

New Perspectives for Long Term Investing

Money does not perform. People do.



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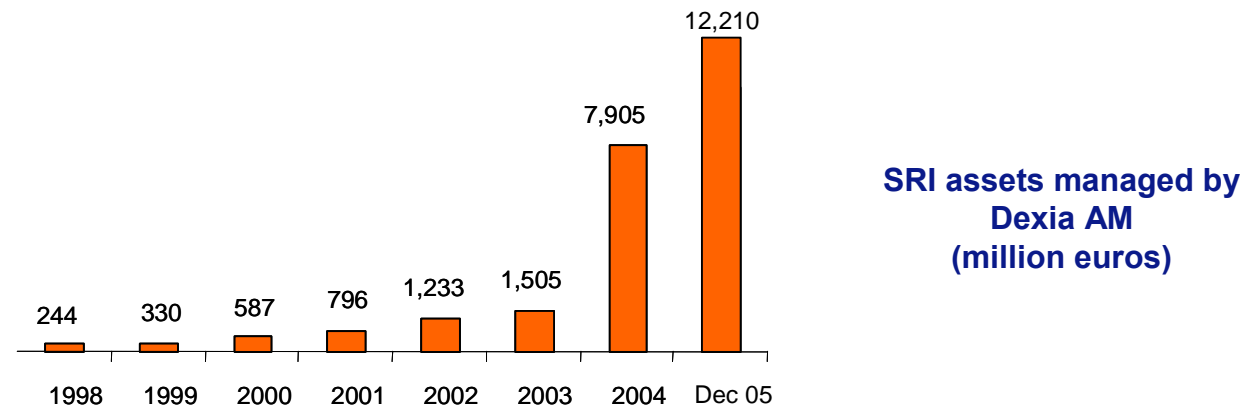
Member of the Executive Committee
Dexia Asset Management

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Consult also the legal notice at the end of the document

Dexia AM - Sustainable and Responsible Investments

- **Since 1996**, Dexia AM has managed the largest range of SRI funds in Europe and numerous mandates dedicated to institutional and private customers
- **€ 13 billion of SRI under management at the end of April 2006**, including:
 - ▶ € 4.3 billion in sustainable management
 - ▶ € 8.7 billion in tailor-made SRI solutions (eg. respecting international standards)



- **11% of the SRI fund retail market in Europe** as of the end of December 2005
- **All the traditional asset classes** are covered by Dexia AM's SRI management

Agenda

- Long term investing = sustainable investing
- Financial Analysis & Sustainable Analysis
- New Perspectives

Long term investing = sustainable investing

- long-term focus
 - ▶ *“I believe that our company must have a long-term strategic focus. To me, this is not altruism or charity, but simply a question of looking at factors that determine the future of our company with a very long-term perspective”* **Lars Rebien Sorensen, CEO of Novo Nordisk**
 - ▶ *“Large companies need to build social issues into strategy in a way which reflects their actual business importance. [...] social issues can have the potential to alter fundamentally their strategic future”* **Ian Davis, worldwide Managing Director of McKinsey & Company**

- broad scope of analysis
 - ▶ the profitability of a company is only sustainable when it takes account of the interests of all its stakeholders: **shareholders / employees / clients / suppliers / environment / society**
 - ▶ relations with stakeholders are a source of real risks and opportunities in the long term

Sustainable investing = Sustainable performance

Orlitzky, Schmidt and Reynes (2004) - Moskowitz Prize 2004
 “Corporate social performance and financial performance , A Meta-analysis”
 “Organization Studies” Volume 24(3): 403-441

