Can Active Ownership/ESG Performance Targets Drive Value?

Evidence Supporting Active Ownership and Engagement Drives Value
In this note we take a closer look at the relationship between ESG (environmental, social and governance) performance momentum and accountability to stock price performance. Although investors tend to generally look at ESG performance from a longer-term time horizon, recent performance data suggests that ESG is starting to generate alpha even in a shorter-term timeframe. Moreover, our work suggests that ESG-linked compensation has had a positive impact on six sectors within S&P 500 over 3- and 5-year periods.

ESG momentum has positive impact on stock performance
48% of the companies in the S&P 500 have shown positive ESG momentum (ESG score improvement) over the past year. In the same time horizon, companies with positive ESG momentum outperformed by 400bps compared to companies with negative ESG momentum; they also outperformed the S&P 500 by 200bps. This analysis shows some evidence for the positive relationship between improvements in ESG scores and company stock performance.

ESG Performance Targets and Board Accountability Positively Impact Performance
ESG linked (ESG performance target linked to executive comp or board) companies outperformed no-link companies by 1% - 20% on a 3-year basis and 4% - 30% on a 5-year basis in six sectors within the S&P 500: Energy, Healthcare, Information Technology, Consumer Staples, Financials and Real Estate. The biggest ESG link vs no-link outperformance was shown in Healthcare (~20%) and Information Technology (~30%) over the past 5 years. The Energy sector has the greatest number of companies with ESG links (66%), while the Information Technology sector has the lowest number of companies with ESG links (15%).

ESG Thematic Portfolio Performance
Our select picks of ESG stocks from the ESG thematic coverage universe have outperformed the S&P 500 on 3m, 6m, 1yr, 3yr and 5yr bases. Over a 5yr time horizon, our select ESG picks have outperformed the S&P 500 by ~65%. Certain themes such as industrial automation, water and sustainable transport stand out over 1yr, 3yr and 5yr time horizons. These stocks have significantly outperformed during the above timeframe relative to the broader indices. The most significant outperformance is shown by industrial automation, outperforming the S&P 500 by 274% over a 5yr time horizon. Certain themes that have not consistently

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outperformed the S&P 500 over 1yr, 3 yr and 5yr time horizons include power infrastructure/smart grid, health & fitness and energy efficiency.
ESG Momentum has shown positive relationship with stock performance

Our analysis within the S&P 500 universe looks at the change in ESG score (ESG momentum) over the past year. It has shown a positive relationship between ESG momentum and stock price performance.

1. 48% of companies within the S&P 500 have shown positive ESG momentum over the past year, compared to 52% with negative momentum.

2. Companies with positive ESG momentum had average stock price performance of 18%, compared to 14% for companies with negative ESG momentum and 16% for the S&P 500.

3. Of the 48% companies with positive ESG momentum, 48% outperformed the S&P 500 over the past year.

4. Of the 52% companies with negative ESG momentum, only 46% outperformed the S&P 500 over the past year.

In a general sense, this analysis shows that companies that focus more on improving ESG-related issues in their business, show better price performance from a market perspective. From these results, we can consider that improvements in ESG may give some insight into the future stock performance of a company. Today, many investors are taking a deeper dive into these ESG topics and many are investing in companies that show improvements in ESG management. Further, many investors work with the company to help address some of the ESG-related issues.

In this short time frame, almost half of all of the companies in the SPX made some type of change or initiative in their business to increase their ESG performance and therefore, in our view, increase the sustainability of their business. Further, we believe that through active engagement, more companies will see positive ESG momentum over the longer term, as investors work with company mgmt. on some of the pressing financially material ESG issues.
ESG Performance Targets and Board Accountability Positively Impact Stock Performance

In this analysis, stock performance of companies in the S&P 500 that have ESG performance target linked with executive compensation or board evaluation are compared to companies without this link or targets. The companies are compared on a sector-by-sector basis to provide a more robust comparison and rule out sector-specific performance drivers. The sectors where companies with ESG-linked comp outperformed those without are Healthcare, Energy, Consumer Staples, Information Technology, Financials and Real Estate.

Energy Sector
66% of companies in the Energy Sector in the S&P 500 have disclosed ESG performance target links. Companies with ESG links outperformed ~6% and ~4% on 3- and 5-year bases, respectively, compared to companies with no links. ESG-linked companies also outperformed the sector average by 1-2% on 3- and 5-year bases.

**Figure 3: Energy Sector ESG Performance Target Links**

![Energy Sector ESG Performance Target Links](image)

*Source: Company reports, Deutsche Bank*

**Figure 4: Energy Sector ESG Link and Stock Performance**

![Energy Sector ESG Link and Stock Performance](image)

*Source: Deutsche Bank, FactSet*

**Consumer Staples**

24% of companies in the Consumer Staples sector have disclosed ESG performance target links. On a 3-year basis, Companies with ESG links outperformed 10% on average compared to companies without ESG links; they also outperformed the industry average by 20%. Over a 5-year time horizon, the
companies with ESG links outperformed the companies without ESG links by ~6%; they also outperformed the industry by over 20%.

