METROPOLE Gestion®
RESPONSIBLE VALUE INVESTMENT

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ESG: a competitive advantage for European businesses

As firm believers in the added value created by incorporating ESG criteria into investment decisions, we have for many years put ESG at the very heart of our management process. Yet, until only recently, ESG was perceived as a constraint by both businesses and investors, in particular because ESG standards are generally based on regulatory requirements. Over the last few years, however, this perception has gradually been reversed as both businesses and investors have become aware of the opportunities ESG has to offer. The Covid-19 turmoil significantly accelerated the introduction of ambitious policies that are now enabling European firms to stand out from the crowd.

The economic direction Europe is taking has positioned it in the forefront of the fight against climate change. As the first economic zone to implement a structured market in carbon certificates, Europe has a long experience of using environmental regulations to encourage businesses across the board to engage with the energy transition. Companies have adapted by investing massively in developing new solutions for reducing their carbon footprint.

The automotive industry offers a perfect illustration of these transformations. Notably incentivised in recent years to innovate in order to reduce their CO2 emissions in accordance with European regulations, Europe's auto manufacturers have already invested heavily in electrifying their vehicle ranges. As a result, they are now in a position to respond to demand that has soared in the wake of the pandemic. Now groups like **Daimler**, **BMW** or **Volkswagen** expect to see half their revenue stream deriving from e-vehicles in 2030. Volvo has even pledged to stop selling ICE vehicles as from 2030. At the cutting edge of this technological transformation, the European manufacturers are solidly positioned to grapple with a transition that now affects the global automotive market as a whole.

For steelmaking, which accounts for around 8% of global CO2 emissions, reducing those emissions is also a substantial challenge. The key European players in the sector have tackled the subject head on, in particular Sweden's **SSAB**, now hailed as a pioneer in zero-emissions steelmaking after replacing coking coal with green hydrogen as part of its HYBRIT project.

The equally emissions-intensive cement industry also faces the same issues. Cement manufacturer **HeidelbergCement** has adopted ambitious environmental targets, aiming to reduce its emissions by 30% by 2025 and achieve carbon neutrality by 2050. In pursuit of its aim, the group is investing particularly in improving the energy efficiency of its production plant and in carbon capture technologies. As with SSAB in steelmaking, the lead HeidelbergCement has taken in the production of carbon-free materials gives it a competitive edge that puts the group in an ideal position as clients seek increasingly to reduce the carbon footprint of their purchasing.

Europe's industries are being urged towards transformation and can draw on public funds to do so, especially the Next Generation EU recovery fund, 30% of which is set aside for fighting climate change. Through the planned introduction of a carbon border tax, Europe will also be protecting its own industrial base, as the new scheme will prevent competitors not subject to EU regulations and enjoying laxer environmental standards from flooding Europe with their lower-cost products.

The environmental and climate stakes that businesses must now face call for exemplary governance in view of the repercussions that, on the financial front alone, could prove considerable. Business leaders have grasped this only too well in the wake of the Gulf of Mexico oil spill that cost **BP** over USD60 billion, and the emissions scandal that has cost Volkswagen close to €30 billion. Transforming what at first sight might look like a constraint into a development opportunity requires a shift in governance that goes far beyond merely strengthening risk control measures. It frequently involves resetting strategic orientations and the resources deployed at every level of the business. It also involves introducing incentivising pay schemes for top management and executives. This is an aspect we addressed in our discussions with companies in our portfolio, as part of our 2018 thematic engagement campaign to encourage companies to incorporate ESG criteria into their executive pay schemes.

Driven by a strict regulatory environment and intense shareholder engagement, in which we actively participate, European businesses had an early introduction to ESG issues. They have made considerable progress over recent years and are now well ahead of their international competitors. This is one of the findings revealed by our proprietary ESG rating model, which covers over 6,000 stocks worldwide. European firms are in the process of transforming what was once seen as a constraint into a development opportunity. The lead they have taken in the field of ESG now gives them a decisive competitive advantage.

METROPOLE Gestion®
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SRI certification extended to the entire METROPOLE Gestion Responsible Value range

METROPOLE Sélection - METROPOLE Avenir Europe - METROPOLE Euro SRI

A COMPREHENSIVE AND INTEGRATED MANAGEMENT PROCESS

RESPONSIBLE VALUE INVESTING

Pre-selection
Evaluation
Catalysts
Managing positions

Pre-selection

Reduction of the investment universe in line with 3 successive criteria:

- Elimination of companies falling within the scope of our exclusion policy.
- Elimination of companies with the lowest ratings under the Best-in-Class/Best Efforts ESG rating produced using our proprietary methodology or which have been the subject of a major controversy.
- Selection of securities that are discounted vis-à-vis their industrial value by using for each sector the same valuation criteria as used for the sector's companies recorded in our proprietary database of past transactions.

Evaluation

Calculation of industrial value, analysis of the balance sheet strength, consideration of extra-financial controversies followed by meeting with management.

- A 360° analysis of the company taking into account three aspects: extra-financial analysis, financial analysis, balance sheet analysis.
- Meeting with management regarding these 3 aspects.
- Choosing an appropriate valuation ratio for each type of business.
- Evaluation of ESG risks and opportunities.

Identification of catalysts

Anticipation of changes in market status for the security selected , likely to reduce any undervaluation relative to their industrial value.

- Identifying financial or extra-financial catalysts, new controversies or changes in extra-financial ratings

Entry

Entry based on a collegial decision and weighting of each security according to its discount and catalysts.

- Portfolio with stocks discounted against their industrial value, with strong balance sheet and ESG qualities.
- Concentrated portfolios with 30 to 40 stocks.

Exit

Strict sell discipline.

- When the valuation target is reached.
- When identified catalysts do not materialise.
- In the event of a sharp downgrade in extra-financial ratings.
- In the event of significant controversy.

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For additional information, please contact either the financial services provider (contact information provided above) or METROPOLE Gestion, at the following address: metropoleg@metropolegestion.fr.

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