- **What is the relationship between Corporate Social Performance (CSP) and Corporate Financial Performance (CFP)?**
- **Research** : méta-analysis = Analysis of 52 studies (aggregation of 33 878 observations)
- **Conclusion**
 - ▶ Positive and significant link between social responsibility and performance
 - ▶ Stronger impact of social performance compared to environmental performance
 - ▶ Simultaneous effect
 - ▶ Stronger impact of reputation compared to the impact of management quality
 - ▶ Stronger impact on accounting-based performances versus market-based returns

| relationship between... | correlation | variance |
|--------------------------------|-------------|----------|
| CFP and CSP | 0.36 | 0.19 |
| without environment | 0.47 | 0.19 |
| only environment | 0.12 | 0.11 |
| Prior CFP and CSP | 0.45 | 0.12 |
| Subsequent CFP and CSP | 0.4 | 0.23 |
| concurrent CFP and CSP | 0.5 | 0.22 |
| CFP and CSP (Skills) | 0.33 | 0.06 |
| CFP and CSP (Reputation) | 0.49 | 0.32 |
| CFP (market based) and CSP | 0.15 | 0.2 |
| CFP (accounting based) and CSP | 0.42 | 0.13 |

Sustainable investing = Sustainable performance

Research

- Multi-factor regression (French & Fama) to adjust for style factors and biases

| Coefficient (<i>t-stat</i>) | alpha | Market sensitivity | Small caps sensitivity | Value/growth sensitivity |
|--------------------------------------|-------------------|-----------------------|---------------------------|-----------------------------|
| ASPI-index | 0.02% (0.27) | 0.99*** (65.08) | -0.15*** (-5.06) | 0.03 (1.46) |
| Ethibel Europe Index | 0.11% (0.58) | 1.13*** (32.61) | -0.25*** (-4.97) | -0.04 (-0.7) |
| Ethibel Global Index | 0.20% (1.14) | 1.05*** (31.49) | -0.16*** (-2.56) | -0.16*** (-3.05) |
| Dow Jones Sustainability Group Index | 0.07% (0.41) | 1.01*** (29.16) | -0.25*** (-3.73) | 0.01 (0.09) |
| Domini Social Index | 0.04% (0.69) | 1.03*** (76.09) | 0.01 (1.31) | -0.12*** (-6.62) |
| FTSE4Good Europe | -0.02% (-0.23) | 1.06*** (68.76) | -0.11*** (-3.49) | -0.03 (-0.81) |

* Significant at 10% level, ** Significant at 5% level, ***Significant at 1% level

Conclusion

- Style-adjusted net alpha of SRI indices all are positive, but one
- Most benchmarks are large cap-biased and some are growth-oriented

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Financial vs Sustainable analysis : different...

Financial

- ▶ Quality of information
 - All information is quantified
 - Standardised formats available (IAS, IFRS ...)
 - Information is audited
- ▶ Information widely covered by a large number of market participants
- ▶ Use of elaborated valuation techniques like DFCF
- ▶ Focus on the company
- ▶ Time horizon
 - Most relevant on a 1-4yr horizon
 - Timing known
 - Re-active

Sustainable

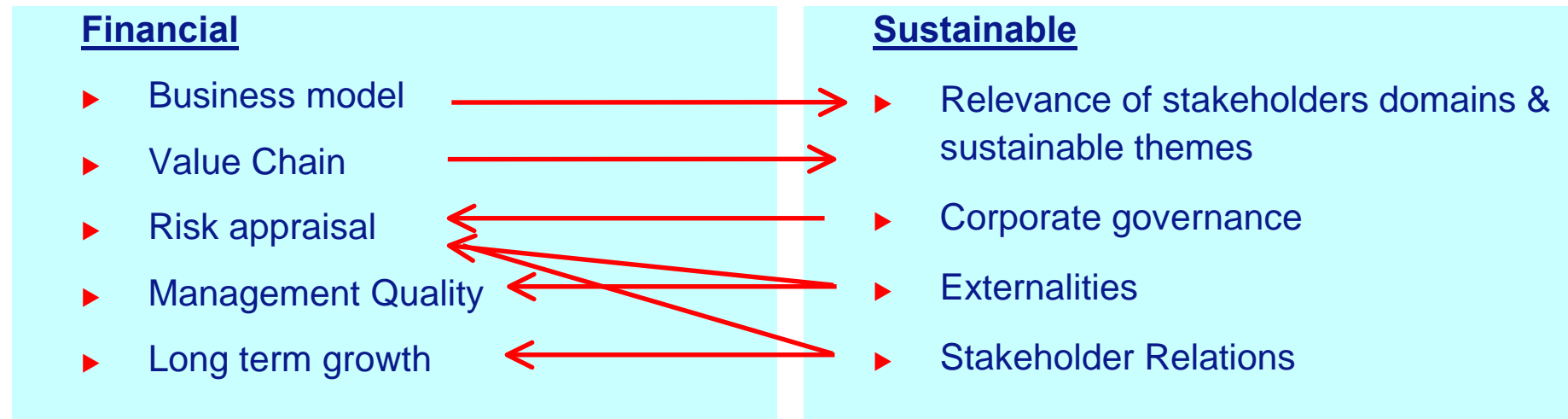
- ▶ Quality of information
 - Information tend to be qualitative and not yet readily quantifiable in monetary terms
 - Indicators are often not standardised
 - Most information not externally certified
- ▶ Systematically analysed by only a limited number of market participants
- ▶ Ranking & classification on most material themes
- ▶ Focus on externalities
- ▶ Time horizon
 - Most relevant on a 3-7yr horizon
 - Timing uncertain
 - Pro-active

