

RepuTex China Sustainability Research

The RepuTex China Top 10

The sustainability performance of CSI 100 companies



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Melbourne | Hong Kong | Shanghai

WHAT IS THE REPUTEX TOP 10?

Beyond the social benefit, sustainability performance is generating a growing impact on corporate competitiveness, profitability, and share price performance. The international financial markets are increasingly paying attention to sustainability as a means of assessing business risk through the integration of Environmental, Social and Governance ("ESG") factors into investment processes.

The Chinese Government has recognised that economic development "at all costs" cannot be sustained

Similarly companies are paying more attention to their own sustainability profiles, taking steps to reduce their environmental and social impacts, while maintaining high levels of growth and returns. For its part, the Chinese Government has recognised that economic development "at all costs" cannot be sustained and has responded through the implementation of a range of environmental and corporate governance controls and guidelines.

The RepuTex China Top 10 is designed to recognise Chinese companies that have achieved beyond their sector peers to manage environmental, social, governance, and workplace risks. The list, to be released annually, takes a best-in-sector approach, identifying the company with the highest RepuTex Sustainability Rating in each of the ten sector classifications. The list is drawn from the wider CSI 100 universe of China A share companies.

The Methodology

Each CSI 100 company is assigned a RepuTex Sustainability Rating according to RepuTex's proprietary sustainability research model.

Companies are assessed according to their specific sustainability footprint, accounting for sovereign, market and industry risks, as well as the company's specific business involvement, asset type, location and revenue.

Based on this footprint, companies are then assessed for their capacity to mitigate sustainability risk through specific policy, practices, systems, expenditure, investments and divestments.

Companies are assigned an overall RepuTex Sustainability Rating, based on a scale of AAA (outstanding) to D (at risk).

ABOUT REPUTEX

RepuTex is a rating and research firm which specialises in quantifying the financial impacts of new risks such as sustainability, energy, emissions and carbon risk.

RepuTex is the only company of its kind operating on the ground in China

Established in 1999, RepuTex has offices in Shanghai, Hong Kong and Melbourne. The company is chaired by the former Managing Director of Standard & Poor's Australia, Mr Graeme Lee.

In China, RepuTex is the only company of its kind operating on the ground, providing the Group with access to local market knowledge and company information.

RepuTex Sustainability Ratings

A RepuTex Sustainability Rating is an independent assessment of a company's capacity to address sustainability risks according to governance, environmental, social and workplace factors.

RepuTex currently has ratings in the market for over 2,500 companies globally, covering over 30 markets, including mainland China. RepuTex undertakes requested ratings for public and private companies and government owned enterprises. Analysis is supported by a range of research reports.

RepuTex Indexes

RepuTex maintains 11 indexes which assist investors and asset managers to measure and track the performance of sustainability themed investments. Indexes cover global and country universes, with a focus on Asia-Pacific markets such as China, Hong Kong, Singapore and Australia.

RepuTex currently maintains two China-specific index series – the RepuTex Sustainable China Index Series, and the RepuTex China Governance Index Series. Indexes are designed to be used as a basis for ETFs, index linked products and a range of tailored investment products such as warrants, certificates and derivatives.

THE REPUTEX TOP 10

The RepuTex China Top 10 is a best in sector list, identifying China's leading companies based on their effective management of environmental, social, governance and workplace risks. Companies are assigned an overall Sustainability Rating based on a scale of AAA (outstanding) to D (at risk).

To be considered for inclusion, a company must have achieved a minimum RepuTex Sustainability Rating of BBB (satisfactory) or above.

