Climate, coal and the big global trends driving change

Released April 2019

Nic Pollock, Chief Commercial Officer K2fly

February 2019 will go down in history as a landmark month, one that culminated in the realisation of a rapidly changing world when it comes to mining, sustainability and a new generation of sustainability awareness.

Recent decisions made in NSW courts, as well as the boardrooms of some of the largest mining companies, could signal a tipping point in action over awareness. If they haven't already, company boards and their senior executive teams are realising that debating climate change is no longer the issue and that they need to get on with the business of responding to the real actions and changes that are taking place with or without agreement.

These changes are being shaped by four key global trends:

1. Sustainable finance
2. Radical transparency
3. Business led climate change
4. Increasing expectations

Friday, 8 February saw the New South Wales Land and Environment Court hand down a landmark judgement. Chief Judge Brian Preston refused a new open cut coal mine in the Hunter Valley, citing climate change as one of the key reasons for his decision. Less than two weeks later, mining major Glencore announced plans to limit its coal production capacity broadly to current levels. The company recognised climate change science as set out by the United Nations Intergovernmental Panel on Climate Change and stated: "to deliver a strong investment case to our shareholders, we must invest in assets that will be resilient to regulatory, physical and operational risks related to climate change."

Four key factors specifically impacting on the resources sector. These are sustainability and ESG across investor decisions; radical transparency; reduced government leadership on climate change; and increased expectations from consumers and shareholders.

Nic Pollock is K2fly's Chief Commercial Officer with 25+years' experience in the enterprise software business and professional services world predominately across resources and utilities sectors.

He is a sustainability champion and sees the value that digital technology can bring to ESG practices, governance and transparency.

Nic studied Economics at UWA but more recently has focused his attention to Corporate Sustainability via NYU, Stern Business school program. He is also GRI and GAICD qualified.

Sustainability in financial markets

Sustainability as a factor in investment decisions has been a growing movement across financial markets for decades. A number of recent examples suggest that it has now reached a tipping point of power over influence. Globally $1 in every $4 is now invested under responsible investment principles, that's increased 38% in two years.

Glencore's decision, to some, suggests inconsistency given the large investments made into Rio coal assets since acquisition.

However, indicators point to the influence of organisations such as the Climate Action100+, an organisation of 290 investors from 29 countries, with $30 trillion under management. This figure represents roughly one-quarter of funds under management globally. Climate Action100+ has a mandate for climate change governance. In Australia, Climate Action 100+ has attracted signatories from major investors such as IFM Investors, Australian Super and more recently Glencore.

Year on year, month on month, sustainability continues to gain momentum. In 2015, in a meta-analysis of 200 academic studies by Oxford University and Arabesque Partners, researchers found that good sustainable practices lowered the cost of capital. Additionally, 80 per cent reported that share price is positively influenced by good sustainability practices. The Boston Consulting Group published a supporting paper in October 2017 called Total Societal Impact. BCG linked environmental, social and governance (ESG) standards to a 19 per cent valuation premium and increased EBITDA margins of 3.4 per cent for top performers in the oil and gas sector.

This bottom-line value is clearly being recognised with 72 per cent of S&P500 companies now reporting on sustainability outcomes.

In 2017, 74 per cent or 148 of ASX200 companies had a formal sustainability report. These reports are not required by regulation but are optional initiatives. In Australia's top 50 mining companies roughly 50 per cent have a sustainability report, with almost all of these in the top 25 by capitalisation. November 2018 saw Rio Tinto launch its first full board ESG investor briefing in Sydney. This was a bold endorsement of the value of sustainability, and one that peers are expected to follow.

Stock values of more sustainable companies outperform less sustainable peers

Source: Eccles, Ioannou & Serafeim / Harvard Business School . 180 companies over 28 years (1993-2011)

Radical Transparency

The second key trend of interest is Radical Transparency. The impacts of declining resources are being amplified by unprecedented growth in the civil sector (particularly non-government-organisations and not-for-profits), as well as active shareholder groups.