Different data availability, valuation techniques and time horizon

=> different analysis processes

Financial vs Sustainable: different... but complementary

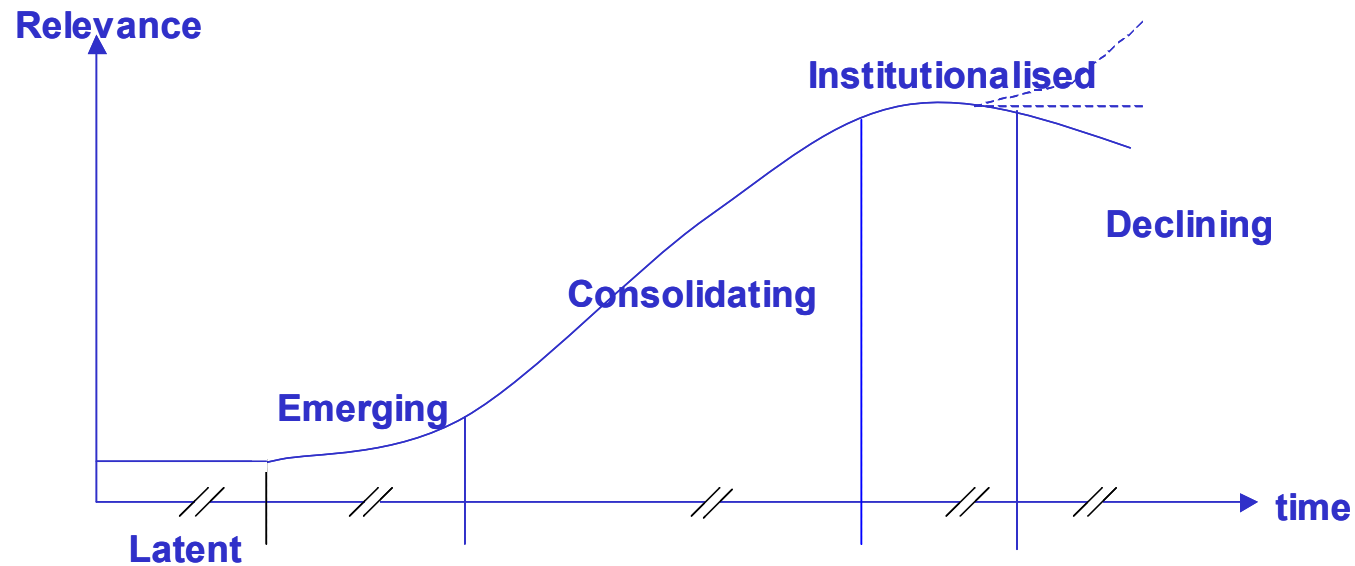
But sometimes financial analysis becomes relevant for sustainable analysis



=> different processes with a separated decision-making unit,
but continuous exchange of information
between financial and sustainability analysts

