly evolving space — but there is a lot more work to do. There is a significant gap between the *Leaders* and *Beginners*. The majority of companies fall into the *Fast Follower* and *Explorer* categories. And for those delayed in getting underway, there is an increasing urgency to catch up fast.

Companies scored best on the Governance section with an average rating of 72%, followed by the Social section (66%), then the Carbon section (52%) and finally the Environmental section (49%). The Utilities, Consumer, Infrastructure, Aged Care, Health Care and Industrials sectors scored above the New Zealand average CESG score.

Best practice CESG ratings in New Zealand. This first iteration helps us to understand where companies are at currently on their CESG journey. It acts as a baseline from which we can measure progress. As the data gets better and our insights deeper, we plan to evolve the framework and methodology, and raise the bar year on year, finding ways to better assess the quality of responses.

We hope that by being completely transparent with our methodology and the company scorecards, we set the benchmark for best practice CESG ratings in New Zealand. We invite feedback and ideas for evolution.

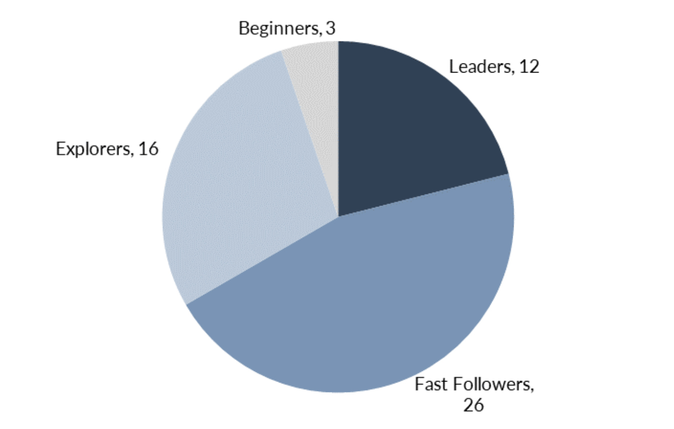
Our findings summarised

The 12 *Leaders* have sustainability strategies that have been in full operation for multiple years and are integrated into business strategies. Generally, they are collecting and reporting on a wide range of CESG metrics. They recognise key CESG risks and opportunities and are managing them. They are well versed on stakeholder demands and how they are evolving. They are already well prepared to meet upcoming climate disclosure standards. In addition, while at an early stage, they are beginning to understand and talk about the potential positive and negative impacts of business operations on the environment, economy and people. Importantly, for ten out of the 12 companies with leading CESG scores, actual carbon emissions are trending down when looked at over a five year period — no doubt helped by COVID but we see this as a strong differentiator from the *Beginners*.

The majority (74%) of companies fall into the *Fast Follower* or *Explorer* categories, reflecting that this is a very quickly evolving space with lots of movement in progress. But catching the *Leaders* will be hard. Gaining momentum on ESG actions can take some time. Actions tend to start with a focus on policies and processes before evolving into outcomes that have a positive impact and can be measured, such as reducing actual greenhouse gas emissions.

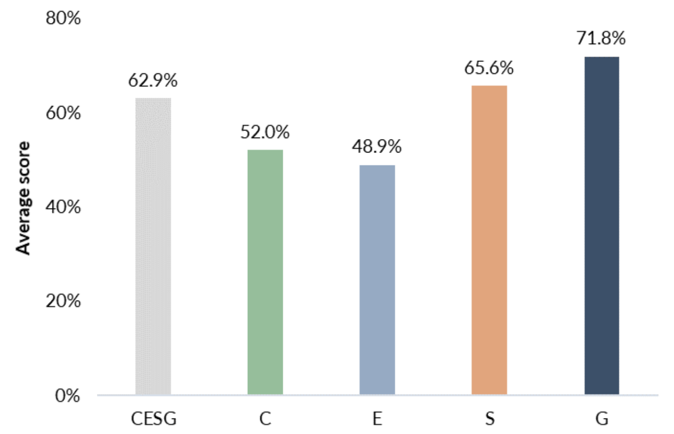
While the *Beginners* are early on in the CESG journey, **almost all the companies we assessed either had a sustainability strategy in place or one under development.** We note there are valid reasons for why a company may only be starting to build CESG management capabilities now. Some companies are newly listed and have not been asked to provide this information before. Others are outside the NZX50 and have not been rated by external ESG ratings providers before, so for these companies it is also the first time being asked for CESG information. Others have not had a commercial or regulatory imperative to report on ESG information until now.

Figure 1. CESG Leaders, Fast Followers, Explorers, Beginners



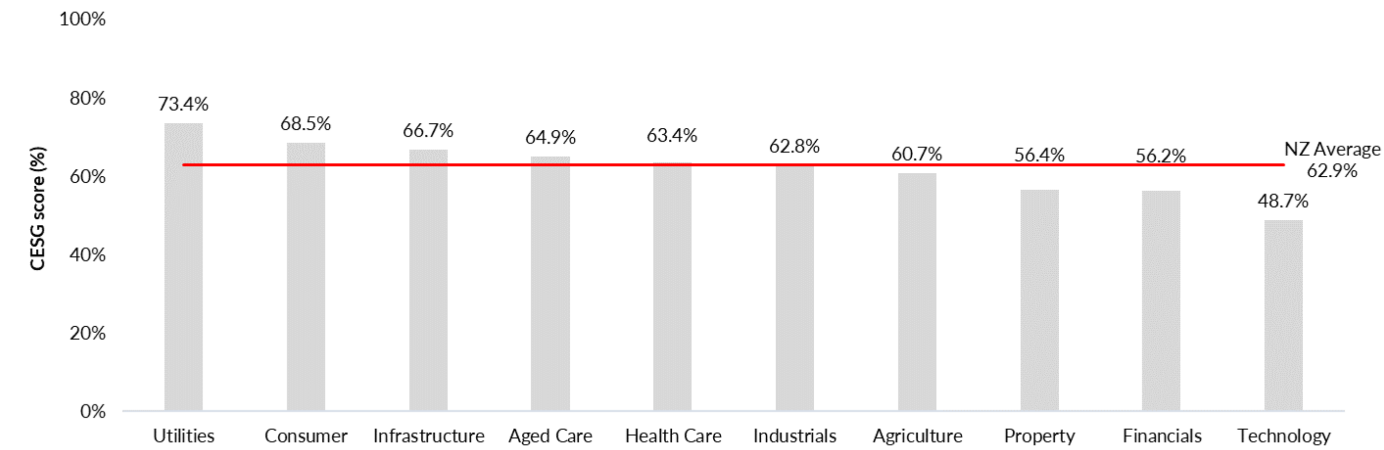
Source: Forsyth Barr analysis

Figure 2. Average CESG scores



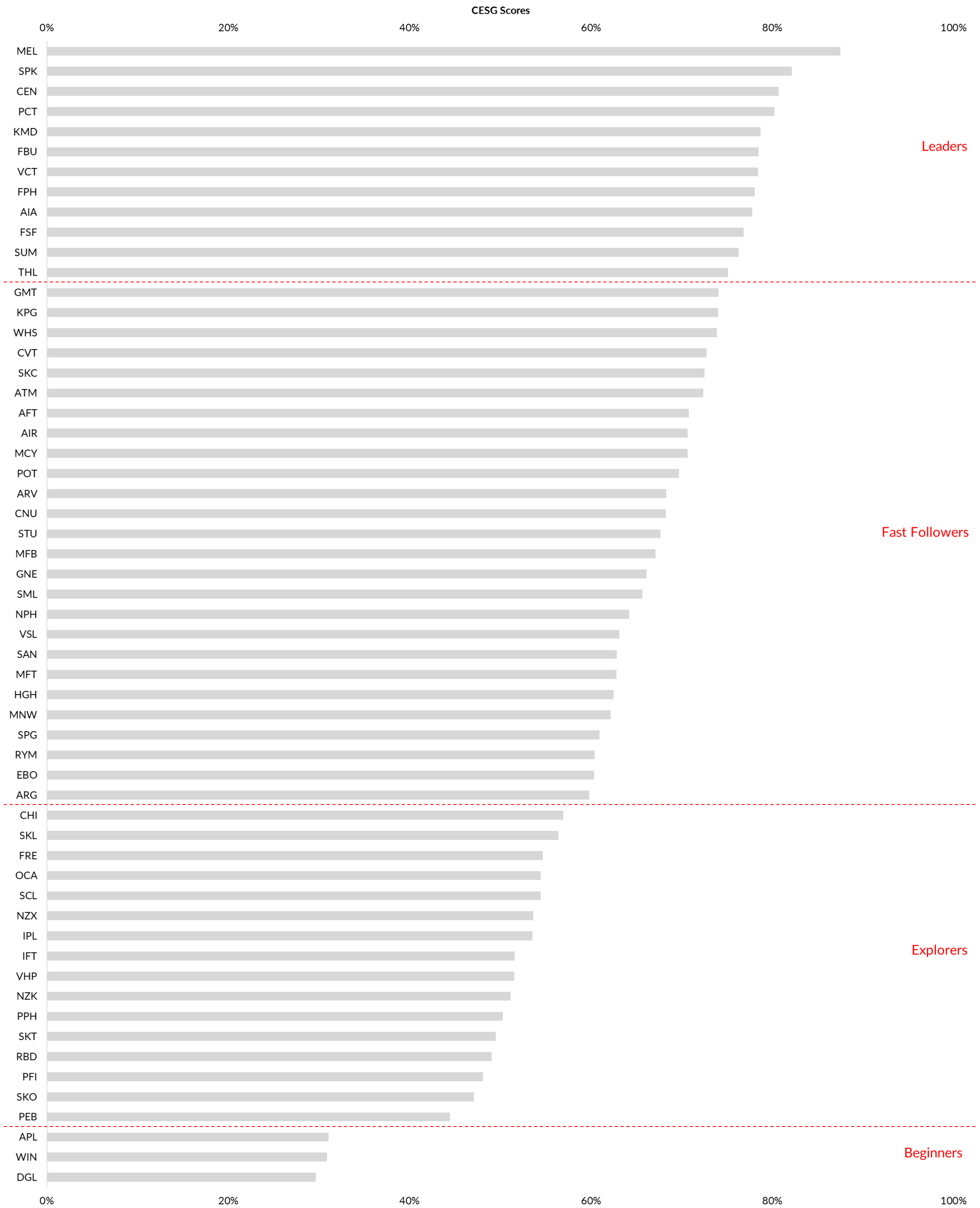
Source: Forsyth Barr analysis

Figure 3. CESG sector performance



Source: Forsyth Barr analysis

Figure 4. Forsyth Barr's inaugural CESG ratings of New Zealand companies



Source: Forsyth Barr analysis

This is our first year of capturing CESG data. We recognise our framework is a work in progress and we accept that some of the data we use is new, quickly evolving and can be prone to restatements. In some situations, the data we have used is focussed on policy rather than implementation or outcomes. On the positive side, companies have been very interested to understand what CESG information is important to investors. They have also appreciated being able to directly see where they can improve.

This first iteration helps us to understand where companies are at currently on their CESG journey. It acts as a baseline from which we can measure progress. As the data gets better and our insights deeper, we plan to evolve the framework and methodology, and raise the bar year on year, finding ways to better assess the quality of responses. We hope that by being completely transparent with our methodology, and the company scorecards, we set the benchmark for best practice CESG ratings in New Zealand. We invite feedback and ideas for evolution.

From a Carbon (C) perspective

With the External Reporting Board (XRB) about to finalise and issue the first Climate-related Disclosures Standards, requiring relevant entities to make disclosures alongside wider year end reporting in 2023, **most companies are well underway with their preparations for responding**. But a few are yet to move. 43 companies have set actual carbon emission reduction targets and/or Net Zero emissions commitments. However, we note the emissions that companies report are prone to recalculations and there are inconsistencies between companies and within sectors in stated emissions sources. Further, **Net Zero targets differ in ambitions and boundaries**. Importantly, for the majority of companies with leading CESG ratings, actual carbon emissions are trending down when looked at over a five year period — no doubt helped by COVID but we see this as a strong differentiator from the *Beginners*.

A HISTORY OF CARBON DATA IS STARTING TO BUILD

27 companies have been reporting Scope 1 and 2 emissions for five or more years

GHG EMISSIONS ARE SHOWING EARLY SIGNS OF DECLINE

15 companies reporting Scope 1 and 2 emissions data for five or more years are showing a declining trend in GHG emissions

CORPORATE AMBITIONS ARE BEING STATED

43 companies have either a Net Zero commitment and/or an Emissions Reduction Target in place

...ROBUSTNESS IS BUILDING

23 companies with Emissions Reduction Targets in place have set Science Based Targets

From an Environmental (E) perspective

Management of environmental issues scores the weakest of the four categories. **Data on waste intensity and water consumption efficiency is often lacking whereas early commitments to reducing the impact of company operations on biodiversity and supporting a circular economy are promising.** While a number of companies were of the view that water consumption is not a material issue for them to manage, we are of the view that companies should be operating to best practice standards to minimise all resource use and the resulting impact on the environment. The very first step in enabling this is to measure resource use. Other E initiatives such as constructing buildings to level six Green Star standard or issuing green bonds are few and far between. Resource consent discharge breaches in the Agriculture sector and environmental fines (more generally) are more common than expected.

ON THE POSITIVE SIDE...

25 companies have made commitments to reduce the impact of operations on biodiversity

AND...

27 companies have made commitments to the circular economy

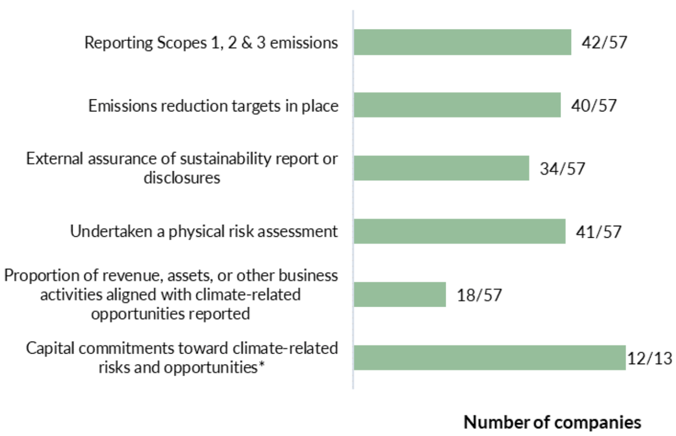
BUT ONLY...

3 companies have made commitments to leasing, retro fitting or building six Green Star buildings

BREACHES AND FINES ARE TOO COMMON FOR COMFORT

8 companies received environmental fines in the last three years and three of eight Agriculture companies have breached resource consent discharges

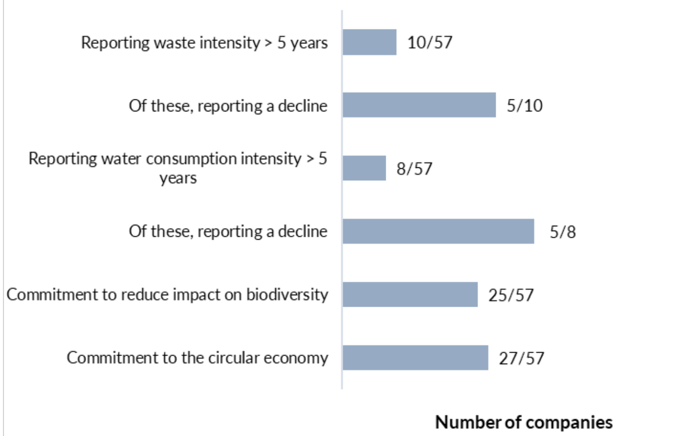
Figure 5. Preparation for NZ's climate disclosure standards is progressing



Source: Forsyth Barr analysis

Note: the capital commitments toward climate-related risks and opportunities metric was only collected for companies in the Industrials and Utilities (heavy-emitting) sectors

Figure 6. Early commitments to preserve biodiversity and support a circular economy are promising



Source: Forsyth Barr analysis

From a Social (S) perspective

The majority of companies have policies in place for managing health and safety, supply chain issues and community involvement. 56% of companies, having modernised their parental leave policies over recent years, show us there is positive momentum in this space. Our diversity metrics focus mostly on gender but we expect this will widen in the near future given the number of external campaigns supporting progress in this area. Disruptions to operations due to data security breaches is a live issue that has significantly affected a number of financial services companies in recent years. Companies are broadly aware of evolving stakeholder demands in 'S' space and regularly talk about community initiatives in place. However, **we are of the view these can become much more strategic, coordinated and aligned with business strategy.** With closed borders over the last few years and the 'Great Resignation' playing out, we also looked at employee turnover. 33% of companies report this figure publicly and the average employee turnover reported was 22%. This compares to c. 20% in the US and c. 15% in Australia.

