



ESG Impact on Valuation

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ValuAsia Connect:
Environment,
Social &
Governance

A webinar series on Valuation in Asia

Agenda

1. Observations from investors & regulators
2. Key findings from ESG Roundtable – “Future of Valuations – The Impact of ESG”
3. ESG Impact on Valuation

Observation from Investors & Regulators

International Sustainability Standards Board (ISSB)

- The first two standards are issued in June 2023.
 - IFRS S1: General Requirements for Disclosure of Sustainability-related Financial Information
 - IFRS S2: Climate-related Disclosures
- Both standards will become effective starting in January 2024 with phased-in dates. This means that an entity would report its first sustainability-related disclosures in 2025, if under scope.
- Early adoption allowed, but only if an entity applies both IFRS S1 and IFRS S2 at the same time.
- Additional industry-specific disclosure standards to follow.

- The ISSB is working with a number of jurisdictions to ensure the IFRS Sustainability Disclosure Standards can be adopted and applied effectively around the world.
- The application of the standards, either voluntary or mandatory, will be predicated on individual jurisdictions' willingness to incorporate them into national laws. Several African, Asian and Latin American countries have expressed interest in adopting.
- Even if the U.S. or the EU do not adopt these standards domestically, U.S. and EU companies with operations abroad will still have to seek to disclosure requirements in jurisdictions where the standards become mandatory.

International Sustainability Standards Board (ISSB)

IFRS S1: General Requirements for Disclosure of Sustainability-related Financial Information

- Objective to require an entity to disclose information about its sustainability-related risks and opportunities that is useful to primary users of general-purpose financial reports in making decisions relating to providing resources to the entity
- Requires an entity to disclose **information about all sustainability-related risks and opportunities that could reasonably be expected to affect the entity's cash flows, its access to finance or cost of capital over the short, medium or long term**. For the purposes of this Standard, these risks and opportunities are collectively referred to as 'sustainability-related risks and opportunities that could reasonably be expected to affect the entity's prospects'
- Core content around
 - Governance – processes, controls, procedures etc
 - Strategy – approach to manage sustainability
 - Risk management – identify, assess, prioritise and monitor
 - Metrics and targets – performance, progress towards targets etc
- Such disclosures will be part of its general-purpose financial reports, covering the same reporting period.

IFRS S2: Climate-Related Disclosures

- The objective of IFRSS2 Climate-related Disclosures is to require an entity to disclose information about its climate-related risks and opportunities that is useful to primary users of general-purpose financial reports in making decisions relating to providing resources to the entity.
- This Standard requires an entity to disclose **information about climate-related risks and opportunities that could reasonably be expected to affect the entity's cash flows, its access to finance or cost of capital over the short, medium or long term**. For the purposes of this Standard, these risks and opportunities are collectively referred to as 'climate-related risks and opportunities that could reasonably be expected to affect the entity's prospects'.
- Core content around
 - Governance – processes, controls, procedures etc around climate related risks and opportunities
 - Strategy – climate-related risks and opportunities – how they affect the entity's prospect
 - Risk management - - identify, assess, prioritise and monitor climate related risks and opportunities
 - Metrics and targets – enable users to understand performance and progress towards climate-risk targets, any targets required by law or regulation etc

ESG Due Diligence for Private Investors

Pre-Transaction Investment Process and Post Transaction Monitoring & Development Guidance

- General – Business Overview
- ESG / Sustainability Governance – Process, Resources, Competency, Committee, Risk Register, Monitoring & Reporting
- Environment – Policy, Permits, Certifications, Breaches, Carbon emissions, waste management, hazardous substance, contamination etc
- Social – health, safety, accidents, enforcements, HR contracts, minimum wages, employee grievances, migrant worker process, anti discrimination policy, diversity, data privacy etc
- Governance – board structure, role, corruption / fraud detection, breaches, audit committee etc

** Source: Invest Europe DDQ for PE Investors and their Portfolio Companies*

Sample Questions

- Please detail the process you have been through to determine what key ESG topics are relevant to your business and have therefore formed the basis of your policies. What stakeholders were engaged in this process?
- Has the company recognized any financial provisions in the accounts to address any environmental liabilities such as contaminated land/environmental restoration and aftercare requirements/removal of asbestos etc.? Please provide further details.
- Does the company have a policy that supports diversity and equal opportunity? If so, please provide details of your key commitments/control measures.
- How is the composition of the Board determined? Please provide details.
- Is ESG discussed at the Board level? If so, how often does this take place and does this follow a set agenda/terms of reference? Provide details of the key issues regularly discussed.

