Verdantix: How Equity Analysts Link Climate Change And Company Valuation

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London, UK. May 28, 2008. Equity analysts divide into three distinct groups based on their climate change perspective, according to a new report from independent research firm Verdantix. Believers, representing 30% of analysts, include climate change factors like regulations and risks in their financial models. Sceptics, comprising 28% of the research participants, think that climate change will have a material impact on profitability within 2 to 5 years. Cynics, comprising 30% of analysts, doubt climate change will ever impact valuations.

“Financial analysis of climate change business issues is in transition” said Verdantix Director, David Metcalfe. “Apart from the utilities sector there is no consensus among analysts covering the same firms and the same sectors on how to incorporate climate change into financial models. For example, some oil and gas analysts are in complete denial while others view climate change regulations, risks and strategy as intrinsic to financial valuation.”

The Verdantix analysis is based on in-depth interviews with 50 equity analysts who cover 13 different industry sectors and represent 22 investment banks including ABN AMRO, Goldman Sachs, Morgan Stanley and UBS. In addition to the high-level segmentation of analyst perspective, the research found that:

Analysts suffer from information and knowledge gaps. Thirty-two per cent of analysts, covering industries as diverse as food production, basic resources, retail, oil, gas, media and banks said they “didn’t know” if firms provide sufficient data on greenhouse gas emissions. Half of the respondents stated that firms didn’t need to verify greenhouse gas emissions although this is essential to establish a baseline for reporting.

Regulations rank highest among climate change factors. Forty-two per cent of the analysts in the Verdantix survey, from sectors like industrial goods, oil, gas, travel and construction, conducted research into climate change regulatory impacts. The EU’s Emissions Trading Scheme loomed large in analysts’ minds rather than the UK’s Carbon Reduction Commitment.

Carbon emission reductions and renewable energy rank lowest. While 32% of analysts had changed a profit forecast due to an energy or fuel efficiency initiative, just 8% did so due to a commitment to reduce carbon emissions and only 6% made an adjustment because a firm committed to buying the majority of energy from renewable sources.

Climate change is perceived as a corporate branding issue. Fully 80% of the equity analysts interviewed consider it likely, very likely or certain that firms they cover will enhance their brand image with their climate change initiatives. Fifty-two per cent of the analysts, representing virtually all industry sectors, consider the industry leader on climate change would achieve a differentiation advantage relative to its competitors in 2008.

“Over the next 18 months firms have the opportunity to shape analyst perceptions of the link between valuation and climate change” said Metcalfe. “Analysts need more guidance from firms on how they incorporate climate change factors into their own financial forecasts and financial analysis. The “do nothing” option for corporates is quickly disappearing”

Based on the equity analyst data, the Verdantix report identifies best practices for climate change financial communications. The analysis suggests that CFOs and investor relations teams should:

1. Draft a company position on climate change. Seventy-eight per cent of analysts, covering all sectors, believe that climate change has strategic implications. Even if the company position is “there is no impact” CFOs need a briefing note in anticipation of the question.

2. Benchmark climate change reporting capabilities. Analysts rely on company reports and investor relations for information on climate change and 34% want more information. IR teams can keep control of the dialogue by establishing baseline climate change data – this will take up to 2 years.

3. Launch a climate change financial analysis project. Firms that do not conduct financial analysis to incorporate climate change issues into their financial communications risk losing credibility with analysts and investors. Accountancy firms like KPMG specialize in this service.

4. Design climate change communications around analyst receptivity. The Verdantix survey data identify issues with high, medium and low levels of receptivity in the analyst community. Brand enhancement and energy efficiency rank high. Carbon emission reductions and climate change strategy rank low.

“The business impact of climate change is going through a period of diminishing uncertainties” said David Metcalfe, author of the report. “By 2010 we expect to see a consensus in each industry on financial valuation and climate change.”

The report, “Verdantix Survey: Equity Analysts Link Climate Change And Company Valuation” (http://www.verdantix.com/index.cfm/papers/Products.Details/product_id/11/survey-how-equity-analysts-link-climate-change-a
can be purchased online and is available to Verdantix clients at www.verdantix.com

About Verdantix

Verdantix is an independent business research firm focused on climate change, carbon markets and corporate responsibility. For more information please visit www.verdantix.com

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