MOST COMPANIES MEASURE SAFETY PERFORMANCE

45 companies have safety management targets in place

PROPOSED REGULATION IS DRIVING BEHAVIOUR

44 companies have made commitments to reduce modern slavery

COMPANIES RECOGNISE THEY CAN INFLUENCE SUPPLIERS

34 companies have a supply chain code of conduct

ETHNIC DIVERSITY DATA HAS ROOM FOR IMPROVEMENT…

18 companies report ethnic diversity data

…BUT GENDER DIVERSITY LOOKS MUCH BETTER

53 companies report the percentage of women managers in relation to employees

From a Governance (G) perspective

Companies scored strongest on the Governance metrics. This is encouraging given we weighted the governance questions at 40% of the total CESG score across all sectors. The importance of strong corporate governance practices has been well evidenced over the decades. If a board ignores corporate governance safeguards a company can fail. On the flip side, when good strong corporate governance processes are in place companies can benefit from a healthy corporate culture and risk control, with procedures streamlined and consistent. Generally New Zealand corporate governance is pretty strong but there are a few idiosyncrasies to note. Notably, **28 companies in New Zealand have had the same auditor for over ten years.**

THE 'G' SECTION SCORED THE STRONGEST OF THE 4

53 companies have independent board members that comprise the majority of boards

GENERALLY NZ COMPANIES DO WELL ON 'G'

54 companies have audit committees where all members are non-executive directors

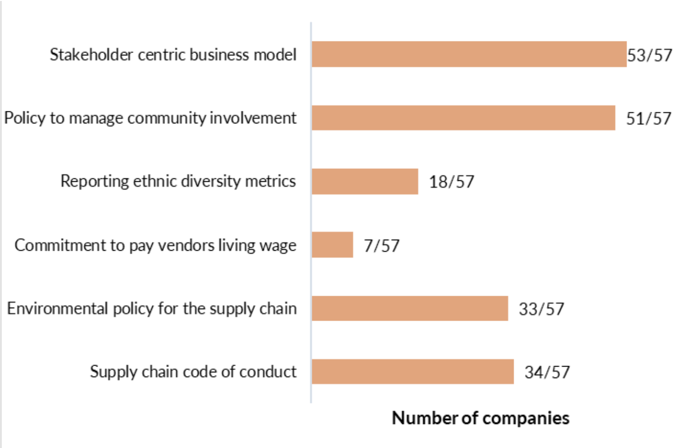
BUT THERE IS ROOM FOR IMPROVEMENT

53 companies have data privacy and protection polices in place

AND AUDITOR INDEPENDENCE IS AN OUTLIER

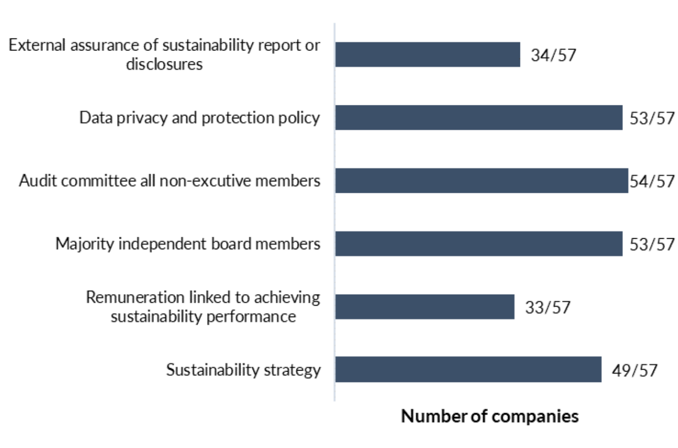
28 companies have auditors with a tenure 10 years or longer

Figure 7. Performance of the 'S' metrics is broadly good



Source: Forsyth Barr analysis

Figure 8. 'G' metrics are the strongest of the four categories



Source: Forsyth Barr analysis

Forsyth Barr's inaugural CESG ratings for NZ companies

The transition to a more sustainability-focussed economy is underway but it is early days. The pathway is uncertain and different parts of the economy are moving at different speeds. From an investment perspective, we recognise the potential for significant disruption for businesses — particularly for carbon-intensive industries, those that sell polluting or harmful products, and those with assets located in areas vulnerable to intensifying physical risks of climate change. The risk is amplified by the introduction of legislation, whether planned or knee-jerk, and carbon pricing, alongside changing consumer and investor preferences. Company executives need to focus on successfully managing a business from a strategic and operational perspective, while also effectively managing CESG risks and opportunities, and thinking long term about how to position the company for the required transition.

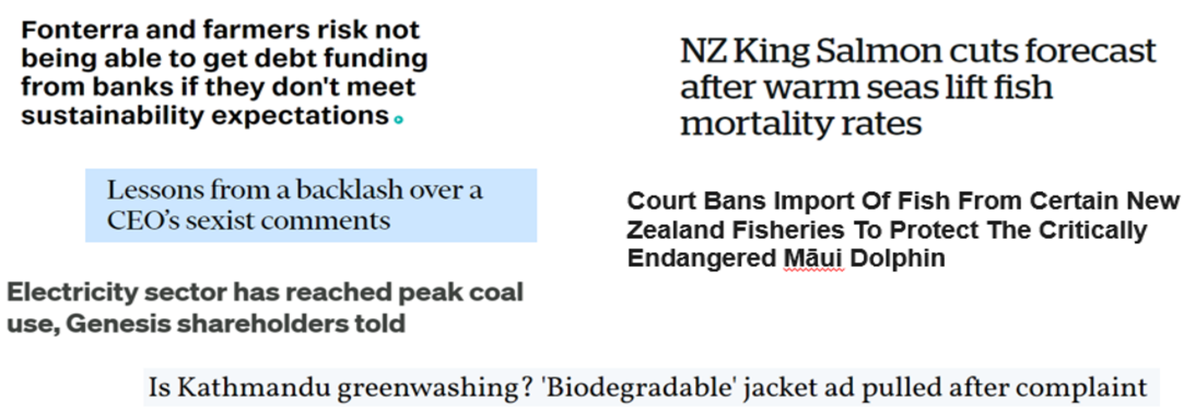
Figure 9. CESG information provides an additional lens for investors to assess the long term prospects of a company

	The benefits	The CESG scorecards can
For investors	▪ Building ESG analysis into the fundamental analysis of a company can help provide a well-rounded, holistic lens that considers a company's financial health as well as an assessment of how well it is planning for a low carbon, more sustainability-focussed economy ▪ The CESG scores are a measure of a company's competitive positioning on CESG, they supplement a screen for quality and they help to identify areas of risk beyond traditional financial analysis that warrants further investigation. In a nut shell, they help to better appraise companies and build confidence in the potential of their long-term success	▪ Act as ESG due diligence on NZ companies ▪ Help identify key ESG risks and opportunities for companies ▪ Identify which companies are managing ESG risks well and are positioning themselves well for a low carbon, more sustainability-focussed future ▪ Support investor engagement efforts with companies on ESG issues
For companies	▪ An ESG strategy can help manage the passage through the transition and the many associated stakeholder demands and expectations ▪ ESG can be framed in terms of business optimisation: it can help make processes more efficient, improve trust with customers, regulators and staff, and help to manage risk. There is also an element of 'because we should' in there. But it is not all about risk, opportunity and cost savings. In reality, spend is needed to do this genuinely and we believe when companies are building out their ESG capability, it is an investment into the longevity of a firm	▪ Enable a company to see how it compares to its peers and the NZ market ▪ Gain insights on what is really important to investors ▪ Build out a programme for improving CESG performance

Source: Forsyth Barr analysis

CESG information, whether in the form of ratings, regulations or banking covenants, is already widely used in decision-making. But hesitancy and a lack of confidence in CESG data still exists.

Figure 10. Sustainability requirements are hitting the headlines


Fonterra and farmers risk not being able to get debt funding from banks if they don't meet sustainability expectations

NZ King Salmon cuts forecast after warm seas lift fish mortality rates

Lessons from a backlash over a CEO's sexist comments

Court Bans Import Of Fish From Certain New Zealand Fisheries To Protect The Critically Endangered Māui Dolphin

Electricity sector has reached peak coal use, Genesis shareholders told

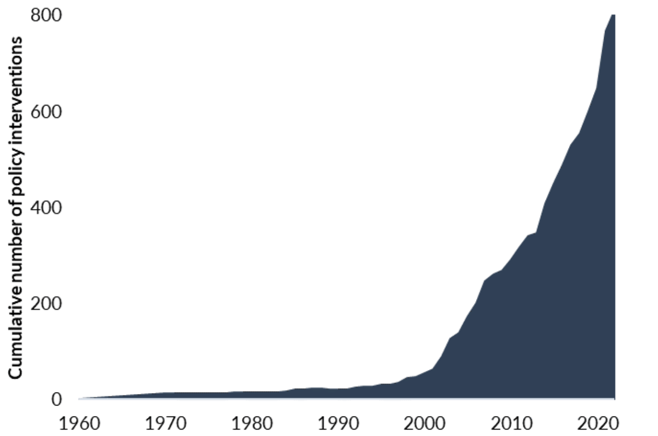
Is Kathmandu greenwashing? 'Biodegradable' jacket ad pulled after complaint

Source: Forsyth Barr analysis

Global focus on sustainability-related disclosures and green-washing

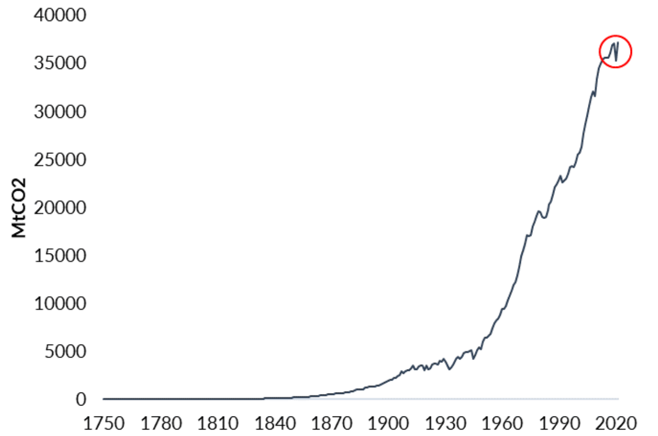
We have released this analysis at a time of heightened focus on sustainability-related disclosures across the world, including in New Zealand. The urgency to act becomes greater by the day as global greenhouse gas emissions recover from the COVID-induced drop, continuing on their steep ascent.

Figure 11. Global policy intervention on sustainable finance



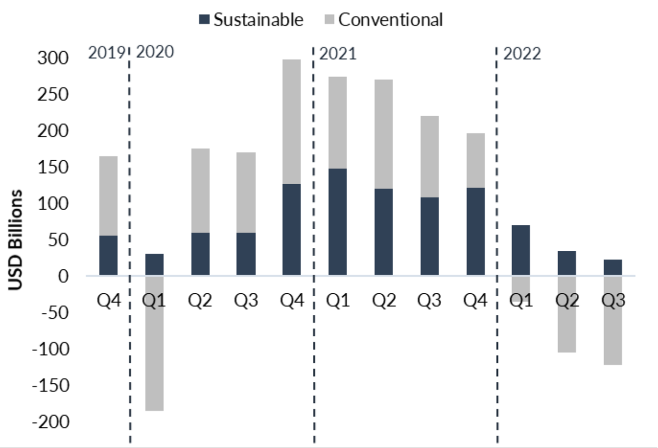
Source: Forsyth Barr analysis, UNPRI database

Figure 12. World annual emissions rebound



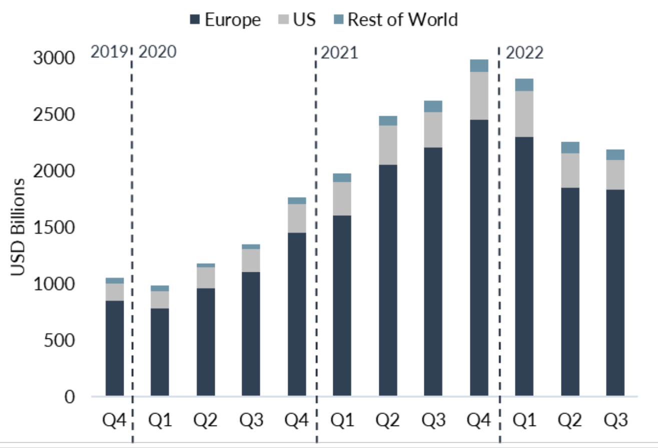
Source: Forsyth Barr analysis, Our World in Data

Figure 13. Sustainable fund flows v conventional fund flows



Source: Forsyth Barr analysis, Morningstar Direct

Figure 14. Quarterly global sustainable fund assets



Source: Forsyth Barr analysis, Morningstar Direct

In addition, green-washing has enhanced the attention of regulators:

- In **Australia, ASIC published guidance for superannuation funds on how to avoid green-washing** when promoting sustainability-related products.
- And **in New Zealand, earlier this year the FMA released results of a survey that revealed 68% of New Zealand investors want ethical and responsible investments but few have actually chosen a fund manager based on its ethical credentials.** Driving this are multiple barriers including technical jargon and difficulty navigating ethical investment options. The FMA noted fund managers need to do a better job of describing their approach, benefits, and objectives, and of describing how investments are selected. A month later, the FMA made additional statements saying fund managers need to do a better job on product disclosure and ensuring their websites, marketing and advertising materials all "knit together".
- The spotlight on green-washing has resulted in the **SEC fining Goldman Sachs Asset Management for not following its ESG investment policies**. This comes on the back of the **SEC's investigation into DWS' ESG claims** last year and a **$1.5m fine for BNY Mellon for misstatements and omissions about ESG considerations** in making investment decisions for certain mutual funds that it manages.

Figure 15. NZ and global sustainability-related disclosure developments

Country	Body	Update
NZ	External Reporting Board (XRB)	In December 2022, the External Reporting Board (XRB) is due to release the final Climate-related Disclosure Standards it has been working on since September 2020 when the government announced its intention to implement mandatory reporting on climate risks. Once the XRB issues the standard, climate-related disclosures become mandatory for large, listed companies with a market capitalisation of more than $60 million; large-licensed insurers, registered banks, credit unions, building societies and managers of investment schemes with more than $1 billion in assets; and some Crown financial institutions (via letters of expectation). These entities will be required to make disclosures alongside wider year end reporting, beginning 2023.
Global	International Sustainability Standards Board (ISSB)	At Glasgow's COP26 last year, we saw the establishment of the International Sustainability Standards Board (ISSB), a standard-setting organization that is subject to the oversight of the IFRS Foundation. The ISSB has been convened with a view to set the foundations of a global baseline for sustainability-related disclosures for the capital markets. During 2022, it has established a board which is now fully operational and committed to issuing its first two standards for adoption in 2023 following extensive global consultation this year.
EU	European Commission	The EU Council on 28 November 2022 announced final approval of the Corporate Sustainability Reporting Directive (CSRD), marking the last major step in the overhaul and expansion of corporate sustainability reporting in the EU. The rules will begin applying from the beginning of 2024 for large public-interest companies with over 500 employees, followed by companies with more than 250 employees or €40 million in revenue in 2025, and listed SMEs in 2026. The new rules will significantly expand the number of companies required to provide sustainability disclosures to over 50,000 from around 12,000 currently, and introduce more detailed reporting requirements on company impacts on the environment, human rights and social standards, and sustainability-related risk.
US	Securities and Exchange Commission (SEC)	The SEC has also proposed requirements for companies to disclose information on climate-related risks that are likely to impact their business, as well as any climate goals or planning that the company has developed in response. It has prompted a polarising response with some critics demanding the SEC halts further work to maintain its 'market-focussed' domain rather than making a 'misadventure into environmental regulation'. Others have argued that the SEC has clear statutory authority to mandate the disclosures for listed companies. Nasdaq also pushed back against the proposals calling for the SEC to consider adopting a comply-or-explain approach rather than mandatory disclosures for all issuers, while some asset owners have called for the SEC to go further, asking for additional disclosure requirements.

Source: Forsyth Barr analysis

Figure 16. Green-washing has caught the eye of regulatory bodies

Source: Forsyth Barr analysis

In our view, the scrutiny is much needed and a sign the market is maturing. While it may seem there is a proliferation of global reporting standards relating to sustainability disclosures, it is actually a much needed consolidation that will, in time, lead to more robust and comparable ESG data from companies across the world.