Capital Market Regulations & Industry Developments

APAC – Regional Diversity requires deeper and wider regulations

- 7 Southeast Asian stock exchanges that are part of Sustainable Stock Exchange Initiative (SSE) and have ESG reporting required as a listing rule for some or all listed companies.
- Several other Asian exchanges like Japan, India, China, Australia, etc are members too
- Some have implemented regulations, others have proposed rules
 - Singapore Exchange has mandatory reporting requirements for climate risk and other ESG factors.
 - ESG factors specified as part of the reporting.
 - Tied up with several ratings firms to provide ESG ratings and risk rating profile from an ESG perspective of all listed companies.
 - Australia has also specific guidance on how to avoid greenwashing when offering or promoting sustainability related products.
 - China Securities Regulatory Commission (CSRC) introduced mandatory disclosures on environmental penalties for all listed companies.

SGX Example - List of core metrics provided with description

- **Environmental factors include greenhouse gas emissions, energy consumption, water consumption, waste generation**
- **Social factors include gender diversity, age-based diversity, employment, development & training, occupational health & safety**
- **Governance includes board composition, management diversity, ethical behavior, certifications, alignment with frameworks, assurance**

* Source: [SGX.com/sustainable-finance/sustainability-reporting](https://www.sgx.com/sustainable-finance/sustainability-reporting)

Key findings from ESG Roundtable – “Future of Valuations – The Impact of ESG”

Future of Valuations – The Impact of ESG

- The recent roundtable discussion titled "Future of Valuations - The Impact of ESG" was pivotal in exploring the integration of environmental, social, and governance (ESG) considerations into valuation.
- Hosted by Colliers International (Singapore) and facilitated by the International Valuation Standards Council (IVSC) and Royal Institution of Chartered Surveyors (RICS), the discussion included leaders in real estate and business valuation.
- The dialogue centered on understanding and addressing challenges and opportunities in integrating ESG into investment strategies, highlighting the crucial role for the valuation profession.
- A summary report of the discussion was published in January 2024

* Source: www.ivsc.org/pdfviewer/future-of-valuations-impact-of-esg



Future of Valuations – The Impact of ESG

Investing with Insight: The Evolving Role of ESG in Valuation

- There's a paradigm shift in the investment landscape towards incorporating ESG factors into valuation methodologies.
- Sustainable practices are now recognized as essential in determining asset value and investment performance.
- Valuation criteria have expanded to include ESG considerations, reflecting a broader understanding of risk and return factors.

• The Emergence of ESG and Green Buildings in Singapore

- Singapore has been a leader in advocating for green buildings, predating widespread recognition of ESG.
- Initially focused on tangible benefits like cost savings, the movement evolved to incorporate green features, leading to increased property values.
- Challenges remain in attributing value increases solely to green features, underscoring the need for concrete evidence to support valuation differentials.

* Source: www.ivsc.org/pdfviewer/future-of-valuations-impact-of-esg

Future of Valuations – The Impact of ESG

Exploring Limitations and Gaps in ESG Valuation

- Challenges exist in linking ESG considerations with financial performance and the scarcity of transparent data.
- Regulatory support is crucial in standardizing ESG reporting and valuation practices to meet investor demands for transparency.
- Collaborative efforts are needed to overcome challenges and drive progress in ESG integration.

- **ESG in Business Valuation and Private Companies**
 - There's a clear trend towards incorporating ESG considerations in business valuation methodologies.
 - Varying approaches to ESG integration impact cash flows and cost of capital, highlighting the need for adaptation in valuation methodologies.
 - The shift towards comprehensive valuation methodologies reflects the increasing significance of ESG factors in investment decision-making.

* Source: www.ivsc.org/pdfviewer/future-of-valuations-impact-of-esg

Future of Valuations – The Impact of ESG

Social & Governance Considerations in ESG

- ESG considerations are expanding beyond environmental factors to include social and governance aspects.
- Well-being certifications and broader policy issues are gaining importance in real estate valuation.
- Investors demand dedicated ESG sections in valuation reports, reflecting a growing awareness of the holistic nature of ESG integration.

Concluding Reflections: Future Directions in ESG and Valuation

- ESG integration into valuation practices is irreversible, driven by regulatory changes and investor behaviors.
- Anticipated shift towards a more balanced approach to ESG integration and future developments expected to refine valuation practices.
- Key developments include stakeholder engagement, enhanced disclosures, and evolving expectations, leading to more refined valuation practices in the future.