Sector	Company	RepuTex Sustainability Rating
Utilities	Beijing Capital Co. Ltd	BBB-
Telecommunication Services	China United Telecommunications Co. Ltd	BBB-
Materials	Baoshan Iron & Steel Co. Ltd	A
Information Technology	N/A	-
Industrials	Sany Heavy Industry Co. Ltd	BBB+
Health Care	Yunnan Baiyao Industry Co. Ltd	BBB+
Financials	Shanghai Pudong Development Bank Co. Ltd	A
Energy	China Petroleum & Chemical Corporation	A-
Consumer Staples	Tsingtao Brewery Co. Ltd	A
Consumer Discretionary	Shenzhen Overseas Chinese Town Holding Co.	A-

KEY FINDINGS

The performance of Chinese companies was higher than commonly perceived

- ▶ The sustainability performance of Chinese companies was found to be higher than commonly perceived;
- ▶ Based on the CSI 100 cohort, the highest performing companies assessed included the Shanghai Pudong Development Bank (Financials) and Baoshan Iron & Steel Company (Materials), both of which received "A" overall Sustainability Ratings;
- ▶ The lowest performing sector was the Information Technology sector which did not qualify for the top 10 list;
- ▶ Overall the sustainability performance of the CSI 100 cohort is positioned at a moderate level and indicates that while sustainability risks are being considered, there is still significant opportunity for improvement;
- ▶ The overall universe (CSI 100 Index) average RepuTex Sustainability Rating was "BB" low;

A portfolio of the RepuTex Top 10 would have outperformed the CSI 100 by 1.10% over the last quarter

- ▶ Analysis suggests that many companies in China have found it a challenge to fully integrate sustainability policies. A central challenge has been the capacity of listed entities to implement measures to ensure that compliance and fundamental business ethics are met;
- ▶ Performance indicates that it is possible to achieve returns through sustainability. A portfolio made up of the RepuTex Top 10 would have outperformed the CSI 100 Index by 1.10% over the last quarter. A wider portfolio of 40 sustainable stocks has kept pace with the CSI 100 benchmark over one year (-0.32%).

KEY SUSTAINABILITY THEMES

Chinese companies are primarily exposed to sovereign risks present in the nature of the regulatory, social, and economic environment of China. These risks can affect the performance of companies in terms of their ability to manage various ESG aspects.

Key sustainability risks include:

- ▶ Legal and regulatory compliance;
- ▶ Transparency and disclosure;
- ▶ Ethical business conduct;
- ▶ Ineffective management and monitoring/assessment procedures;
- ▶ Lack of clear targets and mechanisms to achieve strong overall governance;
- ▶ Social instability;
- ▶ Lack of protection for minority shareholders;
- ▶ Climate change, emissions and electricity consumption;
- ▶ Pollution (air, water, soil) and waste;
- ▶ Occupational health and safety;
- ▶ Employee rights.

CORPORATE GOVERNANCE RISK

Corporate governance and sustainability performance are inextricably linked due to the interconnectedness of management practices with corporate structures, controls and oversight.

Well managed companies are likely to produce profit results beyond market expectations

- ▶ Well managed companies are expected to maintain better operational momentum and are therefore more likely to produce profit results beyond market expectations;
- ▶ 'Blow-ups' caused by governance issues may pose unacceptable risks for investors because the magnitude of the market response is often disproportionate to the event, notably in the context of further reputational impacts;

Business ethics, transparency, oversight and controls are the key governance risks facing Chinese companies

- ▶ Business ethics, transparency, oversight and controls are the key corporate governance risks facing Chinese companies. These factors are viewed as the root cause of the majority of governance inspired market events, largely visible through fraud and corruption;
- ▶ The new national Regulations on Open Government Information have recently taken effect, and although their scope offers application restrictions which create areas of uncertainty, the move indicates the Government's acknowledgement of the need for greater transparency, and potential change in the overall governance landscape;
- ▶ Companies are still lacking transparency, especially in the context of related party transactions, audit, internal control systems, and Board matters;
- ▶ Minority shareholders' interests have not been sufficiently recognised and this remains a chief governance concern requiring urgent attention.

ENVIRONMENTAL RISK

While China faces critical challenges on the environmental front, if Government and enterprise effectively implement and enforce regulations and monitoring systems to achieve targets, there is the opportunity for substantial reduction of impacts both at the national and global levels.

- ▶ Environmental risks pose considerable challenges for companies, especially those in the materials, energy, industrials, and utilities sectors;
- ▶ China has recently demonstrated a greater prioritisation of environmental issues, which can also be observed through the elevation of SEPA to the newly established Ministry of Environmental Protection. Vested with greater authority, the Ministry will likely achieve stronger environmental public management, enforcement, and decision and policy-making that would have a lasting effect on Chinese companies;
- ▶ Mainland Chinese companies demonstrate a level of responsiveness to the environment. In the area of environmental protection, RepuTex is witnessing major activities by a number of companies, for example the development of internal carbon units to reduce emissions.