Methodology — in summary

Forsyth Barr's CESG ratings have been designed to solve the gap in resources. In a year-long investigation, we have undertaken detailed due diligence and analysis of the 57 New Zealand companies that we cover, collected over 6,500 pieces of CESG data and turned it into an overall score that classifies companies as a *Leader*, *Fast Follower*, *Explorer* or *Beginner*. Our methodology is available as are the scorecards of all 57 companies we assessed. This is important as we seek to tackle the well known challenges of ESG ratings and look at how New Zealand is positioning itself for a sustainability-focussed future.

Each piece of data we asked for was carefully chosen to give us a particular insight. For details on why we chose particular metrics and how they are scored, please see Forsyth Barr's CESG Rating Methodology document. We have applied a materiality lens by focussing on information that can highlight where risks and opportunities may lie, as well as a best practice lens to help us understand the maturity level or how far advanced a company is in their positioning for a carbon-constrained and sustainability-focussed future.

Figure 17. The companies we have rated, by sector

Aged Care	Agriculture	Consumer	Financials	Health Care	Industrials	Infrastructure	Property	Technology	Utilities
SUM	FSF	SPK	HGH	FPH	FBU	VCT	PCT	PPH	MEL
ARV	CVT	KMD	NZX	AFT	AIR	AIA	GMT	SKO	CEN
RYM	ATM	THL		EBO	STU	POT	KPG		MCY
OCA	SML	WHS		PEB	VSL	CNU	SPG		GNE
	SAN	SKC			MFT	NPH	ARG		MNW
	SCL	MFB			SKL	CHI	IPL		
	NZK	SKT			FRE	IFT	VHP		
	DGL	RBD					PFI		
							APL		
							WIN		
4	**8**	**8**	**2**	**4**	**7**	**7**	**10**	**2**	**5**

Source: Forsyth Barr analysis

Our expectations

The information we have gathered enables an assessment of how companies are adhering to best practice CESG standards and navigating risks and opportunities associated with CESG themes. It provides insights on how companies are positioning themselves for a low carbon, more sustainability-focussed future, and thinking about the impact of their operations on the environment and society. It also enables an assessment of how companies are adapting to the ever-increasing demands of different stakeholders.

Figure 18. Our CESG expectations of NZ corporates

Category	Example expectations
Carbon	■ Have a good understanding and be proactively managing any physical and transition risks associated with climate change ■ Understand how its business model might be affected by changing consumer preferences ■ Be preparing to meet upcoming climate disclosure standards
Environment	■ Have minimal negative impact on the environment as a result of operations ■ Minimise the use of natural resources and also work to reverse the degeneration of ecosystems ■ Be measuring and monitoring the consumption of water, waste that goes to landfill, and recycling efforts ■ Have good policies in place to help measure and monitor resource use
Social	■ Have a positive impact on the communities that surround company operations/support surrounding communities to thrive ■ Maintain and build on trusted relationships with clients, communities and other stakeholders ■ Ensuring committed and proud employees ■ Be measuring and monitoring health and safety incidents, risk of modern slavery ■ Be aware of and managing potential ESG issues in supply chains ■ Have good policies in place to help measure and monitor impact
Governance	■ Be adhering to best practice corporate governance standards and acting with integrity at all times ■ Ensuring sustainability is linked into the heart of business models ■ Proactively managing issues around, for example, data security, privacy and responsible tax governance

Source: Forsyth Barr analysis

We hope the ratings can help to build confidence in the potential of a company's long-term success and that the scorecards help to identify areas of risk beyond traditional financial analysis that warrant further investigation.

Figure 19. General characteristics of the Leaders, Fast Followers, Explorers and Beginners

CESG Score	Maturity level	General characteristics
A	Leader	▪ Full sustainability strategy in operation for multiple years, often having been updated and refined over time ▪ Detailed and full set of CESG metrics collected ▪ Predominantly meeting best practice standards ▪ Recognise key CESG risks and opportunities and is managing them ▪ Well versed on stakeholder demands and how they are evolving ▪ Understands its potential positive and negative impacts on the environment, economy and people, including human rights ▪ Transition to become a 'sustainable' company is well underway ▪ Well prepared for the upcoming Climate Disclosure Standards requirements ▪ Actual greenhouse gas emissions are stablising or trending down
B	Fast Follower	▪ Earlier stage sustainability strategy and/or a challenging sector for ESG issues ▪ Partial collection of CESG metrics, potentially with a heavy focus on one of the C, E, S or G categories ▪ Sometimes meets best practice standards ▪ Has a handle on key CESG risks and opportunities and has started measuring CESG performance but is not yet seeing deep progress on sustainability results ▪ The transition to become a 'sustainable' company is more a vision than a reality
C	Explorer	▪ Earlier stage of adopting or implementing a sustainability strategy ▪ Few CESG metrics collected with a short history ▪ On the journey towards meeting some best practice standards
D	Beginner	▪ First sustainability strategy under discussion or not yet existent ▪ Reporting few CESG metrics ▪ Really only at the very beginning of the CESG journey

Source: Forsyth Barr analysis

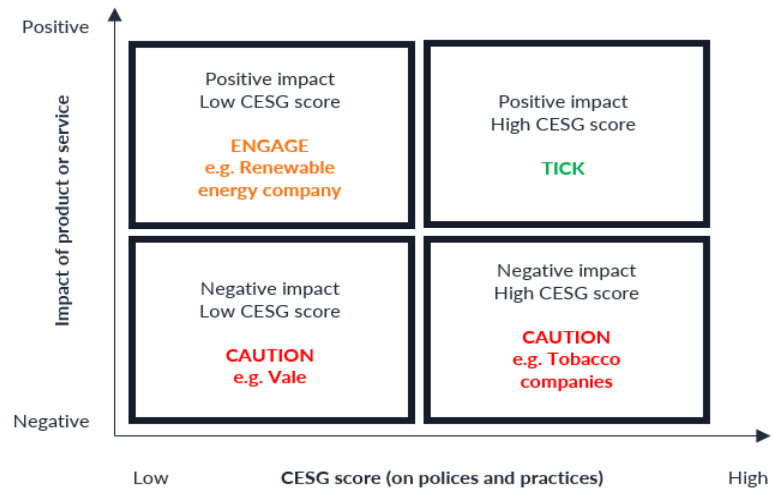
What these ratings are and are not

With the scrutiny on green-washing, the focus on improved labelling and the criticisms of ESG ratings, we thought it would be useful to explain what the ratings are and are not.

What they are: This is an assessment of companies' CESG commitments, policies and practices which are driving corporate behaviour. The objective is to get insights into how New Zealand companies are positioning themselves for a low carbon, sustainability-oriented future and how they are adhering to best practice standards. The ratings act as a baseline from which we can measure progress. **What they are not: It is not an assessment of a company's products and services.**

For investors who would like to bring these two concepts together, the figure below highlights an overlay that may be useful.

Figure 20. Schematic of a 'Products and Services Overlay' that could accompany our CESG ratings



- Products with a negative impact on society or the environment are unlikely to be suitable for sustainability related investment products despite a high CESG score.
- Assessing whether a company is transitioning a product or service towards one that contributes to or benefits from sustainability trends should be a core part of product assessment.

Source: Forsyth Barr analysis

Using the CESG ratings and company scorecards

The CESG ratings can be used in the following ways:

- As a quantitative feed into financial screening tools in a form of **ESG integration.**
- As an **engagement tool** to drive better discussions with company management on ESG issues.

The CESG scorecards can be used in the following ways:

- To aid investor CESG **due diligence** on NZ companies.
- To help investors to **identify key CESG risks and opportunities** for companies.
- Identify **which companies are managing ESG risks well and are positioning themselves well** for a low carbon, more sustainability-focussed future.

For corporates, the CESG ratings and scorecards can:

- Provide insights on **what is really important to investors.**
- Enable a company to see how it **compares to its peers and the NZ market.**
- See their **strengths and weaknesses and plan out a programme for improving CESG** performance.

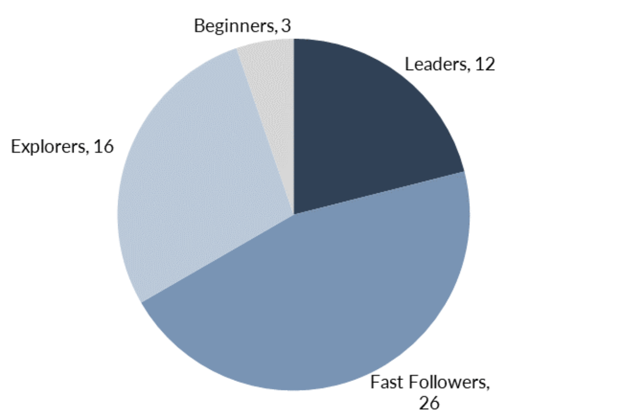
The New Zealand Equities Research Team at Forsyth Barr are considering incorporating the CESG ratings into the cost of equity for the companies. In addition, from now onwards, we will include on all Forsyth Barr New Zealand company specific research reports the overall CESG score along with the breakdown for each category, the sector average and NZ average and classification as *Leader*, *Fast Follower*, *Explorer* or *Beginner*.

The findings in detail

Our findings highlight that corporates are moving on the sustainability agenda and it is a quickly evolving space — but there is a lot more work to do. There is a significant gap between the *Leaders* and *Beginners*. The majority of companies fall into the *Fast Follower* and *Explorer* categories. And for those delayed in getting underway, there is an increasing urgency to catch up.

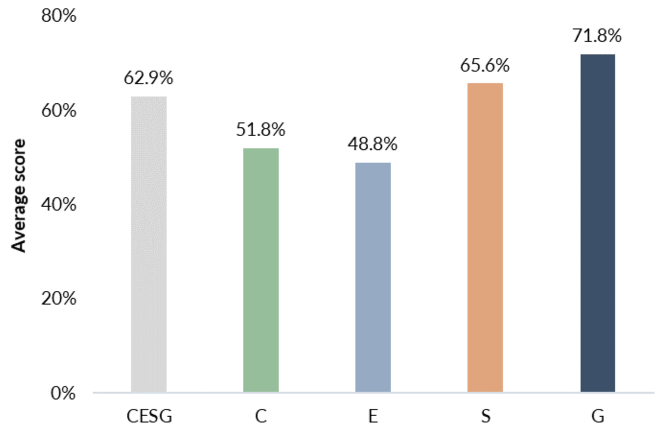
Companies scored best on the Governance section with an average rating of 72%, followed by the Social section (66%), then the Carbon section (52%) and finally the Environmental section (49%). The Utilities, Consumer, Infrastructure, Aged Care, Health Care and Industrials sectors scored above the New Zealand average CESG score.

Figure 21. CESG Leaders, Fast Followers, Beginners, Explorers



Source: Forsyth Barr analysis

Figure 22. Average CESG scores



Source: Forsyth Barr analysis

Broadly, **the 12 *Leaders* have sustainability strategies that have been in full operation for multiple years and are integrated into business strategies.** They are collecting and reporting on a wide range of CESG metrics. They are predominantly meeting best practice standards, are recognising key CESG risks and opportunities and are managing them. The *Leaders* are well versed on stakeholder demands and how they are evolving. They are already well prepared to meet the upcoming Climate-related Disclosure Standards. In addition, while at an early stage, they are beginning to understand and talk about the potential positive and negative impacts of operations on the environment, economy and people. And importantly, for 10 of the 12 companies with leading CESG scores, actual carbon emissions are trending down when looked at over a five year period - no doubt helped by COVID but we see this as a strong differentiator from the *Beginners*.

The majority (74%) of companies fall into the *Fast Follower* or *Explorer* categories, reflecting this is a very quickly evolving space with lots of movement in progress. But catching the *Leaders* will be hard. Gaining momentum on ESG actions can take some time. Actions tend to start with a focus on policies and processes before evolving into outcomes that have a positive impact and can be measured, such as, for example, reducing greenhouse gas emissions.

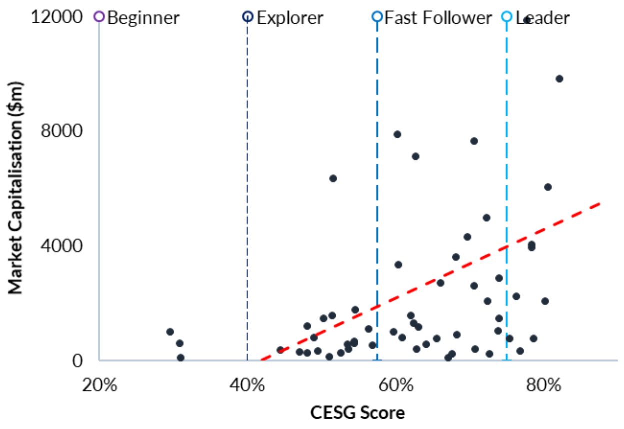
While the *Beginners* are early on in the CESG journey, **almost all the companies we assessed either had a sustainability strategy in place or one under development.** We note that there are valid reasons for why a company may only be starting to build CESG management capabilities now. Some companies are newly listed and have not been asked to provide this information before. Others are outside the NZX50 and have not been rated by external ESG ratings providers before; for them, it is also the first time they have been asked for CESG information. Others have not had a commercial or regulatory imperative to report on ESG information until now.

Correlations

We looked for correlations with the CESG scores and a variety of metrics. We found the following:

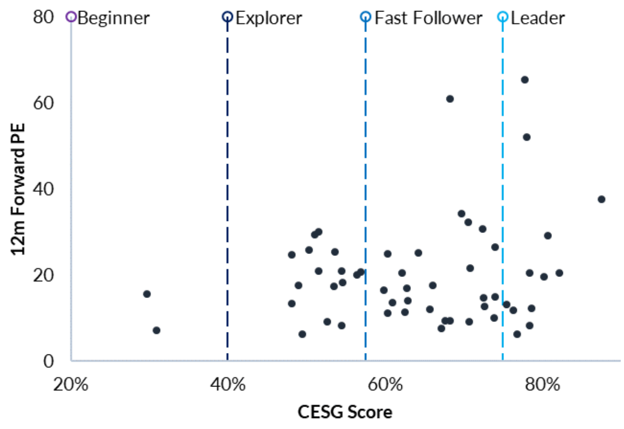
- **Market capitalisation:** While the *Beginners* are of smaller market capitalisation, there was a broad spread across the CESG scores for the smaller companies (under NZD $2000m). Two of the three largest companies fell into the *Leader* category but we do not find that size has much correlation with those companies in the *Fast Follower* and *Explorer* categories. CESG score versus enterprise value shows a slightly stronger correlation.
- **Price/earnings ratio:** We found a slight positive correlation between PE and CESG rating. The correlation is stronger when we look at the PE of the Top 20 (by market cap) companies and the CESG ratings.
- **Sector:** The Utilities, Consumer, Infrastructure, Aged Care, Health Care and Industrials sectors scored above the New Zealand average CESG score.
- **Enterprise value:** We found that companies with higher EVs generally had higher CESG scores.
- **Heavy emitters:** The top ten greenhouse gas emitters (Scope 1 and 2 data only) score more highly than the bottom ten greenhouse gas emitters. The gap narrows when you look at carbon intensity.