These groups have additional mobilisation power due to the growth in information technology and social media platforms. Literally millions of people can be rapidly mobilised. Estimates are that the number of voluntary and not-for-profit organisations focused on environmental concerns now exceeds 1 million. These numbers reflect only direct involvement. If we consider the effect of indirect flow-on, each member can extend the reach ten-fold via liking or sharing content. These numbers then grow exponentially. This, combined with consistent data, creates Radical Transparency.

In Australia, we are also seeing superannuation funds getting more deeply involved in shareholder activism. Given they control more than $2.3 trillion in funds under management they are a powerful voice. In 2018, a record 17 sustainability related shareholder proposals were submitted to ASX200 companies.

Over the last three years, ESG shareholder activism has been steadily increasing including institutional investors who are now more inclined to support these resolutions than before.

Business, not Government leadership

The third trend sees business not waiting for Government to take a leadership position on climate change policy. The role of government is to protect and regulate, not necessarily to advocate sustainability. While politicians debate over policy, big miners such as BHP and Rio don't argue about climate change but get on with the job of trying to operate more sustainably.

Supporting this sentiment is the Globescan State of Sustainable Business Survey 2017. Here 85 per cent of respondents rated large global companies as having more impact on advancing sustainability than national governments (57 per cent). Not surprisingly, European respondents have more confidence in their governments' ability to impact (69 per cent) than North Americans (51 per cent). President Trump withdrawing from the Paris Accord may have influenced the voting population, however it seems to have had no impact (65 per cent) on corporations and their sustainability agenda. The overwhelming consensus is that business will continue to lead on climate change. In fact, President Trump's decision has resulted in 17 per cent of North American Corporations saying it will strengthen their commitment.

The Age newspaper recently published an article on the International Panel of Climate Change (IPCC) report released in October 2018 and the current Federal Government's essential dismissal of its recommendations. In fact, it goes further saying that "Mr Morrison's response to the IPCC report confirms the next election will be the first since 2004 in which one of the major parties will campaign without even the skimpiest fig leaf of a policy on climate change."

The report's economic foundations were provided by Yale economist William Nordhaus, who recently won the Nobel prize for economics, and found that the cost of investment in emissions reduction was far better value than the cost of doing nothing. Many politicians tend to argue economics and climate change metrics rather than climate change action, a sentiment disputed by both the Nobel committee and the IPCC.

> "We also see many governments failing to prepare for the future, on issues ranging from retirement and infrastructure to automation and worker retraining. As a result, society increasingly is turning to the private sector and asking companies respond to broader societal changes."

BlackRock Larry Fink
2018 Letter to Shareholders

k2fly

Increasing expectations and the rise of the aspirational consumer

Increasing expectations is a trend that invites and encourages companies to think about the very essence of demand, especially in the context of a transparent and networked world. Investors, regulators, employees and customers expect sound social and environmental license from corporations. The rise of the aspirational consumer is having an enormous impact on company strategies.

Representing 40 percent of the global public, Aspirationals are defined by their love of shopping, desire for responsible consumption, and their trust in brands to act in the best interest of society. They are among the most likely to support companies and brands that have a purpose of making a positive difference in society through their products, services, and operations, yet only half can think of a single company as having a strong purpose in this way.

This applies increased pressure on corporates which can be frequently driven by short-termism influenced by market growth. One of the big shifts in perception over the last decade has been that 'green' products were more expensive and of a lesser quality. Think of that dreadful loo paper we used to get. The reasonable expectation in today's economy and consumer society is that green doesn't mean a compromise on quality or style. A prominent example is Tesla and its impact on the automotive market. This presents clever disruptive opportunities in the new era, as well as smaller incremental changes that can benefit all.

Winning an argument over the reality of climate change is a waste of time. Notwithstanding the need for balanced science and evidence as critically important, whether the planet is warming by one, two or even three degrees is largely irrelevant. Whilst climate change is often the highest priority issue that organisations are attempting to overcome, it is only one element of good ESG sustainability practices.

Many major corporations, including leading mining companies, are just getting on with it as it makes common sense as well as business sense. As one CEO said, "what's the business case for screwing the planet?" Perhaps business should be more wary of the cost of doing nothing at all.