Financial vs sustainable: ...time matters

- sustainable becomes sometimes financial ...when externalities are internalised



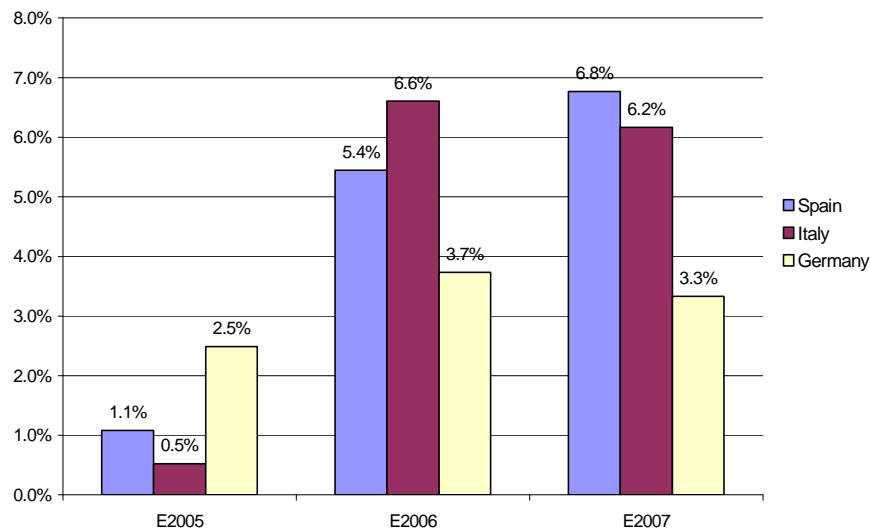
- Example of CO2 emissions
 - ▶ “Institutionalized” in the Utilities sector
 - ▶ “Consolidating” in the Transport sector
 - ▶ “Emerging” in the Bank sector

Case study / Utilities: financial impact on company valuations

| Average annual cost (€m) | E2005 | E2006 | E2007 | Total |
|--------------------------|--------|--------|--------|--------|
| Spain | | | | |
| Endesa | -116.4 | -314.5 | -365.2 | -796.1 |
| Iberdrola | -63.9 | -80.1 | -188.7 | -332.7 |
| Union Fenosa | -29.8 | -150.4 | -130.1 | -310.2 |
| Gas Natural | 44.7 | 8.1 | -36.7 | 16.1 |
| Italy | | | | |
| ENEL | -25.4 | -336.4 | -318.6 | -680.4 |
| Germany | | | | |
| Eon | -88 | -170.2 | -170.2 | -428.0 |
| RWE | -169 | -328.6 | -328.6 | -826.2 |

| EBIT (€m) | E2005 | E2006 | E2007 | Total |
|----------------|-------|-------|-------|--------|
| Spain | | | | |
| Endesa | 4 244 | 4 604 | 4 636 | 13 483 |
| Iberdrola | 2 180 | 2 452 | 2 711 | 7 343 |
| Union Fenosa | 924 | 1 018 | 1 085 | 3 027 |
| Gas Natural | 1 079 | 1 249 | 1 404 | 3 732 |
| Italy | | | | |
| ENEL | 4 821 | 4 759 | 4 850 | 14 429 |
| Germany | | | | |
| Eon | 7 449 | 7 778 | 8 967 | 24 193 |
| RWE | 4 446 | 6 225 | 6 902 | 17 573 |

CO2 cost as a % of EBIT



| % EBIT | E2005 | E2006 | E2007 | Average |
|----------------|--------------|--------------|--------------|--------------|
| Spain | | | | |
| Endesa | -2.7% | -6.4% | -7.3% | -5.5% |
| Iberdrola | -2.8% | -3.2% | -6.5% | -4.2% |
| Union Fenosa | -3.1% | -12.9% | -10.7% | -8.9% |
| Gas Natural | 4.3% | 0.6% | -2.5% | 0.8% |
| Average | -1.1% | -5.4% | -6.8% | -4.4% |
| Italy | | | | |
| ENEL | -0.5% | -6.6% | -6.2% | -4.4% |
| Average | -0.5% | -6.6% | -6.2% | -4.4% |
| Germany | | | | |
| Eon | -1.2% | -2.2% | -1.9% | -1.8% |
| RWE | -3.8% | -5.3% | -4.8% | -4.7% |
| Average | -2.5% | -3.7% | -3.3% | -3.2% |
| Average | -1.4% | -5.3% | -5.4% | -4.0% |

From Short- to Long Term Who Cares ?