Figure 23. CESG scores vs market capitalisation



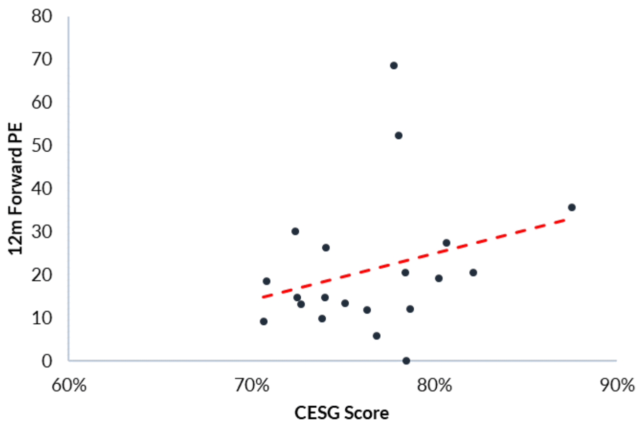
Source: Forsyth Barr analysis, Refinitiv

Figure 24. CESG scores vs PE



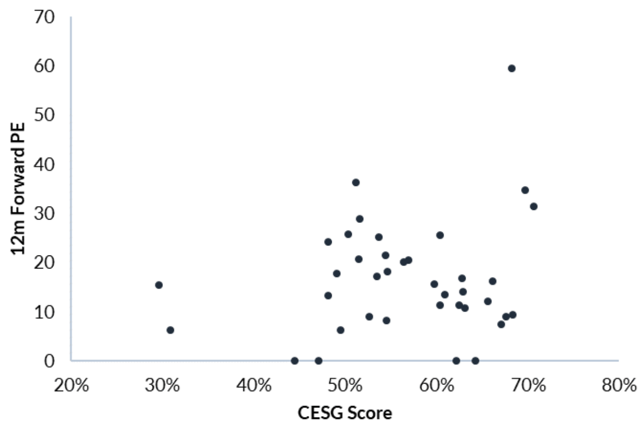
Source: Forsyth Barr analysis, Refinitiv
Note: APL has PE ratio of 660x

Figure 25. Top 20 CESG scores v PE



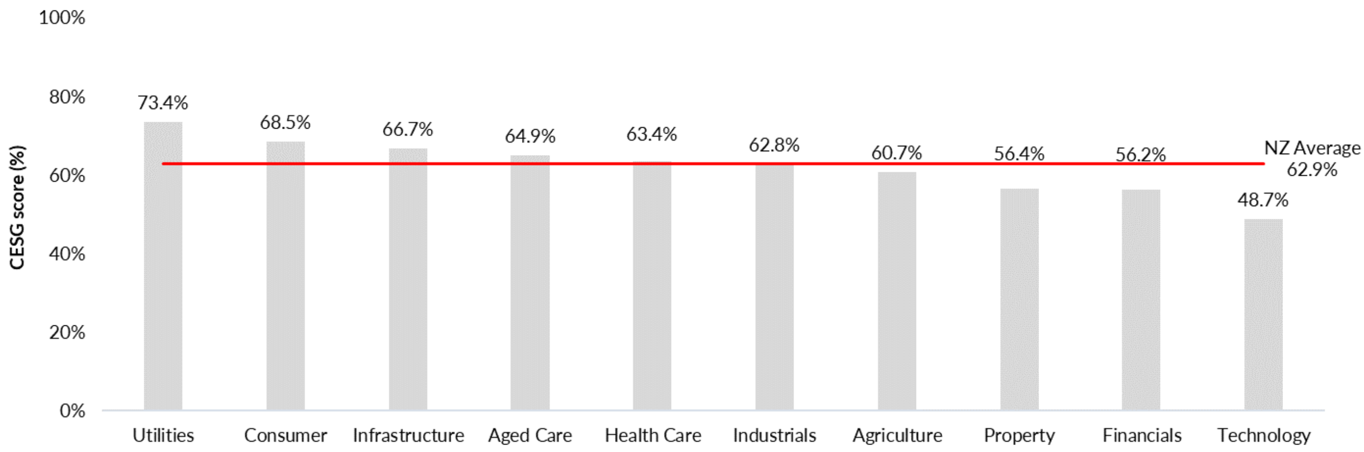
Source: Forsyth Barr analysis, Refinitiv

Figure 26. Remaining 37 companies CESG scores v PE



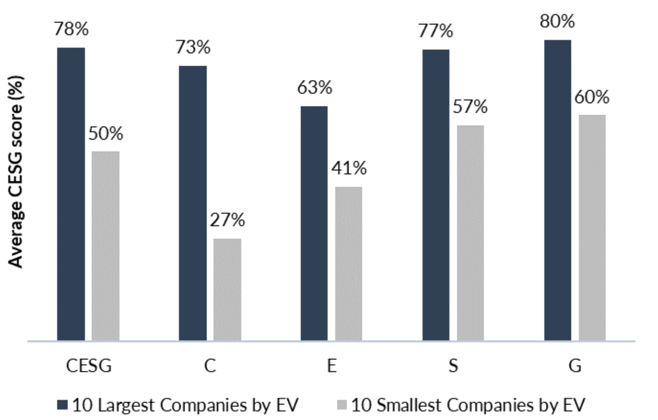
Source: Forsyth Barr analysis, Refintiv
Note: APL has PE ratio of 660x

Figure 27. CESG scores by sector



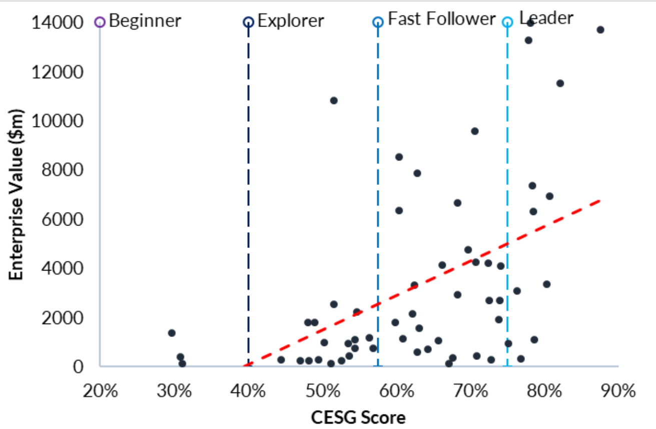
Source: Forsyth Barr analysis

Figure 28. Average CESG score by enterprise value



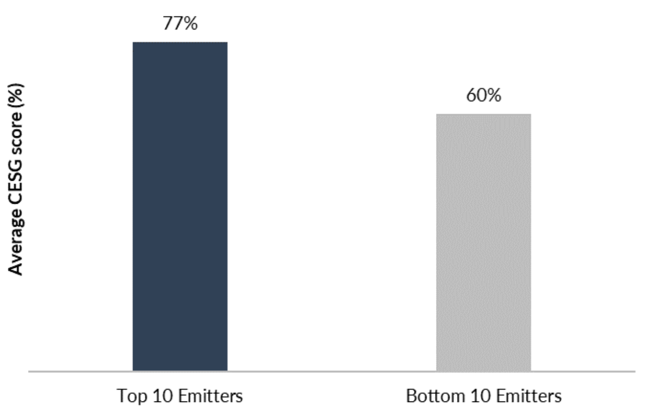
Source: Forsyth Barr analysis, Refinitiv

Figure 29. CESG score vs enterprise value



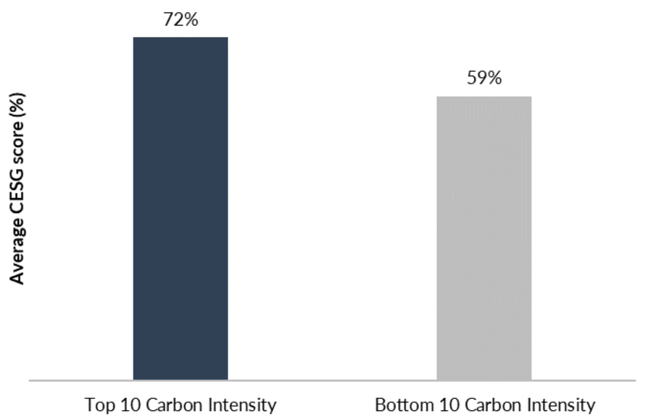
Source: Forsyth Barr analysis, Refinitiv

Figure 30. Average CESG score by absolute emissions



Source: Forsyth Barr analysis, Refinitiv

Figure 31. Average CESG score by carbon intensity



Source: Forsyth Barr analysis, Refinitiv

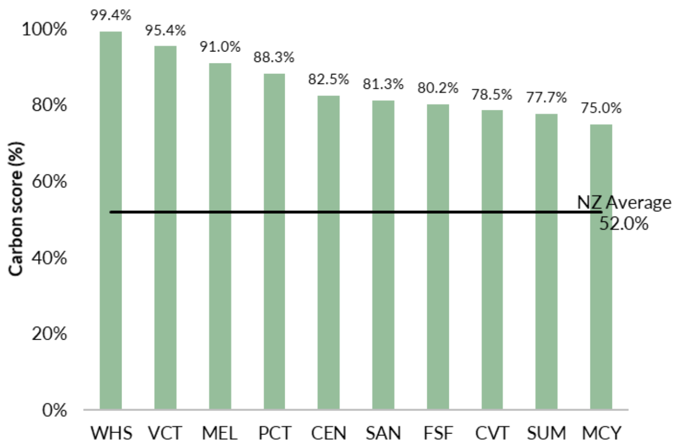
Detailed insights on C, E, S and G trends

Carbon: Companies are generally well underway with preparations for the upcoming climate-related disclosure requirements, but a significant gap exists between *Leaders* and *Beginners*

It is an interesting time for New Zealand as companies start to adapt to legislation mandating action on climate change. 2022 has so far seen the release of our First Emissions Reduction Plan, our first National Allocation Plan, tightening discussions on bringing agriculture into the Emissions Trading Scheme, and advanced progress on the development of Climate-related Disclosure Standards due to come into force from 2024. While these measures have not come without debate, the direction of travel is crystal clear.

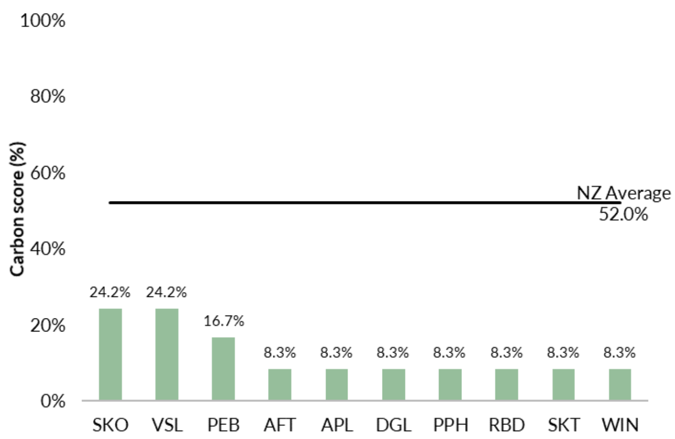
In designing the methodology for the Carbon (C) part of our ratings, we wanted to align with the upcoming disclosure standards while also bringing in a forward-looking lens to help assess where companies are at with their preparations. We wanted to know if New Zealand companies are starting to act on mitigating and preventing climate change, if Net Zero emissions targets have been set, which companies are committed to spending real money on adapting to climate change and which are ready for the impending disclosure standards.

Figure 32. Top 10 carbon performers



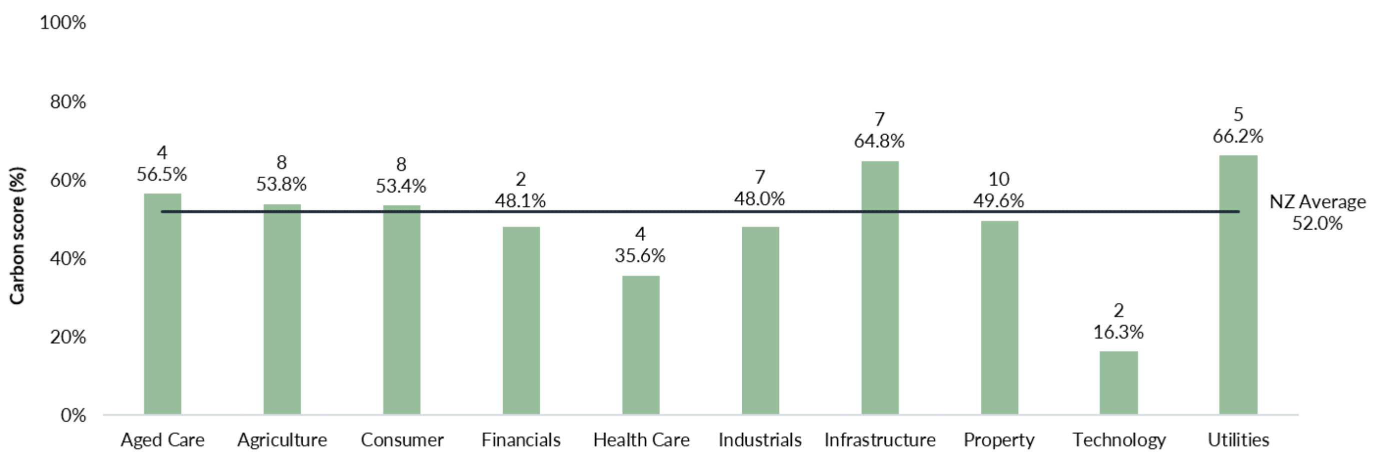
Source: Forsyth Barr analysis

Figure 33. Bottom 10 carbon performers



Source: Forsyth Barr analysis

Figure 34. Carbon performance by sector



Source: Forsyth Barr analysis

Figure 35. Carbon insights

Category	Commentary
Greenhouse Gas Emissions	▪ Of the 27 companies that have reported their Scope 1 and Scope 2 emissions for over five years, 15 have reported that emissions are declining ▪ Of the top ten carbon performers, nine have been reporting Scope 1, 2 and 3 emissions for more than five years and eight reported actual decreases in Scope 1 and 2 emissions data (over a five year period) ▪ 44 companies are reporting Scope 3 emissions data. However, we note the information is likely to be incomplete, can be highly volatile and prone to recalculations. We view high Scope 3 GHG emissions as a possible carbon transition risk signal. In other words, companies with high Scope 3 emissions may face future risks related to carbon markets, regulation, technology disruption and changing consumer demands
Emissions Intensity/ Transition Risk	▪ 18 of the 27 companies that have reported Scope 1 and 2 emissions for over five years show declining carbon intensity

Emissions Management	▪ 27 companies have Net Zero emissions targets. However, Net Zero commitments differ in ambition and also in what they cover. Of the 27 companies with stated Net Zero targets:
	  ▫ Two have targets that align to a 2 degree C world, eight have targets that align to a 1.5 degree C world and the remaining 17 do not state
	  ▫ Six include Scope 1, 2 and 3 GHG emissions in their targets and 11 include Scope 1 and 2
	  ▫ 22 have set interim targets towards meeting Net Zero commitments
	  ▫ Seven are already Net Zero
	▪ 24 companies have Science Based Targets
	▪ For the top 10 carbon performers:
	  ▫ Nine have Science Based Targets
	  ▫ Five have Net Zero commitments aligned with a 1.5 degree C world
	  ▫ Zero include scope 3 in Net Zero commitments
	  ▫ Seven have interim targets in place or a goal of a 50% reduction in GHG emissions by 2030

Risk and Opportunity Management	▪ 42 companies indicated physical risk assessments had been undertaken. All of the top ten had completed a physical risk assessment ▪ Only three companies (SML, GNE and FSF) own fossil fuel reserves and of these, two have indicated plans to divest ▪ 18 companies and nine of the top ten report a proportion of revenue, assets or other business activities aligned with climate change ▪ We asked companies in the heavy emitting industries if they are spending or committing capital towards climate-related opportunities, 12 responding with yes and one with no

Source: Forsyth Barr analysis

Carbon conclusions

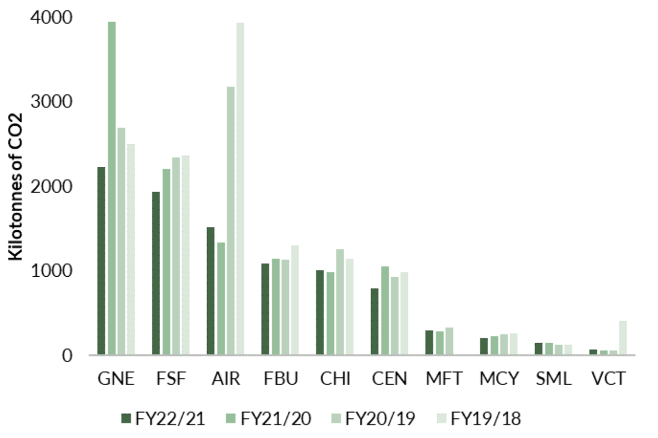
With the External Reporting Board (XRB) about to finalise and issue the first Climate-related Disclosures Standards, requiring relevant entities to make disclosures alongside wider year end reporting in 2023, **most companies are well underway with their preparations for responding**. But a few are yet to move. 43 companies have set actual carbon emission reduction targets and/or Net Zero emissions commitments. However, we note the emissions that companies report are prone to recalculations and there are inconsistencies between companies and within sectors in stated emissions sources. Further, **Net Zero targets differ in ambitions and boundaries.** Importantly, for the majority of companies with leading CESG ratings, actual carbon emissions are trending down when looked at over a five year period — no doubt helped by COVID but we see this as a strong differentiator from the *Beginners*.

