ESG report

Bridging the gap for the overlooked

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Executive summary

The ESG momentum is growing, nobody can deny it

In the face of both conviction and obligation, the momentum behind Environmental, Social, and Governance (ESG) considerations is undeniably growing. The devastating impacts of climate change have heightened awareness of ESG issues, with a focus not just on physical consequences but also on their financial implications. At Degroof Petercam, ESG stands as a cornerstone of our strategy, integrated across all our business lines, including Investment Banking.

An integrated approach as competitve edge

In our pursuit of ESG excellence, we recognize the need for an integrated approach, going beyond standalone financial analysis. Sell-side research plays a pivotal role, guiding institutional investors in ESG integration and raising awareness among companies on their ESG journey. Hence, we have developed a standardized ESG analysis methodology combining a quantitative scoring and qualitative assessment. Regulatory frameworks, such as the EU Taxonomy, the Corporate Sustainability Reporting Directive (CSRD), and the Sustainable Finance Disclosure Regulation (SFDR), are shaping the ESG landscape. Simultaneously, the rise of ESG-oriented investments is driving demand for robust ESG research.

Bridging the gap for the overlooked

Our aim with this report is to bridge the gap for companies that are not yet widely rated by predominant ESG rating agencies. This report first delves into the challenges and progress observed within various sectors ranging from the challenges posed by non-financial reporting, the lack and consistency of ESG targets when they exist as well as the level of preparation for CSRD reporting.

Emphasizing sector differences

With 61 companies covered in this report, we observed that reporting and ESG integration vary among sectors. Consumer goods companies excel in ESG reporting, with robust initiatives. Technology firms display good reporting quality but face challenges in ESG performance. Industries like real estate, already cognizant of ESG, struggle with data collection. Biotech and healthcare, due to their early development stage and related resource constraints, lag in reporting. Investment companies face complexities in reporting, emphasizing the need for portfolio-focused analysis.

Committing to pave the way

In conclusion, bridging the ESG gap is a collective effort. While challenges persist, progress is evident. Standardization, targeted guidance, and sector-specific approaches will pave the way for a more sustainable future.

At Degroof Petercam, we remain committed to guiding companies and investors in this transformative ESG journey.

Why this report?

We will all get there, should it be by conviction or by obligation

The ESG momentum is growing. Rare are those who have never heard that word. Beyond the physical impacts of climate change, which have been devastating in some parts of the world, awareness around the financial impact of ESG issues is increasing. The materiality of non-financial risks and how the latter could impact companies' performance is a growing concern.

ESG is one of the key pillars of Degroof Petercam's strategy. Sustainability is integrated in all our four business lines and Investment Banking is no exception. At Global Markets, which is part of Investment Banking, not only do we aim to be an early adopter, but also a leader in our BENELUX SMEs market by integrating ESG within all our business lines. That is of course a work in progress and one of our starting points has been sell-side research.

We believe that a standalone financial analysis fails to capture the reality companies are evolving into and no longer accurately reflects the performance of the latter. We have therefore developed an integrated approach where we combine fundamental financial and non-financial research.

In our view, the ESG role of sell-side research is twofold:

- Guiding institutional investors through the integration of ESG considerations within their investment decision process and
- Raising awareness among companies and helping them in their ESG journey

The rise of regulations impacting both companies and financial market participants cannot be ignored. Among others, the EU Taxonomy, the CSRD and the SFDR, make the integration of ESG all the more relevant. Along with those, regulations framing the environmental performance of assets for example, are foreseen to have a material impact going forward. On the other hand, demand for ESG research is also driven by the rise of ESG-oriented investments with more and more article 8/9 funds. According to the European Fund and Asset Management Association, net assets of article 9 and 8 funds amounted to EUR 341bn and EUR 6.44tn respectively, representing c.2.4% and 45% of the EU fund market[1].

Bridging the gap

Our aim with this report is to bridge the gap for companies that are not yet widely rated by predominant ESG rating agencies such as Sustainalytics or MSCI. We will progressively extend our integrated research approach to our entire coverage.

We have drawn four main conclusions from the analysis of those companies that are overlooked by ESG rating providers:

- The fact that 45% of the analyses included in this report are scored "No Data" illustrates that reporting represents a huge challenge. On one hand because it requires significant resources and on the other hand because it requires ESG knowledge
- CSRD is cumbersome and not everyone has started yet
- Targets are essential to back commitments, yet too few companies have set some
- Some sectors are performing better than others, pushed by regulations

[1] https://www.efama.org/sites/default/files/files/EFAMA_MKT%20INSIGHTS%2312_final.pdf

ESG research methodology: an integrated approach as competitive edge

DP sell-side research has committed to include ESG scoring in its fundamental research. Hence, the team developed an internal ESG rating methodology based on a two-steps process: 1/ a quantitative analysis and 2/ a qualitative analysis. We have chosen an integrated approach, combining both financial and ESG aspects with the ESG analysis being conducted by the analyst covering the name. This approach provides another level of analysis by emphasizing sector trends and challenging companies' midterm ESG strategy based on their financial and competitive situation.