Climate Change, Energy and Pollution

Chinese companies must decouple emissions from wider economic growth

- ▶ Energy security poses a key challenge for the industrials, utilities, energy, and materials sectors in China. As an energy-hungry nation and with rocketing global oil prices, while China is under pressure to increase its own crude production, it is also facing rapidly depleting domestic reserves. The risk of disrupted energy supply is also present, indicating the importance of effectively managing energy usage by these sectors;
- ▶ Chinese companies have the opportunity to decouple emissions and electricity consumption from wider economic growth;

Many companies are failing to formulate clear environmental targets

- ▶ An increasing number of Chinese companies have implemented management systems to reduce their CO₂ and SO₂ emissions, recycle waste and treat wastewater, and have obtained ISO 14001 certification;
- ▶ Despite some positive steps, many companies are failing to formulate clear environmental targets. Target formulation and implementation is still required in order to achieve notable change, especially for the energy, industrials, materials and utilities sectors;
- ▶ Targets set in the five-year environment plan for 2001 to 2005 were not met. This has demonstrated the need for greater collaboration of all industries towards meeting these goals, and consideration of potential systemic risks such as energy demand;
- ▶ China's goal is to double the amount of renewable energy in its energy mix by 2020 (including the National Development and Reform Commission's aim to generate 100 gigawatts of wind power) and at least 30 percent of its total energy requirements satisfied by renewable energy sources by 2050;
- ▶ Although China has clearly considered renewable energy sources, these will only take full effect in the long term. There is still reliance on 'dirty' sources such as coal, hence reinforcing the dire need for Government and company participation – especially high emitting but extending to low emitting sectors – in the reduction of emissions.

Policy Development

SEPA has implemented a range of policies targeted at high polluting sectors

SEPA has implemented a range of green policies to address pollution, ultimately targeted at high polluting sectors. As a fundamental rule, environmental protection regulations must be complied with. RepuTex notes that:

- ▶ Green insurance policy affects higher polluting risk industries, and is expected to better monitor polluting industries and compensate victims of environmental incidents;
- ▶ Green credit policy provides that financial institutions have the responsibility to reject loans to high energy waste and polluting companies;
- ▶ Green securities policy mandates high polluting companies to pass environmental inspections when applying for an IPO or refinancing.
- ▶ The effective implementation of these policies would likely promote environmental awareness and improved standards within high polluting industries – if at least the incentive to act on green initiatives and greater accountability – and “showcase” the organisations responsible as financing them.

SOCIAL RISK

Strong government stability presides in China, nevertheless with inflation reaching record highs, the gap between the wealthy and disadvantaged is slowly increasing. The gravity of this has already been demonstrated through the inflation of food such as pork and soft commodities.

Supply chain performance remains a key risk area for many Chinese companies

- ▶ The impact of inflation associated with rent, energy, commodities and food has not only affected consumers but also various key sectors;
- ▶ Recent natural disasters in China have illustrated the strong desire for companies to give back to society and the community at large. SOEs in particular have been praised for their on-the-ground and in kind contributions to the recent Wenchuan Earthquake which saw many employees assisting directly in relief efforts;
- ▶ China's participation in the most recent United Nations Global Compact World Leaders' Summit on human rights, labour, environment, and anti-corruption, included the involvement of the largest group of Chinese business leaders in history, and reflects China's growing concern for sustainability issues;
- ▶ The CSR guidelines recently issued by 11 national industrial federations and associations highlights responsibilities expected of companies in the industrials sector. Companies are expected to release regular CSR/sustainability reports in line with the guidelines. Many Chinese companies are yet to fulfil adequate levels of sustainability reporting in line with their international peers;
- ▶ Addressing sustainability factors across the supply chain is not a well developed area for many major Chinese enterprises. Chinese companies in all sectors are strongly encouraged to engage constructively with supply chain partners to ensure ethical behaviour and awareness of standards in accordance with international expectations.