* Source: www.ivsc.org/pdfviewer/future-of-valuations-impact-of-esg

ESG Impact on Valuation

ESG impact on Valuation

Parameters to consider & IVS Inclusion

- Valuation Parameters

- Cashflows

- Benefits versus costs

- Adjusting cashflows for any ESG related expenses, contingent liabilities around lawsuits or Government subsidies or penalties, long term revenue impact

- Cost of capital

- Companies with lower ESG ratings may have a higher risk profile and hence a higher cost of raising funds
- Simpler to quantify in certain circumstances but challenging in others

- Comparable company multiples

- Choice of companies
- Adjustments to multiples

- ESG ratings

- Data sources

- Ratings and ESG related information
- Business specific information (IFRS S1 and S2)

- IVS (effective 2024) under consultation, section on ESG

- IVS 104 Data and Inputs related to ESG Factors: Appendix A10

- Valuers must consider significant factors that may pose risks or opportunities.
- Some examples given for environment include air and water pollution, biodiversity, climate change, carbon emission, waste management, resource efficiency etc.
- Social includes community relations, customer satisfaction, gender and racial equality, human rights etc
- Governance include board diversity, audit committee structure, bribery and corruption, management succession planning etc
- All known / available ESG information which would affect how a market participant would assess the value of an asset(s) and what they would pay for an asset should be included in each valuation.
- ESG factors and the ESG regulatory environment should be considered in valuations to the extent that they are measurable and would be considered reasonable by a peer applying professional judgement

ESG impact on Valuation

Additional Guidance Available

- IPEV Dec 2022 guidelines section on ESG
 - Funds are requested to communicate responsible investment practices and valuation impact pertaining to ESG factors
 - Primarily where valuation impact can be measured (does not include qualitative disclosures)
 - Cashflow impact – positive and negative – alternative sources of energy, employee costs, facilities costs, supply costs etc
 - Impact from changed risk profile, company specific risk premium
 - Comparability of peer companies
 - Adjustments to enterprise value to include ESG considerations such as decommissioning provisions, expected legislations etc

- IVSC perspective papers on ESG and Social Value
 - Defining & Estimating Social Value – July 2022
 - Human Capital – May 2022
 - ESG and Real Estate Valuation – Oct 2021
 - A framework to assess ESG value creation – May 2021
 - ESG and Business valuation – March 2021
 - How to define and estimate social value – Nov 2020

- In Conclusion,
 - This has been a focus for the regulator and investment community, hence it will impact valuation
 - There are questions around over-engineering these aspects, too many regulations, greenwashing, extent of impact on valuation vis-à-vis other financial metrics, cost versus benefit of the exercise etc.
 - This is still an evolving topic, but likely to stay and stabilize in the foreseeable future.

Questions?

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Srividya is Managing Director & Southeast Asia Leader, Valuation Advisory Services at Kroll. She set up American Appraisal Singapore operations in 2012, which later got acquired by Duff & Phelps which has been rebranded as Kroll.

She has 26 years of experience in valuations, transactions and management consulting. She has advised numerous companies on valuations for the purposes of financial reporting, transaction, restructuring, taxation, dispute resolution and financing.

She is a member of the Business Valuation Board of the International Valuation Standards Council (IVSC), the global standard setter for valuation. She is a former member of the Institute of Valuers & Appraisers, Singapore (IVAS) Council and chaired their Professional Development Working Group as well as a former member of the global Regulatory Board of the Royal Institution of Chartered Surveyors (RICS). She is a member of the Intangible Asset (IA) Disclosure Industry Working Group set up by Singapore Government agencies as well as the ESG & IA Valuation Working Group set up by ASA, CBVI, IVAS & RICS.

Srividya has advised several global and Asian alternative investment funds including sovereign wealth funds, private equity, private credit and venture capital investors as well as corporate clients across a variety of sectors such as technology, life sciences, manufacturing, consumer products, energy & resources etc.

Srividya has published various articles on valuation, PE/VC and M&A, and has been interviewed by several television channels, newspapers and magazines. She is a regular speaker at conferences and seminars.

Srividya is a registered Chartered Valuer & Appraiser (CVA) with IVAS and Member of the RICS (MRICS). She also has a Post Graduate Diploma in Management (equivalent to MBA), is a Graduate of the Institute of Cost & Works Accountants of India and a Bachelor of Commerce.

Thank You