Rio Tinto Chairman Simon Thompson's opening comments at their inaugural ESG investor briefing sums it up well.

"We do not see ESG or profits as an either/or decision," he stated. "Increasingly, we also see ESG as a source of differentiation, as society, and particularly millennials, demand higher standards of governance and transparency from the companies they work for, and invest in."

Global Presence

22
COUNTRIES

22, 000
SAMPLE SIZE

40 - 60%
ASPIRATIONALS

20 - 39%
ASPIRATIONALS

Sustainability frameworks

While businesses are required to report on environmental impacts to regulators, increased societal disclosure expectations have led corporates to mandate non-financial reporting annually, through a sustainability report. The good news is that sustainability frameworks are now well established. Such examples of reporting standards and protocols are the Global Reporting Initiative (GRI) and the UN Sustainable Development Goals (SDG).

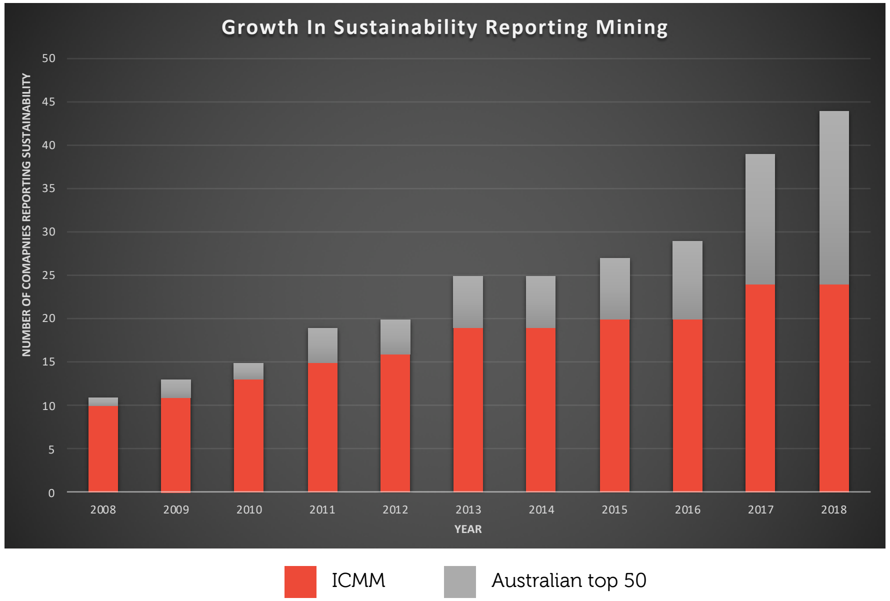
Leading companies, like BHP, reference both standards in its sustainability report. Standards allow different organisations to be compared, but the standard does not insist that everything needs to be reported on. Different companies will address different material items, and their stakeholders. The GRI G4 framework alone indicates five indicators that could be reported on (economic, environmental, social, society, product responsibility). Within these parameters, businesses can choose to disclose indicators that hold material relevance to the organisation, and can be verified or assured.

According to EY's 2018 investor survey, many organisations are only at the point of considering sustainability, not yet embedding it into the core of their long-term strategy. Like anything, it needs to be led from the top. EY also note that "sustainability managers who are asked to navigate change often do not have a direct influence on the setting of the business strategy."

Like anything, if it's not measured, it very likely won't be managed. It's no different to how companies chose to successfully introduce safety standards and reporting requirements.

Global miner South32, for example, has linked emission reduction targets to executive pay. The company has a five-year target to keep emissions below a 2014-15 baseline by 2020-21 and by 2050 aims to have zero net emissions.

At K2fly we provide systems and solutions for organisations in mining, resources and land intensive businesses. Our systems enable our clients to govern their land assets more efficiently and provide better outcomes for all stakeholders; be they communities, regulators or investors.



k2fly

For more information please contact
Nic Pollock, Chief Commercial Officer, K2fly
E: Nic.P@k2fly.com | P: +61 8 6333 1833

www.k2fly.com