WORKPLACE RISK

Workplace issues have been no less scrutinised than its other sustainability counterparts. The protection of employee rights, for instance fair treatment and equitable remuneration, and occupational health and safety, have been key issues affecting the Chinese labour landscape;

- ▶ The utilities, industrials, energy, and materials sectors in China remain significantly exposed to occupational health and safety (OHS) risks. This is often a result of insufficient and/or ineffective implementation and oversight of OHS systems and standards, regular OHS audits, and comprehensive safety training for employees. Implementation of these processes and employee awareness of risk is likely to reduce accident rates;
- ▶ The closures of small coal mines that have failed to reach acceptable safety standards is a good example of the importance of a company's risk management systems in the context of sustainability, and the associated impact on the sector as a whole, as well as the economy – the closures have contributed to the high price of coal;
- ▶ Disclosure of workplace accidents is low due to feared reputational damage. Stronger levels of transparency would lead to greater accountability (in particular by senior management or the Board), and might be used as a tool to identify the policy and operational changes required;

Some companies have already recognised employees' rights to collective bargaining

- ▶ The new Labour Contract Law sets standards for mandatory contracts and dismissal through defined components of written contracts, and provides more authority to trade unions. Some CSI 100 sustainability top performers have already recognised employees' rights to collective bargaining through the establishment of a Labour Union to deal with such matters.

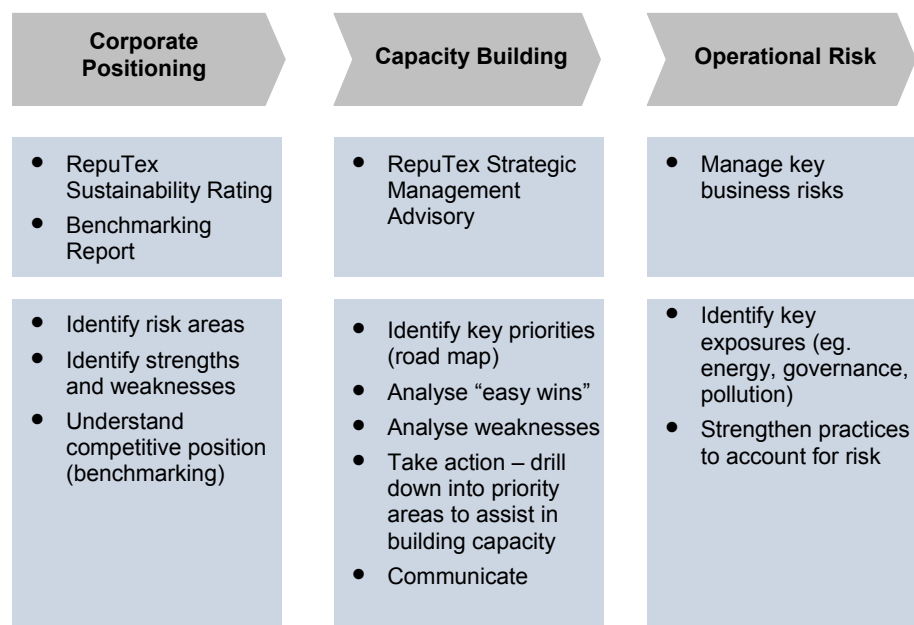
WHY DEVELOP A SUSTAINABILITY MANAGEMENT STRATEGY?

Companies are increasingly recognising that sustainability issues pose potentially material business risks and opportunities. When integrated into the strategic development and management of a company, it is better placed to mitigate the current and potential risks that it faces.

RepuTex provides the tools to assist companies prioritise risks and opportunities

Companies are under close scrutiny from investors, consumers, governments and communities to demonstrate that they take tomorrow seriously. To meet the challenge companies must manage new economic risk and work harder towards getting the right message out.

RepuTex provides the information tools and frameworks to assist companies prioritise risks and opportunities, build capacity and enhance value for tomorrow. As the global environment changes a coordinated effort is required to build knowledge, design strategy, and communicate the right message.



Financial institutions such as fund managers, pension funds and brokers are able to access RepuTex research.

For more information, please contact RepuTex.

CONTACT US

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