Looking ahead

Going forward, we plan to build assessment of the **scenario analysis** companies are undertaking and to build out a focus on the quality of disclosures to help assess real progress rather than just rewarding if something is disclosed. We will also consider a focus on a **'Just Transition'** and encourage companies to develop Climate Transition Plans. Use of **offsets** in meeting Net Zero commitments is another area we would like to explore in detail.

Interesting carbon-related insights

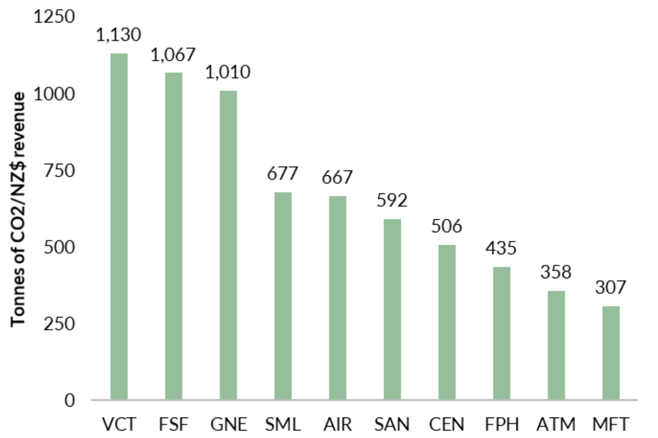
Figure 36. Top 10 absolute emitters through time, scope 1+2



Source: Forsyth Barr analysis, company reports

Note: FY22 refers to the most recent disclosure year, for some companies this may actually be FY21

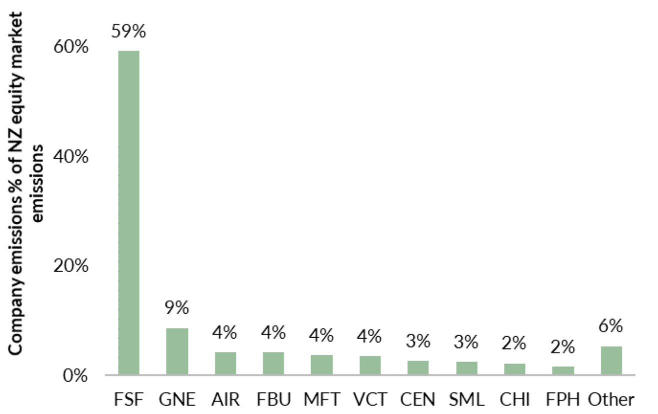
Figure 37. Carbon intensity (TCO2e/revenue), all scopes



Source: Forsyth Barr analysis, company reports, Refinitiv

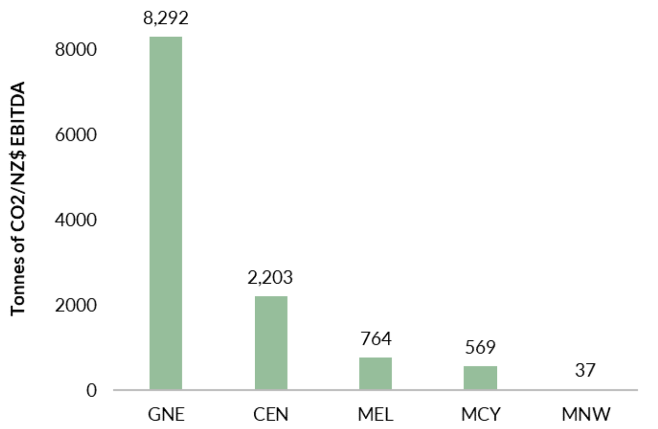
Excluding CHI, as latest emissions data reflects CHI's refinery operations pre-conversion to an import terminal

Figure 38. Company emissions % of NZ market emissions, all scopes



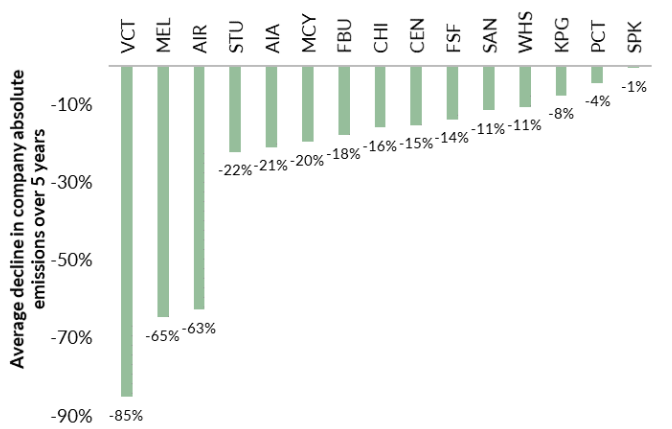
Source: Forsyth Barr analysis, company reports

Figure 39. Utilities sector carbon exposure relative to EBITDA, all scopes



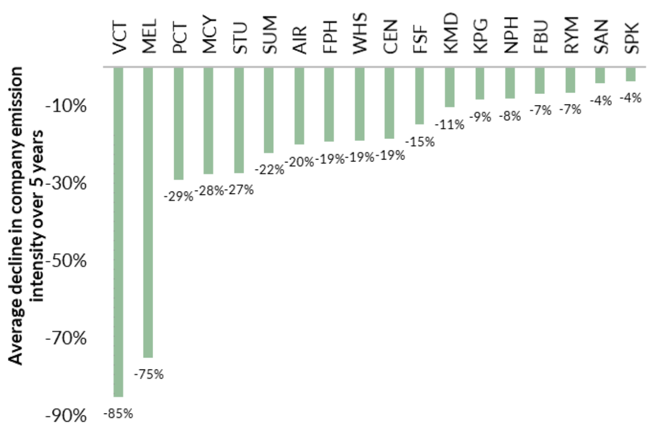
Source: Forsyth Barr analysis, company reports, Refinitiv

Figure 40. Top GHG reducers, over 5 years, scope 1 + 2 absolute emissions



Source: Forsyth Barr analysis

Figure 41. Top carbon intensity reducers, over 5 years, scope 1 + 2 emissions



Source: Forsyth Barr analysis

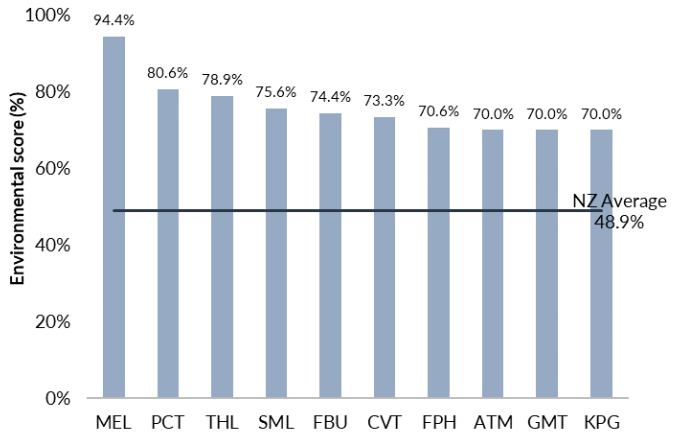
Environment: Companies are making efforts to minimise their impact on the environment but these are yet to turn into clear outcomes and there is plenty of room for improvement

The health of the environment and the health of the economy are inextricably linked. Businesses use natural resources as their raw materials, so when ecosystems break down or when biodiversity diminishes there are implications for raw material costs, as well as disruptions to business operations and supply chains. Finding a state where our demands on nature do not exceed its supply is becoming exceedingly important.

As awareness of the importance of nature to the economy grows, the expectations on business to operate more sustainably grows. There is now a wide-spread expectation that businesses should not only have minimal negative impact on the environment as a result of their operations but also work to reverse the degeneration of ecosystems.

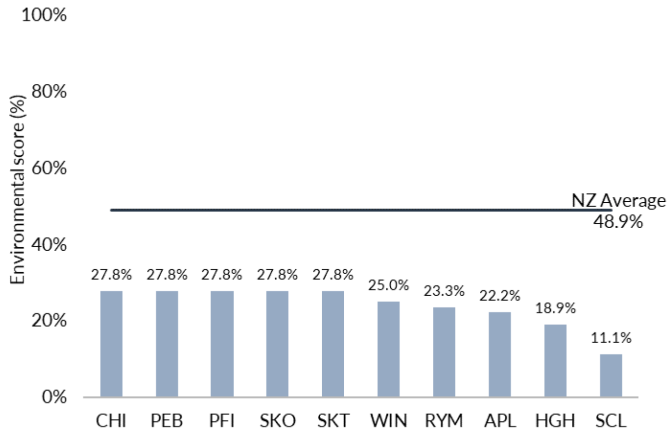
In designing the methodology for the Environmental (E) part of our ratings, we were of the view that companies should be operating to best practice standards to minimise their impact on the environment. Companies should be measuring and managing their waste, water consumption and impact on biodiversity. In addition, leading companies are moving to build principles of the circular economy into how they operate. We wanted to get a sense of what NZ companies are doing.

Figure 42. Top 10 environmental performers



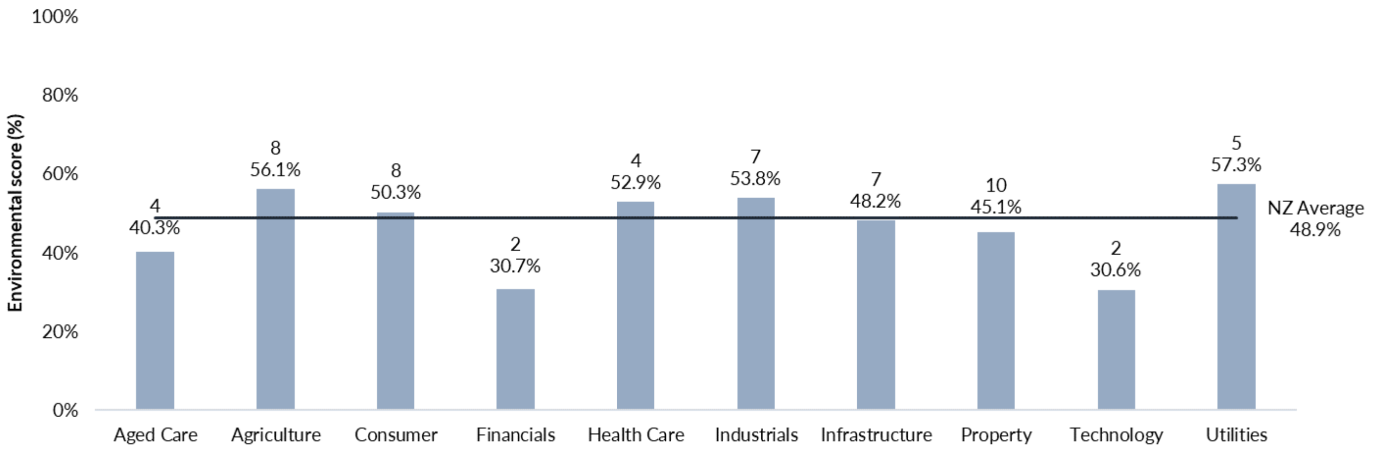
Source: Forsyth Barr analysis

Figure 43. Bottom 10 environmental performers



Source: Forsyth Barr analysis

Figure 44. Environmental scores by sector



Source: Forsyth Barr analysis

Figure 45. Environmental insights

Category	Commentary
Environmental Management Systems	■ 14 companies have issued green/social bond(s) or committed to a sustainability linked loan. Five of these companies are in the top ten environmental performers. These were GMT, KPG, MEL, PCT and SML ■ Only three companies (GNE, SUM, and VCT) have made commitments to new build or retrofit to meet level six of the Green Star standard in owned or leased buildings. In almost all cases here, the commitments are to one or two buildings rather than full portfolios ■ Seven companies out of the top ten Environmental performers have an Environmental Management System in place for all applicable sites. These include, for example, ISO14001, Toitu Carbon Zero and Future Fit
Waste	■ 46 companies have a commitment to reduce waste in place. The average length that data has been reported is 3.1 years. Only nine companies have been reporting waste intensity for five years or more and of these companies, five report declining waste intensity ■ We asked companies in the Agriculture industry if there had been any breaches in resource consent discharges in the last five years. In three of the eight companies, we found there had been resource consent discharge breaches ■ Only two of the top ten environmental performers (MEL and PCT) have been reporting waste intensity data for more than five years. In both cases, waste intensity had increased
Water	■ Only 19 companies have water use efficiency targets and just eight have been reporting water consumption intensity for five years or more. Of these companies, water consumption has declined for five and increased for three ■ Only four of the top ten environmental performers (CVT, FPH, MEL and PCT) have been reporting water consumption intensity for at least five years. In all cases, water consumption intensity levels are declining
Biodiversity	■ 25 companies have a commitment to reduce their impact on biodiversity. For companies in the Utilities sector, many are committed to protecting and restoring the waterways which they influence. Across all sectors, there are a number of programmes committed to supporting endangered species in New Zealand ■ Eight of the top ten environmental performers have made commitments to reduce the impact of operations on biodiversity
Circular Economy	■ 27 companies have a commitment to the circular economy. We define the circular economy as a production and consumption model that ensures sustainable growth over time. It is based on three key principles: 1) design out waste and pollution; 2) keep products and materials in use; 3) regenerate natural systems. We scored companies positively if they talked about the circular economy in their sustainability-related disclosures. In time, we hope to assess the quality of commitments to the circular economy. Common comments from companies included the recycling of end-of-life assets and waste elimination schemes while in the Agriculture and Consumer sectors there are common commitments to circular economies regarding packaging ■ Eight of the top ten environmental performers had made a commitment to the circular economy
Environmental Fines	■ We also found that eight companies have received environmental fines in the last three years. Interestingly, there was little concentration of fines within particular sectors but one thing to note is the vast majority of fines are related to accidental discharges/ spillages

Source: Forsyth Barr analysis

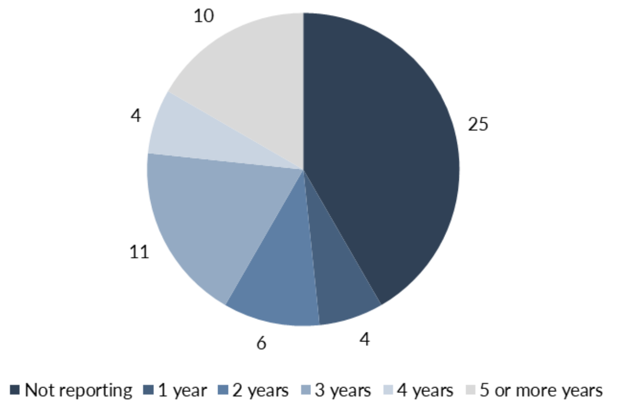
Environment conclusions

Management of environmental issues scores the weakest of the four categories. **Data on waste intensity and water consumption efficiency is often lacking whereas early commitments to reducing the impact of company operations on biodiversity and supporting a circular economy are promising.** While a number of companies were of the view that water consumption is not a material issue for them to manage, we are of the view that companies should be operating to best practice standards to minimise all resource use and the resulting impact on the environment. The very first step in enabling this is to measure resource use. Other E initiatives such as constructing buildings to level six Green Star standard or issuing green bonds are few and far between. Resource consent discharge breaches in the Agriculture sector and environmental fines (more generally) are more common than expected.

Looking ahead

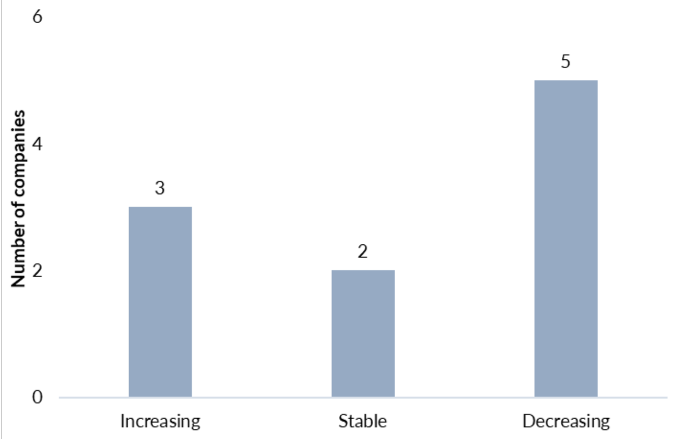
We are conscious that this is a quickly evolving area with many challenges for collecting data. This is one of the reasons the **Taskforce for Nature-related Financial Disclosures (TNFD)** has been set up, a disclosure initiative that is following the same framework as the Taskforce for Climate-related Financial Disclosures (TCFD). The TNFD is endorsed by the G7 Finance Ministers and the second version of its beta framework has been released for market consultation. A further two iterations of the beta versions are planned — November 2022 (v0.3) and February 2023 (v0.4) — before the release of version 1.0 of the framework in September 2023. While reporting on nature related risks is a different challenge to reporting on climate-related risks, we note considerable momentum behind the initiative and expect it to gain in mass over the near future.