Money does not perform. People do.



Case study / IT Hardware: financial impact of waste

Hazardous substances (RoHS)

- R&D for alternative substances
- Changes to manufacturing procedures & design
- Higher operating costs
- Substances tracking systems with suppliers
- Risk of market share loss / loss of major customers
- Fines from non-compliance

E-waste (WEEE)

- Treatment and recovery of waste: historical and new equipment waste
- Fines from non-compliance

Diverse estimated compliance costs:

~ 2% of company revenues

(AMR Research)

400 – 600 million GBP / year (UK only)

(UK DTI)

€650 – 1050 million / year (EU 15)

(EU Commission)

Beyond compliance: Eco-design

- less toxic materials
- easy snap-to-parts
- lower weight (fewer cables & wires)
- competitive price point

Integrated, cross-functional strategy

Case study / Automobiles: financial impact of training

- Productivity was first improved in the sector through process automation. But as per Ford T, full automation has a limit
- There is also a need of flexibility and reactivity, in order to optimise the existing production capacities and customise different products
- Training and career management enable the employees to address the flexibility of the product flow and of the production range
- Flexibility = productivity gain

Example:

Renault strong Human Resources policy

- Training: 5% staff expenses & 80% employees involved
- Career management and development: available to all positions
 - ... fitting with the new strategy of Renault, presented in February 2006
 - ▶ Launch of 27 new models
 - ▶ Focus on luxury cars segments and customised models

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Not about merging but cross-fertilisation

- A long term focus implies a higher level of uncertainty, taking into account **intangible and qualitative** aspects
- Sustainable analysis & financial analysis have a **different approach because of difference in data & time horizon**
- To date, the degree to which sustainable analysis translate into **cash flow forecasts is variable** from sustainability issue to issue and sector to sector
- **Cross-fertilisation and synergies** of ideas originated from both types of analyses improves the overall company analysis & stock selection
- Sustainability analysis will continue to generate a large number of **new and unexplored ideas with a long-term investment horizon**

Sustainable and long-term investing : Who cares ?

- **Companies** do : even if it sometimes in the first place a public relation exercise
- **Screening agencies** do : improving the quality via specialisation or consolidation
- **Asset managers** do: integrated investment philosophy & processes
- Some **institutional Investors** do : specialist mandates and/or overlays, few are ready to change evaluation horizons
- Do **consultants**: do they want to think out of the box ?
- **Regulators** do : transparency can help
- **Academics** do: but their research conclusions suffer from lack of definition
- Most **trustees** don't - cf retail market share, but a marketing & education help

Perspectives for long term investing

- Long term investing should be more than a buzzword or an tautology : call it sustainable or responsible investing
- Transparency is a true driving force behind the development of sustainable investing and there is no way back
- Sustainability criteria will be gradually integrated to the traditional financial analysis depending upon their relevance to performance, as is already the case with corporate governance
- The strength of an asset manager will depend upon his ability to respond to the demands of long-term investors who put sustainability clearly on the agenda
- Sustainable and long term investment strategies will be shaped by performance objectives, risk budget and investment constraints of investors and track records.

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Important information concerning the sustainability analysis

Dexia AM's Sustainability Analysis is based upon different sources of information developed by Dexia AM's SRI team, among others: sector studies and company analyses by Dexia AM's sustainability analysts, "Dexia AM's Sustainability Analysis Research Methodology 2006", "Methodology Guidelines November 2005" by Franca Morroni, "Dexia AM SRI Business Case 2004" and Dexia AM leading SRI principles and multiple research conducted since 1996 as well as data from selected SRI data providers.