



ESG update

Value Adviser Associates is a UNPRI signatory. Over the past year Value Adviser Associates have working on incorporating Environmental, Social and Governance ("ESG") factors into unlisted infrastructure valuations.

Firstly, we started by researching ESG factors commonly used by ESG ratings agencies. This was followed up with two think tanks in Melbourne and Sydney with financial services industry participants to identify the ESG factors that the industry thought had the greatest effect on financial value.

After the think tanks assessments of how the factors could be incorporated into infrastructure valuations we made by using 13 infrastructure asset valuations as case studies. In addition, valuation experts in particular infrastructure sectors provided examples from their experience in valuing particular kinds of assets. Finally, research was carried out into work done in quantifying the value of different factors.

General ESG valuation principles - key findings

- » An ESG checklist with a list of ESG factors is useful because it helps you to consider factors you might otherwise forget/not consider;
- » ESG factors that will definitely affect value should be considered in the primary valuation. It is useful to include some uncertainty modelling (e.g. using Monte Carlo or other tools) as many ESG factors have uncertain outcomes; and
- » Binary ESG factors either will or will not happen e.g. an environmental disaster. Binary factors could be modelled separately as scenarios, rather than incorporated in to the primary valuation.

Environmental factors - key findings

- » Infrastructure assets are regularly affected by climatic events. While insurance and contract structures may reduce the risk to asset owners, we found many examples where this was not the case. Valuers tend to incorporate the effects of past climatic events into valuations, but there is rarely any consideration of future climatic events.
- » Many environmental events are highly uncertain and require valuation techniques that incorporate uncertainty, the value of mitigation strategies and downside risk. In some cases, insurance costs and catastrophe bonds may give an indication of the effect potential climatic events have on value.



Social and governance factors - key findings

- » Research has indicated that companies with good social practices (particularly Human Resource practices) and good governance trade at premiums to other similar companies. However, it is very difficult to isolate the value effect of single initiatives. The premia for good social or governance practices may often be implicitly built into management cash flow forecasts, so valuers need to be very wary of adding premia to discounted cash flow valuations, as this could double count the value. However, all else equal, it is likely that companies with superior human resource practices and/or governance relative to comparable companies, will trade at higher multiples than comparables. Downside risks associated with poor governance and social practices could be considered in scenarios.

Other key findings

- » There is some analysis that indicates that compliance costs are typically under-estimated by management. There are significant ESG compliance costs. Valuers should look carefully at forecast compliance costs forecasts to check they are appropriate.

ESG regulation can have a huge impact on value and potential regulatory changes need to be identified and monitored as part of the valuation process. The uncertainty surrounding regulatory outcomes is often not sufficiently explicit in the periodic asset valuations of unlisted infrastructure assets.

To discuss ESG in-depth please contact Megan Raynal, Senior Corporate Adviser at Value Adviser Associates on 03 9626 4300 or m.raynal@vaassociates.com.au

Value Adviser Associates is a specialist, independent business and securities valuation practice with offices in Melbourne, Brisbane, Adelaide and operating in Tasmania.

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