Figure 46. Length of time reporting waste intensity is disappointing



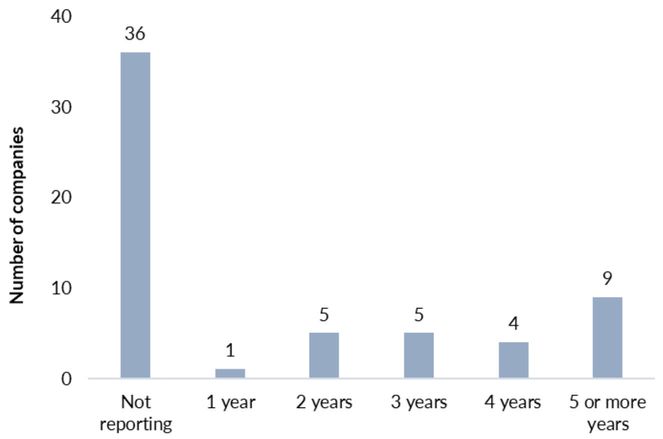
Source: Forsyth Barr analysis, company reports, Refinitiv

Figure 47. For companies with five years of data, waste intensity is trending down — but it's not convincing



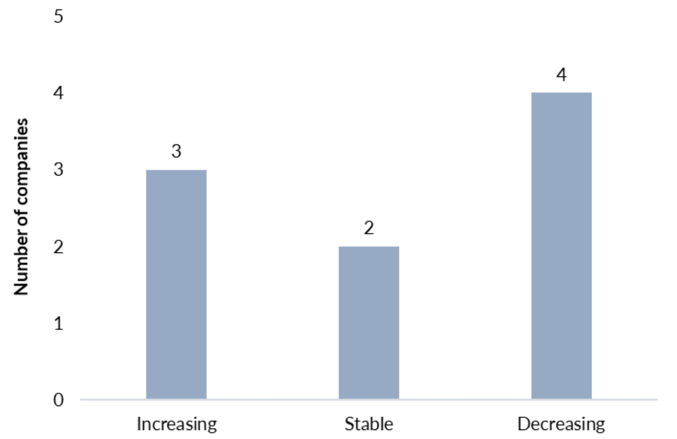
Source: Forsyth Barr analysis

Figure 48. Years reporting water consumption efficiency is disappointing



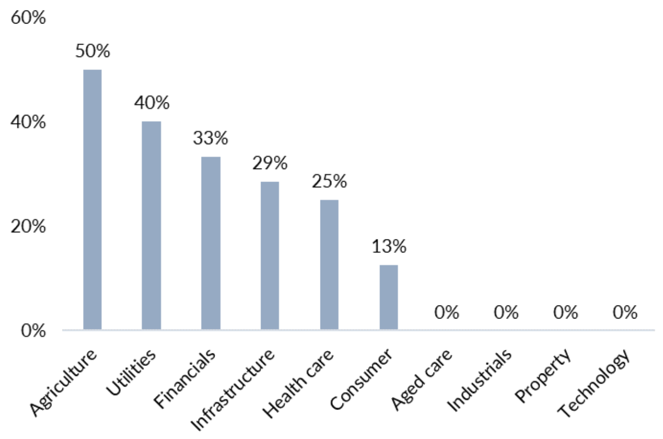
Source: Forsyth Barr analysis, company reports, Refinitiv

Figure 49. For companies with five years of data, water consumption efficiency is trending down — but it's not convincing



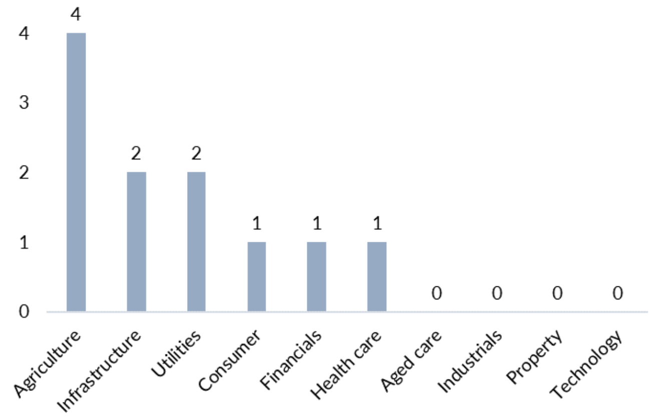
Source: Forsyth Barr analysis

Figure 50. Percentage of companies by sector with environmental fines



Source: Forsyth Barr analysis, company reports

Figure 51. Number of environmental fines by sector



Source: Forsyth Barr analysis, company reports, Refinitiv

Social: Social issues change with the decades but build on a fundamental base of health & safety reporting

The importance of the S in ESG has often been misunderstood by market participants or perceived as having less relevance than the C, E and G parts of a rating. In our view, the necessity of successfully managing 'S' related issues is only growing.

Some of the early examples highlighting the importance of managing 'S' issues were in relation to the retailers, for example, Nike and Gap, with allegations of **child labour and inhuman conditions for factory workers** in the supply chain. The negative impact on the companies' brands was out-sized and the time taken for Nike to rebuild its reputation and corporate integrity pushed into the decades. The issue has continued to remain in the public eye, reiterated by the tragic Rana Plaza collapse in April 2013 which housed five garment factories and killed at least 1132 people, injuring more than 2500. Awareness of the **supply chain issues** continues to remain elevated as demand for sustainable products and sourcing grows.

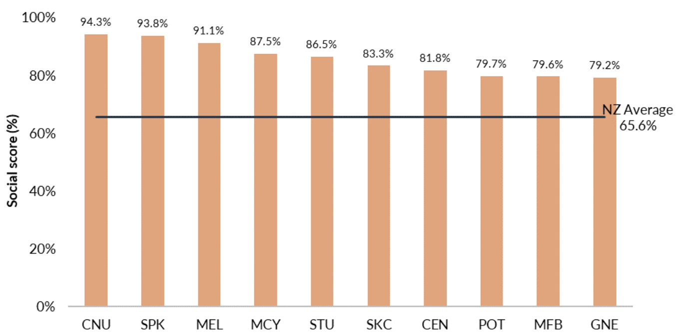
In New Zealand over recent decades, there has been a focus on the role of directors in ensuring all organisations provide **a healthy and safe work environment.** The benefits of good health and safety are well known and evidenced, ranging from increased productivity and job satisfaction to, for example, fewer injuries, less employee turnover and absenteeism, less costs, fines and litigation. In addition, our primary industries face elevated risks in terms of **managing migrants and contract labourers**. The Ministry of Business, Innovation and Employment (MBIE) is in the process of developing new legislation regarding **modern slavery and worker exploitation** in New Zealand.

Over the more recent years, and particularly over the COVID years, we have seen an increased focus on how organisations **take care of employees and offer flexible working** arrangements. As the labour market tightened with borders closed, a focus on **talent attraction and retention** has grown in importance, and we have seen companies modernising their 'employee value proposition'.

The digitalisation of our economy has brought in a new set of 'S' related issues for companies to manage. Protecting an organisation's and its customers' information with **robust data privacy and security systems** so it cannot be accessed by those who have no right to it, or those who may pose a threat. Other issues such as **surveillance** and the **sharing of harmful content on social media platforms** are growing in importance, challenging and sometimes polarising viewpoints. A very interesting nexus between human rights, technology and regulation is emerging which we believe is becoming one of the defining social-political issues of our time.

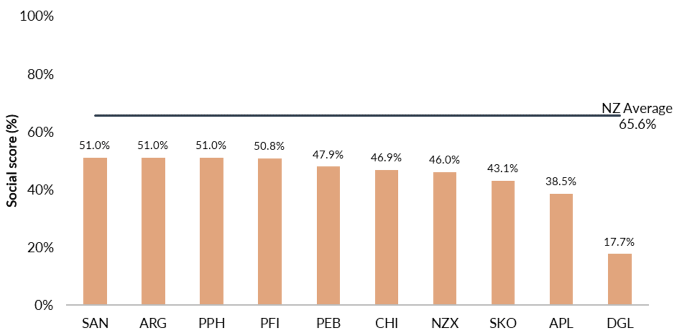
In designing the methodology for the Social (S) part of our ratings, we were of the view that companies should have standard policies in place for managing health and safety, human rights, supply chain issues and community involvement. In addition, companies should be modernising employee value proposition policies and measuring diversity metrics. We also wanted to know if there had been any product quality or service fault issues.

Figure 52. The top 10 social performers



Source: Forsyth Barr analysis

Figure 53. The bottom 10 social performers



Source: Forsyth Barr analysis

Figure 54. S insights

Category	Commentary
Health & Safety	■ All 57 companies have Health and Safety policies in place. 45 companies have safety management targets in place and 44 report safety measures. Of the 28 companies that have reported safety measures for over five years, only 12 show a decline in incidents, five show a stable rate of incidents and 11 show an increase. Six companies have experienced a workplace fatality over the last five years ■ Of the top ten social performers, all but one (MEL) have safety targets in place. Eight have been reporting on safety measures for over five years. Of these eight companies, three (CNU, SPK, STU) are reporting improving safety data, and five report worsening safety data
Human Rights	■ 29 companies have a human rights policy in place and 44 companies have a commitment to preventing modern slavery. We note it is mostly companies also operating in Australia that currently have commitments to prevent modern slavery given the legislative requirements there. Incidences of modern slavery have unfortunately been growing within New Zealand. In response, the Ministry of Business, Innovation and Employment (MBIE) is working on proposed legislation regarding modern slavery and worker exploitation, forced labour, people trafficking and slavery. While certain industries are more exposed to the risk of modern slavery, the responsibilities of the proposed legislation is aimed at the operations and supply chains of all 'New Zealand' entities. We expect this to be an area of increasing focus going forward
Supply Chain	■ 34 companies have a supply chain code of conduct in place and 33 have an Environmental Policy specifically for their suppliers. Seven companies have committed to pay their suppliers a living wage ■ Of the top ten Social performers, nine have environmental policies in place for supply chains. Only three (GNE, MEL and SPK) have formally committed to paying suppliers a living wage
Product Quality and Accessibility	■ Ten companies have had unplanned product or service faults that have resulted in disruption to operations or product recalls. A reasonable portion of these companies come from the Infrastructure sector reporting unplanned service faults. This is an important area for investors to engage with companies to ensure appropriate capital expenditure and polices are in place. These types of disruptions can be of significant detriment to a brand and the level of trust associated with it. Along with being a costly exercise, these can also take up a significant amount of time for senior managers. Keeping an eye on cause and regularity of these types of incidents may give some insight into the quality of a company
Aged Care Sector Specifics	■ For the Aged Care companies, there are two key 'S' metrics that we think are very important to the sector from an ESG perspective: the affordability of care beds and employee turnover. We have had mixed responses from the four Aged Care companies in providing this data. We will continue to discuss these issues with the companies going forward
Employee Value Proposition/ Culture	■ 19 companies report employee turnover publicly. This is a metric that is currently of particular interest given the tight labour market. Of the companies that report employee turnover, average employee turnover is 22%. This compares to c. 20% in the US and c. 15% in Australia ■ 32 companies have a modern parental leave policy in place. We are looking for recently updated polices that cover things like, for example, primary and secondary parental leave, flexi-working options, fertility treatment, adoption, surrogacy leave, miscarriage and still-birth. We are trying to capture those that go well above statutory requirements, really designed with equality, talent attraction and retention in mind ■ 26 companies have made a commitment to pay employees the living wage. A number of companies note its employees are paid at least the living wage despite not having a formal policy or commitment
Diversity	■ 18 companies report ethnicity diversity metrics. Seven of the top ten social performers report ethic diversity metrics ■ For 53 companies we were able to calculate the percentage of women managers in relation to the percentage of women employees. This metric enables us to reflect the expectation and monitor progress towards a goal that the percentage of female employees is matched by the percentage of females in management. Of these companies, 25 have a ratio between 0.8 and 1.2. Eight of the top ten social performers received full marks for this question
Community Relations	■ 52 companies showed evidence of involvement in the community through donations, volunteering, philanthropic activities, and community investments or if there are corporate social responsibility programs in education, health, and the environment
Stakeholder Relations	■ 54 companies have stakeholder centric business models

Source: Forsyth Barr analysis

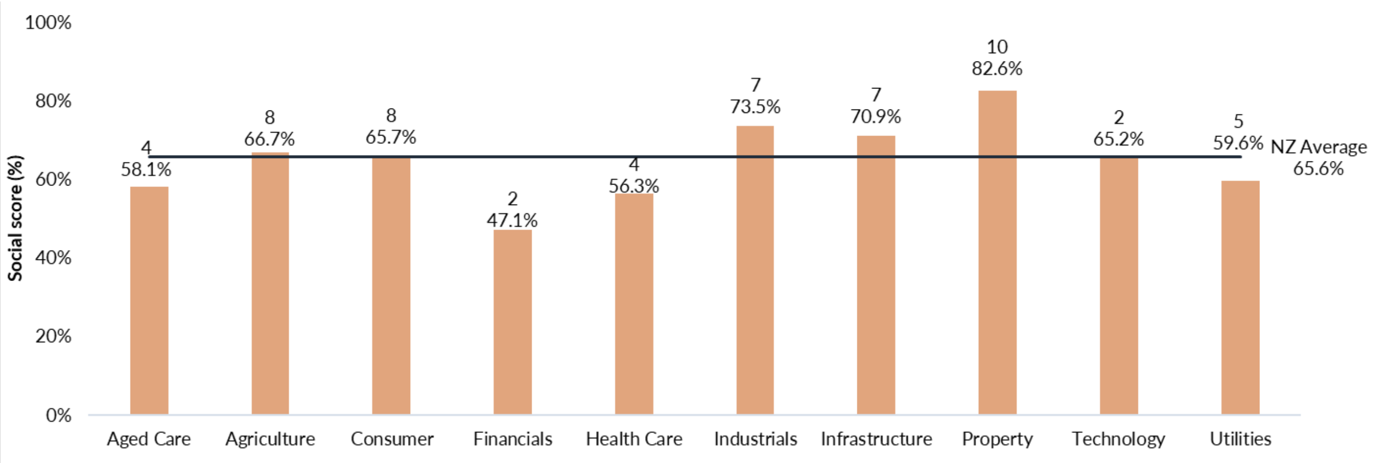
Social conclusions

The majority of companies have policies in place for managing health and safety, supply chain issues and community involvement. 56% of companies having modernised their parental leave policies over recent years shows us there is positive momentum in this space. Our diversity metrics focus mostly on gender but we expect this will widen in the near future given the number of external campaigns supporting progress in this area. Disruptions to operations due to data security breaches is a live issue that has significantly affected a number of financial services companies in recent years. Companies are broadly aware of evolving stakeholder demands in 'S' space and regularly talk about community initiatives in place. However, **we are of the view these can become much more strategic, coordinated and aligned with business strategy.** With closed borders over the last few years and the 'Great Resignation' playing out, we also looked at employee turnover. 33% of companies report this figure publicly and the average employee turnover reported was 22%. This compares to c. 20% in the US and c. 15% in Australia.

Looking ahead

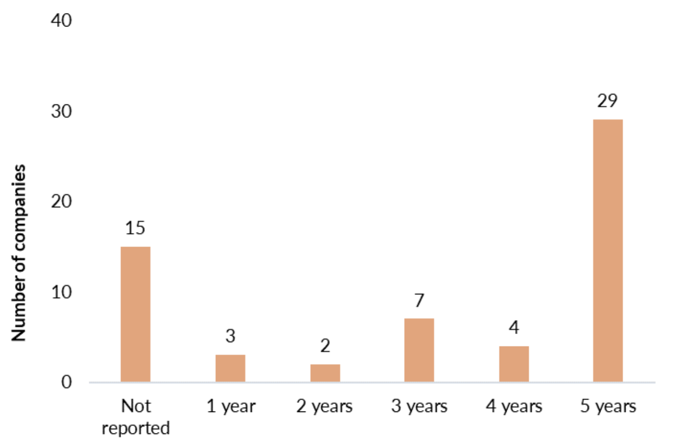
We expect the Social metrics to continue changing over time. Our scoring methodology is currently quite binary and questions are focussed on policies. We expect S reporting by companies to improve and standardise over time, which will help us better assess this category and begin a focus on outcomes. In the immediate future, we expect **diversity metrics** to improve as well as additional **employee value proposition** assessments. With a specific focus on New Zealand companies, we would also like to consider a **te ao Māori** lens and an assessment of how companies meet our commitments to **Te Tiriti o Waitangi**.