**Figure 5: Consumer Staples ESG Performance Target Link**

![Pie chart showing ESG-linked and non-ESG-linked companies performance.](image)

*Source: Company Reports, Deutsche Bank*

**Figure 6: Consumer Staples ESG Link and Stock Performance**

![Bar chart comparing performance with ESG links and without.](image)

*Source: Deutsche Bank, FactSet*

**Healthcare**

22% of companies in the Healthcare sector of the S&P 500 have disclosed ESG performance target links. Companies with ESG links outperformed those without links by ~22% and outperformed the industry by ~12% over a 5-year time horizon.
Financials
23% of companies in the Financials sector of the S&P 500 have disclosed ESG performance targets. On a 5-year basis, companies with ESG links outperformed ~15% and ~11% on average compared to companies without ESG links and the sector average, respectively.
Information Technology

15% of companies in the Information Technology sector of the S&P 500 have disclosed ESG performance target links. Companies with ESG links outperformed ~30% over a 5-year time horizon compared to both the industry average and companies without links.
Real Estate
22% of companies in the Real Estate sector in the S&P 500 have disclosed ESG performance target links. Companies with ESG links outperformed 3% on average over 3- and 5-year horizons over companies with no links; they also outperformed the sector average by 2% over 3- and 5-year horizons.
Active Ownership and Engagement

One area of ESG where investors have shown increased interest is investing in companies through active ownership/engagement. The idea of active ownership allows investors to work with company management to help solve ESG-related issues that the company may be facing. In this respect, active ownership benefits not only the company (guidance from external source), but also the shareholder because the company may be able to avoid financially material ESG-related issues that could impact its share price. Further, through active ownership investors are able to bring ESG-related issues to mgmt.’s attention, especially in certain industries where ESG factors may seem impactful. Studies have shown that when investors are actively engaged with management, the
shareholder value increases. The figure below shows that initial engagements increase shareholders’ value on average, with a +2.3% cumulative abnormal return over the period of one year post engagement. For a market-adjusted normal return, the one-year CAR is +1.8%. This return is shown by the bold line in the figure. Even more so, the data shows that when these engagements are successful, the company outperforms on a greater basis. For this set of data, companies with successful ESG engagements showed almost 8% return on an 18-month basis.

**Figure 15: Active engagement leads to better stock performance**

![Figure 15](image)

Source: Oxford University

**ESG Thematic Portfolio Performance**

Our select picks of ESG stocks from the ESG thematic coverage universe have outperformed the S&P 500 on 3m, 6m, 1yr, 3yr and 5yr bases. Over a 5yr time horizon, our select ESG picks have outperformed the S&P 500 by ~65%. Certain themes such as industrial automation, water and sustainable transport stand out over 1yr, 3yr and 5yr time horizons. These stocks have significantly outperformed during the above timeframe relative to the broader indices. The most significant outperformance is shown by industrial automation, outperforming the S&P 500 by 274% over a 5yr time horizon. Certain themes that have not consistently outperformed the S&P 500 over 1yr, 3yr and 5yr time horizons include power infrastructure/smart grid, health & fitness and energy efficiency.
Figure 16: ESG Thematic Portfolio Select Picks Performance

ESG Thematic Portfolio Performance vs. S&P500

- 3 month: 7.4%, 5.8%
- 6 month: 11.1%, 8.1%
- 1 yr: 23.7%, 18.0%
- 3 yr: 55.9%, 29.7%
- 5 yr: 139.9%, 74.5%

Source: Deutsche Bank, FactSet

Figure 17: ESG Thematic Portfolio 1 Year Performance

- Industrial Automation: 18.0%
- Sustainable Transport: 33.8%
- Power Infrastructure / Smart Grid: 27.3%
- Sustainable Agriculture: 25.9%
- Water: 5.6%
- Health & Fitness: 0.7%
- Energy Efficiency: (15.4%)

Source: Deutsche Bank, FactSet
Figure 18: ESG Thematic Portfolio 3 Year Performance

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Source: Deutsche Bank, FactSet

Figure 19: ESG Thematic Portfolio 5 Year Performance

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Source: Deutsche Bank, FactSet

Past performance is no guarantee of future results. Performance calculations exclude transaction costs, etc. Additional information available upon request.

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Appendix 1

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<td>Acuity Brands</td>
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Historical recommendations and target price. Acuity Brands (AYI.N)
(as of 10/04/2017)

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Current Recommendations
Buy
Hold
Sell
Not Rated
Suspended Rating

** Analyst is no longer at Deutsche Bank
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