We would like to emphasize that we have taken a relative scoring approach, assessing the performance of each company vs. its peers. Hence, our analysis cannot be considered or used as an absolute rating. We aim to provide the reader with a good understanding of the positioning of the company within its peer group, evaluating whether it is ahead or lagging vs. sector peers.

Our two-steps analysis leads to an ESG score between zero and five stars.

- **ESG Outperformer**: ahead of the peers (**** and *****)
- **ESG Neutral**: in-line with the sector (***)
- **ESG Underperformer**: lagging the sector (**, *, no star or no data)
- **No Data**: insufficient amount of data (<60%)

Analysing the overlooked: 4 takeaways

Reporting - State of play: not there yet

Non-financial reporting is undoubtedly a cumbersome process. Most companies covered in this report have been rated as "No Data", yet none of them completely ignore ESG matters. Our analysis highlighted that numerous companies have already been setting up good initiatives but do not have the necessary resources to report on the latter. This backs the relevance of a qualitative approach, also considering that many elements are not quantifiable and are hence difficult to capture in a quantitative rating. Most of these companies are however committed to improve reporting going forward.

We observe a common ground across all sectors:

- Non-financial reporting requires significant resources
- Collecting data is often a big challenge
- CSRD represents a huge work - we dig into details into this in the next section
- The lack of standardization among ESG ratings and reporting requirements create a huge burden for the companies
- ESG interest is growing among institutional investors with an increasing number of requests on that topic

The above-mentioned considerations highlight that as far as non-financial reporting is concerned; we are not there yet. Progress will have to come from both the standardization of reporting standards and the increase in ESG- related knowledge among companies, investors and analysts.

CSRD - The doldrums

The EU commission introduced the Corporate Sustainability Reporting Directive (CSRD) under the Green Deal's Sustainable Finance Package. The latter entered into force end of 2022. The CSRD will gradually apply to the companies with the first ones having to report in 2024 and the last ones in 2028 according to the timeline below.

Exhibit 1 CSRD timeline

2025 (FY2024)	2026 (FY2025)	2027 (FY2026)	2028 (FY2027)
Large companies already covered by NFRD that exceed at least 2 criteria's: > 500 employees > 20M EUR assets > 40M EUR net turnover	Large companies that exceed at least 2 criteria's: > 250 employees > 20M EUR assets > 40M EUR net turnover	SMEs that exceed at least 2 criteria's: > 10 employees > 350 000 EUR assets > 700 000 EUR net turnover	All non-EU-country companies, with net turnover above 150 M EUR in the EU and if they have at least one subsidiary or branch in the EU

Source: Worldfavor

Overall, the take-away from our analysis is that preparing for the CSRD represents a big challenge for all companies. Many emphasized that collecting all the required data and measuring some metrics such as scope 3 emissions, require a large amount of time and resources. The development of a roadmap and the allocation of a budget therefore appears necessary to be able to meet the standards on time. Companies also mentioned that the challenge lies in the fact that only draft versions of the CSRD were available which makes it more difficult to prepare efficiently for the directive. What companies do appreciate is that the application of the CSRD will bring some standardization, coping with the current lack of consistency between the different reporting guidelines.

When looking at the progress made in the preparation of the CSRD, we observe large variations among companies. For some, the topic is still a long way off, for others it has already been worked on for several months/years. Few companies stand out with already a first report out using CSRD methodology. We observed that the difference in progress made often lies in the CSRD deadline, the size of the companies and the sector in which the company operates (e.g. companies operating in highly regulated industries such as real-estate tend to be more advanced). The majority of companies included in this report which will have to report in 2025 (FY2024) for the first time, have already started and done the taxonomy alignment assessment. Companies which have to report at a later stage seem to feel less concerned at the moment.

Exhibit 2 Share of companies in this report on which the CSRD will apply

2025 (FY2024)	2026 (FY2025)	2027 (FY2026)
66%	13%	18%

Source: Degroof Petercam

Targets - If you don't know where you are going, you will never get there

Nowadays, almost all companies publish sustainability reports in which they communicate on their ESG performance by disclosing quantitative data or by describing initiatives that have been set up. Even though, this gives the stakeholders a broad indication of where the company is going, we believe **well-defined targets** are necessary to better assess the company's trajectory and consequently future risks. Targets are a mean to back commitments. Next to being important for stakeholders, targets are also important for allowing companies to allocate their resources and to implement new initiatives more efficiently to achieve their goals. We believe short term-targets are as indispensable as long-term targets. Short-term targets allow the company to track its progress, assess whether it is on a good trajectory, assess the work that remains to be done and step in and adapt the original plan if necessary.