Figure 55. Social scores by sector



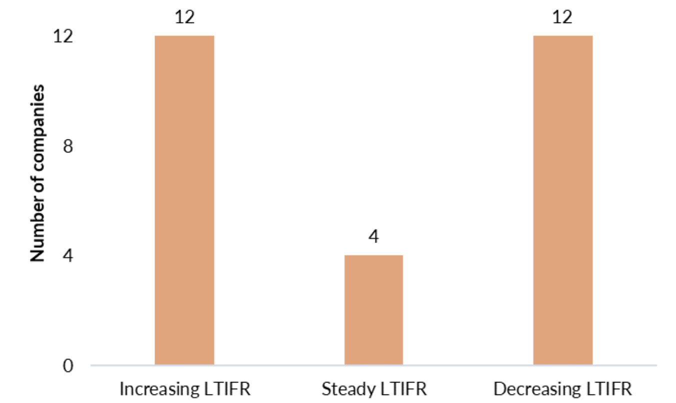
Source: Forsyth Barr analysis

Figure 56. Safety reporting is reported by the majority but certainly not all



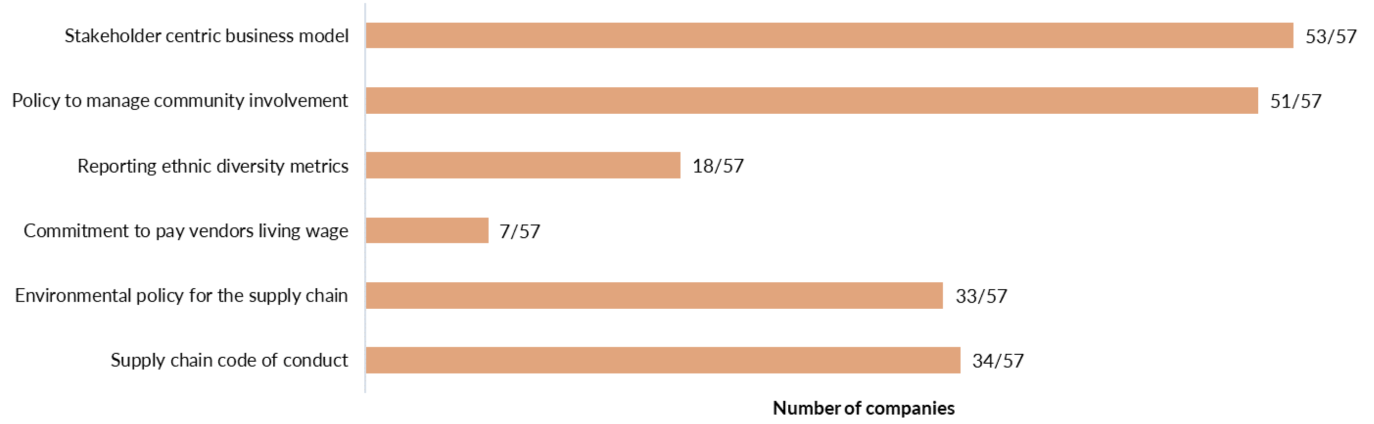
Source: Forsyth Barr analysis, company reports, Refinitiv

Figure 57. Safety statistics trends are mixed



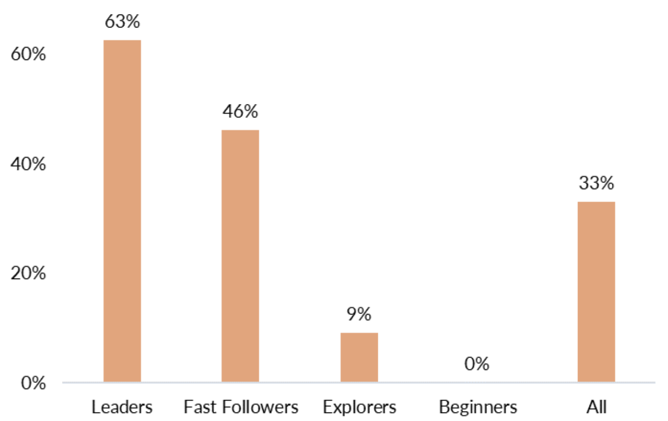
Source: Forsyth Barr analysis

Figure 58. Broad 'Social' performance



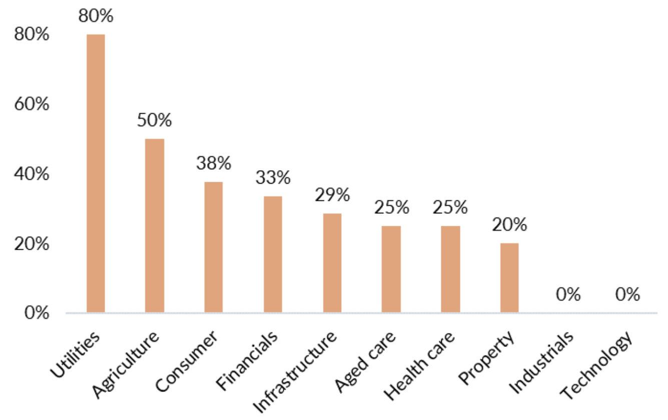
Source: Forsyth Barr analysis

Figure 59. Percentage of companies publicly reporting employee turnover by category



Source: Forsyth Barr analysis

Figure 60. Percentage of companies publicly reporting employee turnover by sector



Source: Forsyth Barr analysis

Governance: Is broadly strong but there are some idiosyncrasies in the New Zealand market

Corporate governance is the framework that defines the business relationships that exist between company shareholders, management teams, Boards of directors, and all other key stakeholders. Simply put, it is the system by which organisations are directed and managed.

The relationship between good corporate governance and the financial success of companies is well known and has been well studied over the years. Good corporate governance ensures that an organisation's board of directors meet regularly, retain control over the business and are clear in the division of their responsibilities. It also ensures robust risk management policies, practices and systems. Strong and effective corporate governance helps to cultivate a company culture of integrity. Essentially, it exists to increase the accountability of all individuals and teams within a company, working to avoid mistakes before they can occur.

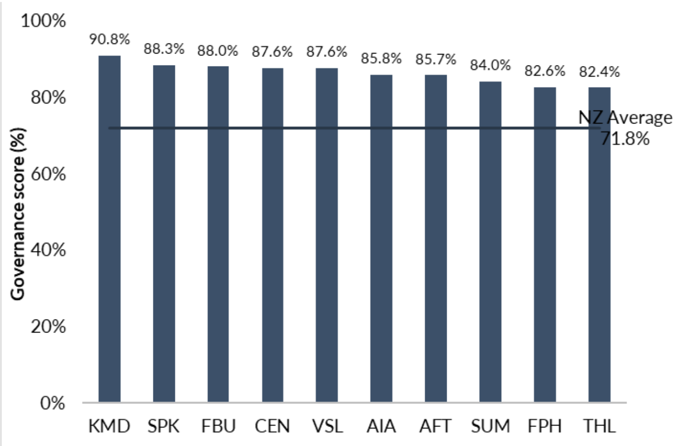
There are many examples which highlight corporate failures resulting from poor corporate governance. From Enron and Tyco in the US, to Parmalat and Sports Direct in the EU/UK. New Zealand has not been immune with CBL and Mainzeal providing two of the more recent examples. If a Board ignores the corporate governance safeguards it should be considering, companies can fail. On the flip side, when strong good corporate governance processes are in place, companies can benefit from a healthy corporate culture and the control of risk, with procedures streamlined and consistent.

We rate the importance of governance highly across all sectors. Good corporate governance is equally important across all sectors. Reflecting this, we have allocated a weighting of 40% for the corporate governance metrics across all sectors in our rating methodology.

In designing the methodology for the Governance (G) part of our ratings, we collected 28 different metrics. This is only a small subset of the possible universe of data. However, we focussed on data which we believed would give us true insights and was robust and comparable across sectors. We assessed the different investor protection mechanisms in place, Board make up, auditor tenure, data security policies, whether tax governing frameworks are in place, reporting and assurance practices. We also looked at how sustainability strategies are integrated into business models.

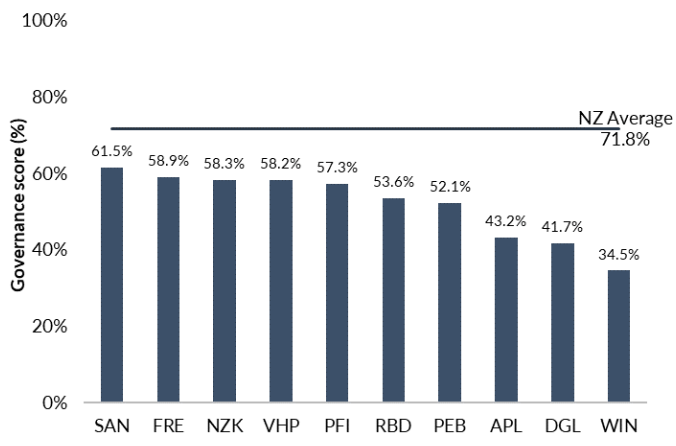
The G section also includes five questions with the potential for negative scoring. We recognise some of the data we are collecting is so important to the integrity, trust and protection of shareholder value that if poor behaviour has been captured, it has also been penalised.

Figure 61. Top 10 governance performers



Source: Forsyth Barr analysis

Figure 62. Bottom 10 governance performers



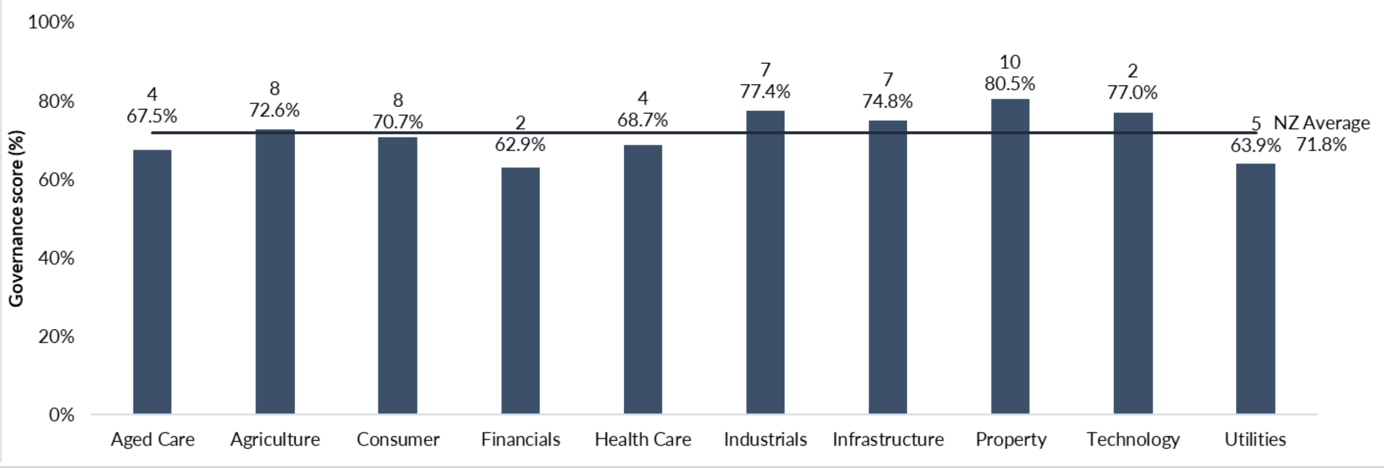
Source: Forsyth Barr analysis

Figure 63. Governance insights

Category	Commentary
Sustainability	▪ 49 companies have a sustainability strategy in place, of which 35 we deem to be integrated and 14 to be separate. A sustainability strategy that is integrated into the main company strategy can indicate unified internal thinking and sets a more holistic tone to the way sustainability may be viewed ▪ 33 companies have remuneration linked to sustainability performance. We highlight an innovation by GNE here, where, in FY23 a sustainability metric was introduced into the Executive Long Term Incentive (LTI) scheme. This will vest depending on achievement of reaching the company's science based emissions reduction target and represents 20% of the LTI ▪ Sustainalytics finds no companies have any major controversies. In addition, none are in breach of UN Global Compact Principles nor are any on the watch lists ▪ One company is a registered B Corp (SML) and one is a Future Fit company (THL). Within KMD Brands, Kathmandu is a a B Corp while Oboz and Ripcurl are in the process of applying to be a B Corp
Investor Protections	▪ Only one company has shares with different voting rights (FSF). This is one of the five metrics we score negatively as super-voting shares can give key company insiders greater control over the company's voting rights, its Board, and corporate actions, creating risk of influence that may not be in the interests of all shareholders ▪ 16 companies have shareholders owning greater than 25% of equities on issue. The government is the shareholder in four of these cases ▪ Refinitiv Eikon data finds that 42 companies have more than three anti-takeover devices which reduce the likelihood of a financially successful hostile takeover. However, if there are too many preventative mechanisms in place, there is a risk that in a hostile takeover situation things skew to protect management at the expense of shareholders ▪ We find only two companies to have significantly negatively treated minority shareholders with a capital raising in the last three years (NZK and VHP). This metric is scored negatively in our framework. In our view, the capital raising structure that is most fair to shareholders is a pro-rata offering, and ideally a "traditional" pro-rata, quoted, renounceable rights offer. However, we do recognise that in certain circumstances issuers can, and sometimes should, legitimately raise capital using non-pro-rata methods
Board	▪ 53 companies have Boards where independent board members comprise the majority ▪ Only one company has a CEO who is also the Chair ▪ Average Board tenure across the companies reviewed was 5.9 years with only three companies' average Board tenure greater than ten years ▪ The average Board size across the companies we reviewed was 6.8 members, with all companies bar one having between five and nine (inclusive) Board members ▪ 52 companies disclose a skills matrix of their Board members ▪ 56 companies have a policy for maintaining a well-balanced Board composition ▪ 54 companies have audit committees where all members are non-executive directors ▪ 35 companies have a Board that comprises no more than two-thirds of members being one gender
Auditors	▪ 28 companies have auditors where the tenure has been longer than ten years. Too long a tenure can lead to strong social and economic bonds between auditor and company, thus potentially damaging the independence of the auditor. The NZ Corporate Governance Forum suggests there should be active consideration of audit firm rotation every ten years. The 28 companies include: AIR, APL, CNU, CVT, FPH, FRE, GNE, GMT, HGH, IFT, KPG, MFT, MCY, MEL, NZK, OCA, PEB, POT, RBD, RYM, SAN, SCL, SKT, SUM, WHS, THL, VCT, VSL ▪ Six of the companies with auditor tenure over ten years are defined as public entities and therefore are subject to the Public Audit Act 2001. This means that choosing an auditor is not something they can control. The point is taken but the risk remains. Of these six companies, the longest auditor tenure is over 25 years ▪ All of the companies report auditor compensation of non-audit fees and only two have paid over 70% of the cost of the statutory audit fee in non-audit fees and it is worth noting that both are newly listed on the NZX
Data Security & Strategy	▪ 52 companies have a cybersecurity policy in place ▪ 53 companies have a data privacy and protection policy in place
Tax	▪ 35 companies have a tax governing framework in place which most note as having been approved by its respective Board
Reporting & Assurance	▪ 34 companies have received assurance of their sustainability report or disclosures. We note this is predominantly a company's Greenhouse Gas Emissions inventory ▪ In our view, 56 of 57 companies have acted with integrity in financial reporting and in the timeliness and balance of corporate disclosures over the last five years. ATM was the outlier. This is a negative scoring metric