Whether a certain target is relevant or not is very difficult to assess for the company and its stakeholders. Therefore, companies can use several ESG standards, frameworks and initiatives to align their targets with overarching objectives such as those set by the Paris Agreements. The SBTi (Science Based Target initiative) is an example of a frequently used framework.

Exhibit 3 SBTi targets

Short term		Long term		Net zero	
Validated	Commited	Validated	Commited	Validated	Commited
11%	8%	2%	0%	2%	3%

Source: Science Based Targets

Regarding the companies included in this report, when looking at the past 3 years, we can observe a significant increase in the quality of the Sustainability reports both at the levels of reporting and target setting. Currently, most targets have been set up at the Environmental level, and less at the Social and Governance levels. Most GHG emissions reduction targets only include scope 1 and 2 emissions, with few companies already setting targets on scope 3. We also observe an increasing trend in companies having their GHG targets validated by the SBTi. Since the CSRD requires companies to define targets on specific non-financial aspects based on a materiality assessment, we expect the disclosure of ESG targets to improve even more in the coming three years.

Sector differences – Regulations and size into play

The level of reporting and the importance and integration of ESG considerations in the different companies covered in this report show diverging trends. We observed that the size of the companies and the regulations that apply to the different sectors contributed to this phenomenon. We would like to emphasize that the following observations are solely based on the analysis of the 61 companies included in this report.

Consumer goods

In the consumer goods sector, ESG is already a lively topic with better reporting than in other sectors. Based on our methodology, we were able to give an ESG rating **to most of the companies (6/11)** included in this study**.** The fact that those companies are obliged to report in line with the CSRD in 2025 for FY2024 for the first time might also explain why most of them are already reporting on many ESG metrics.

Technology and Business Services

When looking at the Technology companies in our scope of study, we can conclude that the reporting quality in this sector is relatively good with all companies disclosing sufficient data for us to be able to rate them. Even though the reporting quality is exemplary, 3/6 are performing worse than their peers. The fact that those companies will need to report in line with the CSRD in 2025 for FY2024 for the first time might also explain why most of them are already reporting on many ESG metrics.

Industrial/cyclical

The industrial sector includes very polluting businesses such as companies active in the energy, transportation, manufacturing or construction sectors. Hence, innovation and transition will become necessary for those companies to survive. When looking at the companies included in this study, we notice that the number of companies with ESG data available and consequently an ESG rating **(10/12)** reflects the importance of ESG in this sector. Similarly to the consumer goods sector, all these companies will have to report in line with the CSRD by 2025 for FY2024 for the first time.

Investment companies

Compared to other sectors, reporting on ESG is not as straightforward. Currently, investment companies will only have to report on their "corporate" impact under the CSRD. However, taking into account the nature of their business, we consider the sole "corporate impact" not to accurately represent the ESG performance of investment companies. However, we acknowledge the fact that reporting at the portfolio level represents a heavy burden for companies. Only 2 out of the 8 investment companies included in this report disclosed sufficient data to be rated. Most of the investment companies in our coverage will have to report following the CSRD in 2025 for FY2024 for the first time.

Biotech/healthcare

This sector appears to be the one with the lowest reporting performance. However, many of the companies included in this report are still at an early development stage. We acknowledge that reporting on ESG metrics represents a significant burden for companies, both in terms of time and financial resources. We believe earlier-stage companies have other short-term priorities and limited time and financial resources to dedicate to ESG. 3 out of 12 companies included in this study have been rated. The companies in this sector will have to report in line with the CSRD for FY2025-2026 for the first time. This might also contribute to the fact that the reporting quality in this sector is still poor.

Real Estate

Since real estate is among the most polluting sectors, ESG considerations and regulations have been embedded in this industry for a long time. As such, different certificates attesting from the environmental performance of an asset have been developed (i.e. BREAAM, HQE,…). Even in terms of reporting, specific standards and rating agencies have emerged such as the GRESB and the EPRA's sustainability best practices. When considering ESG in the real estate sector, it is important to make the difference between the REIT's and the Developers. While it makes sense for a REIT to report on ESG metrics on an annual basis, it would make more sense for a developer to report on a project basis, for example. Approximately half of the real estate companies (5/12) included in this report do not report sufficient data for us to be able to rate them, most of them being developers. We believe this is due to their small size and to the challenge data collection represents for this sector. In the real estate sector, companies included in this report will have to report against the CSRD by FY2024, 2025 and 2026 for the first time.

Disclosures

None

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This report represents a shortened version of the initial extended ESG report: “Bridging the Gap for the overlooked”.

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