Source: Forsyth Barr analysis

Figure 64. Governance scores by sector



Source: Forsyth Barr analysis

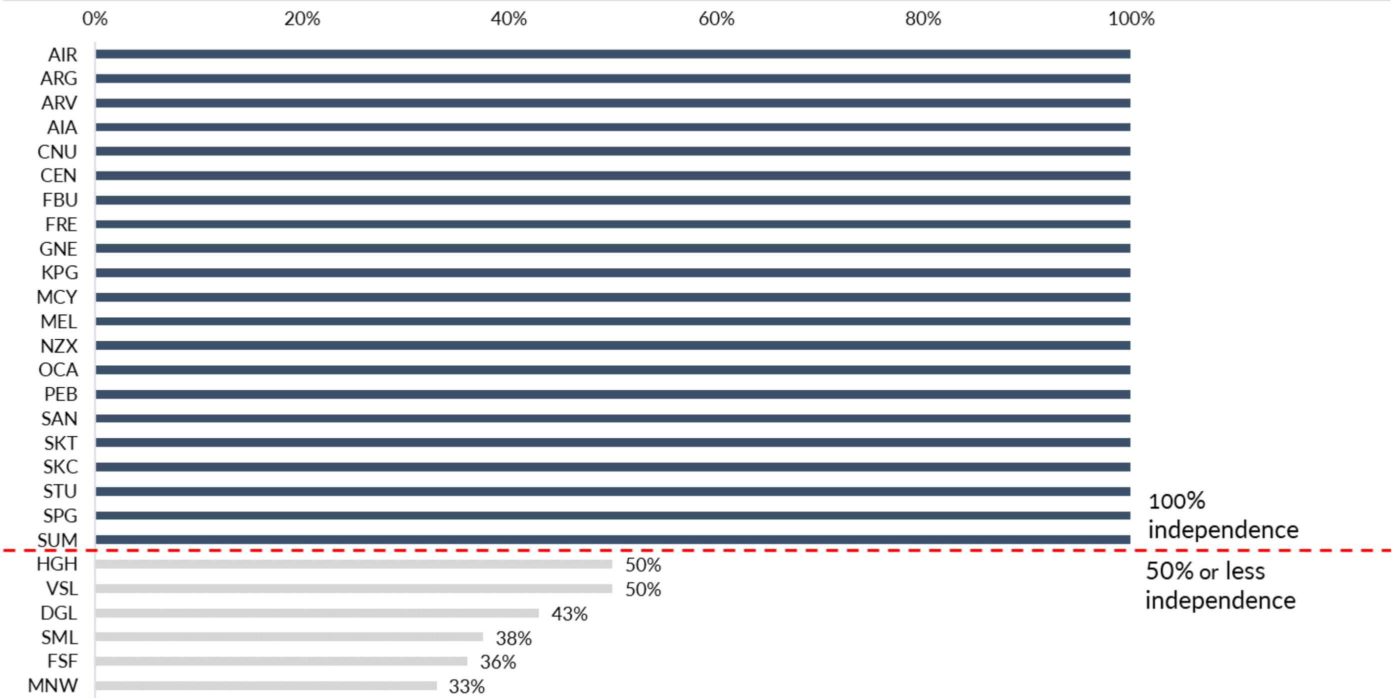
Governance conclusions

Companies scored strongest on the Governance metrics. This is encouraging given we weighted the governance questions at 40% of the total CESG score across all sectors. The importance of strong corporate governance practices has been well evidenced over the decades. If a board ignores corporate governance safeguards, a company can fail. On the flip side, when strong good corporate governance processes are in place, companies can benefit from a healthy corporate culture and the control of risk with procedures streamlined and consistent. Generally, New Zealand corporate governance is pretty strong but there are a few idiosyncrasies to note. Notably, **28 companies in New Zealand have had the same auditor for over ten years.**

Looking ahead

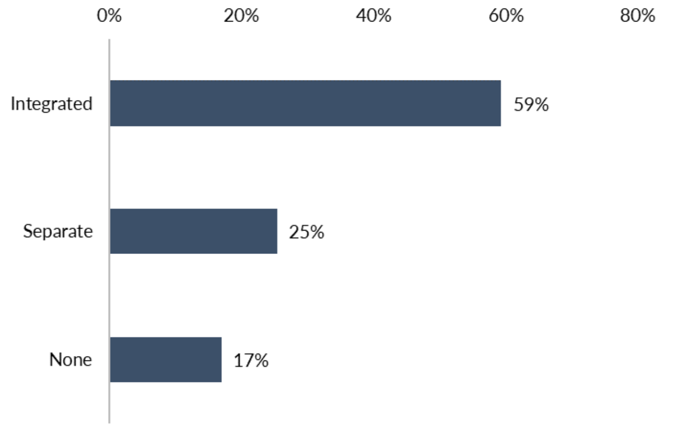
Going forward, we plan to build in metrics that look into whether a **board undertakes a self review**, how policies (such as cyber-security polices) are being **implemented** and if or how the board **assess ethical concerns**.

Figure 65. Percentage of independent directors



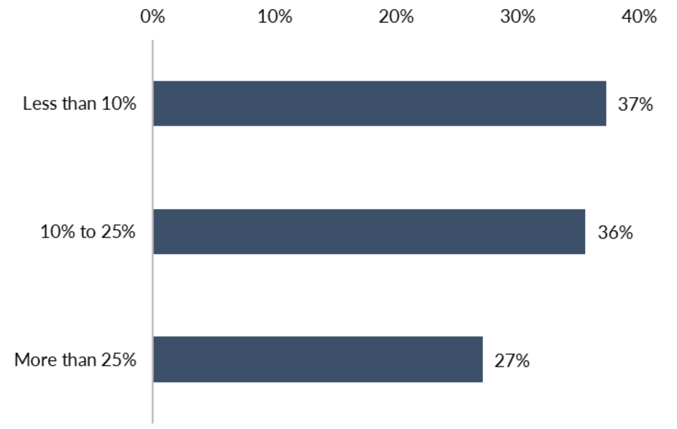
Source: Forsyth Barr analysis, company reports, Refinitiv

Figure 66. Companies with sustainability strategies



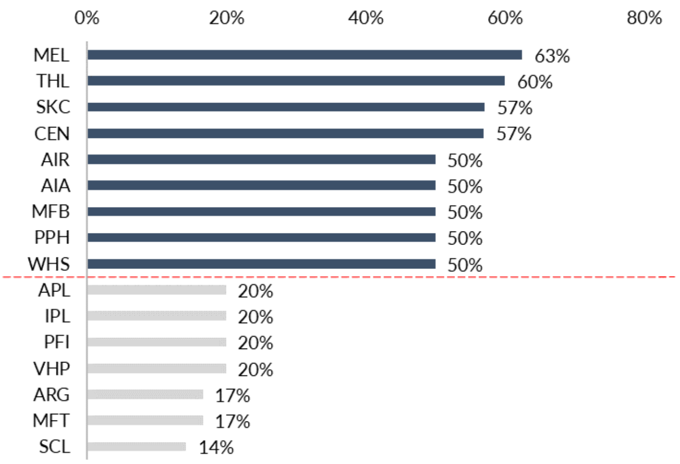
Source: Forsyth Barr analysis, company reports

Figure 67. Companies with potentially blocking shareholders



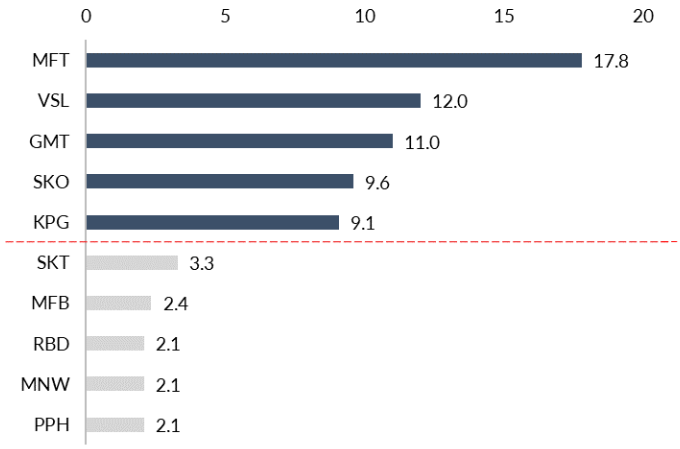
Source: Forsyth Barr analysis, company reports

Figure 68. Percentage of female directors



Source: Forsyth Barr analysis, company reports, Refinitiv

Figure 69. Average Board tenure (years)



Source: Forsyth Barr analysis, company reports, Refinitiv

Omissions and anomalies

Of the 57 companies we requested CESG information from, only four declined to participate. In these situations we collected publicly available data and still created a scorecard. Each company was given an opportunity to comment on their scorecard before we published this report.

Figure 70. Non-participating companies

Company	Reason for declining to particpate
DGL	Not in a position to respond
EBO	Not willing to fill another survey out and believe enough ESG information is already publicly available
FPH	Not willing to fill another survey out and believe enough ESG information is already publicly available
WIN	Not in a position to comment (newly listed)

Source: Forsyth Barr analysis

In addition, there were a number of anomalies that it is helpful to explain and which should be considered when using the ratings.

Figure 71. Anomalies

Company	Reason for anomaly	Forsyth Barr response
IFT	IFT completed the survey to the best of its ability but, given it is an investment company that does not strictly have offices or employees, some of the questions were challenging to answer	Accept this anomaly and recognise that IFT's CESG rating may be lower than warranted
APL	Given APL has no physical infrastructure or employees and relies on an external manager (Centuria), it was unable to answer questions around employees	Apply external manager's employee policies to the framework
IPL	Given IPL is run by an external manager (Stride Property), it was unable to answer questions around employee turnover and employee value proposition	Apply external manager's employee policies to the framework
VHP	The manager of VHP is NorthWest Healthcare Properties Management Limited, a subsidiary of Toronto listed global healthcare fund manager and owner, NorthWest Healthcare Properties REIT. VHP's response reflects NorthWest's policies	The external manager's policies are applied to the Framework
GMT	GMT's responses are based on the policies of its parent company, Goodman	The external manager's policies are applied to the Framework
CHI	CHI's CESG score is a touch misleading as the data reflects its prior refinery operations before the significant transformation to become an import terminal. We will update CHI's scorecard as soon as annual results are released (Feb 2023)	Noted that CHI's greenhouse gas emissions are not reflective of future performance

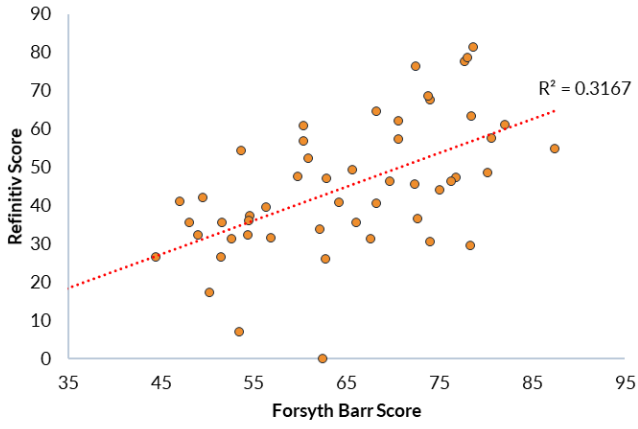
Source: Forsyth Barr analysis

Comparing Forsyth Barr CESG ratings with others

Current external ESG ratings do not give us the information we need. We do not feel the ESG ratings of New Zealand companies provided by international external rating houses give enough granular detail, cover an adequate range of companies, or provide geographical nuance for our particular market. In addition, there is a lack of transparency regarding the methodology used and a valid argument that ratings contradict each other. We also wanted to insert a focus on the future.

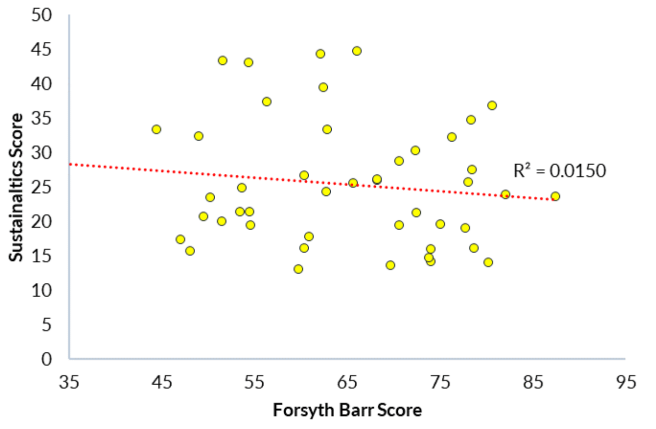
We have tried to tackle these issues by providing a fully transparent methodology. We accept it is not yet perfect and is only iteration number one. However, we firmly believe that the scorecards start the ESG conversation with companies off on the right foot. We expect over time disclosure will continue to improve and eventually, the market will be satisfied by not just the provision of data but also an awareness of whether real change is underway. Our CESG Framework offers a way to measure progress in a consistent, comparable, robust and informative way. We plan to evolve it each year, raising the bar on our expectations and increasing capability to assess the quality of responses.

Figure 72. Forsyth Barr CESG scores v Refinitiv ESG scores



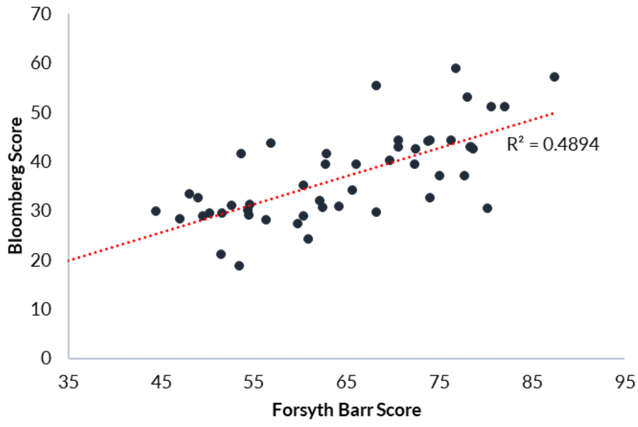
Source: Forsyth Barr analysis, Refinitiv

Figure 73. Forsyth Barr CESG scores v Sustainalytics ESG Risk scores



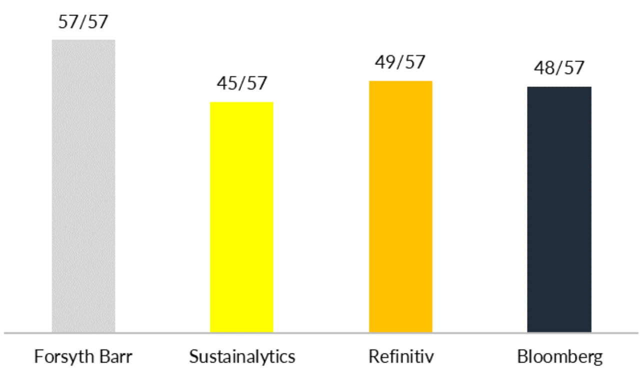
Source: Forsyth Barr analysis, Sustainalytics

Figure 74. Forsyth Barr CESG scores v Bloomberg ESG Disclosures scores



Source: Forsyth Barr analysis, Bloomberg

Figure 75. Number of NZ companies covered by ESG ratings



Source: Forsyth Barr analysis

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Appendices

Appendix A: Company scorecards (alphabetical order)

AFT - AFT Pharmaceuticals
AIA - Auckland International Airport
AIR - Air New Zealand
APL - Asset Plus
ARG - Argosy Property
ARV - Arvida Group
ATM - A2 Milk Company
CEN - Contact Energy
CHI - Channel Infrastructure
CNU - Chorus
CVT - Comvita
DGL - Delegat Group
EBO - EBOS Group
FBU - Fletcher Building
FPH - Fisher & Paykel Healthcare
FRE - Freightways
FSF - Fonterra Shareholders' Fund
GMT - Goodman Property
GNE - Genesis Energy
HGH - Heartland Group
IFT - Infratil
IPL - Investore Property
KMD - KMD Brands
KPG - Kiwi Property Group
MCY - Mercury
MEL - Meridian Energy
MFB - My Food Bag Group
MFT - Mainfreight
MNW - Manawa Energy
NPH - Napier Port Holdings
NZK - New Zealand King Salmon
NZX - NZX Limited
OCA - Oceania Healthcare
PCT - Precinct Properties
PEB - Pacific Edge
PFI - Property for Industry
POT - Port of Tauranga
PPH - Pushpay Holdings
RBD - Restaurant Brands
RYM - Ryman Healthcare
SAN - Sanford
SCL - Scales Corporation
SKC - Skycity Entertainment Group
SKL - Skellerup Holdings
SKO - Serko
SKT - SKY Network Television
SML - Synlait Milk
SPG - Stride Property
SPK - Spark
STU - Steel & Tube Holdings
SUM - Summerset Group Holdings
THL - Tourism Holdings
VCT - Vector
VHP - Vital Healthcare Property
VSL - Vulcan Steel
WHS - Warehouse Group
WIN - Winton Land
All companies' scorecards

Appendix B: Methodology document

Please find the methodology document here

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As at 7 Dec 2022, Forsyth Barr's research ratings were distributed as follows:

OUTPERFORM	NEUTRAL	UNDERPERFORM
44.0%	38.0%	18.0%

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