

**Environmental, Social, And Governance (ESG) Evaluation**

# ABC Steel Co.

## Executive Summary

ABC Steel Co.'s operations are mainly in Southeast Asia, and the company is one of the largest steel producers globally. ABC primarily manufactures integrated steel products and sells them around the world.

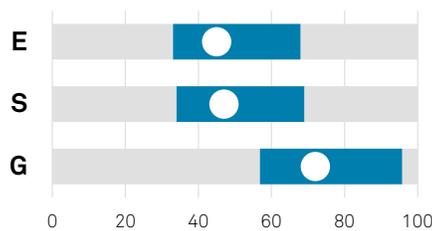
The company's ESG Profile score of 56 reflects a relatively high sector-related ESG risk for metals and mining for contamination risks, water usage, waste pollution, and biodiversity. Social factors are also important considerations due to lagging workforce diversity and safety management. A strong governance framework somewhat offsets the low sector score with the company's long established board framework structure, and clear transparency and reporting means. Placing greater focus on environmental and social factors by disclosing specific targets to reduce greenhouse gas (GHG) emissions and wastewater discharge, or enhancing diversity and safety measures would entail a different scoring of the overall ESG Profile.

ABC is aware of emerging strategic risks to its business model driven by environmental and technological changes, but has yet to implement concrete plans to address those changes. This constrains the final ESG Evaluation score (51).

<b>Entity</b>	ABC Steel Co.
<b>Location (HQ)</b>	SE Asia
<b>Primary Operation Location(s)</b>	SE Asia
<b>Publication Date</b>	April 11 2019
<b>Primary Contact</b>	
<b>Secondary Contact</b>	

### Profile Score

**56/100**



Company-specific attainable and actual scores

### Preparedness Opinion

**Emerging**

Awareness:	<b>Good</b>
Assessment:	<b>Good</b>
Action:	<b>Developing</b>
Culture:	<b>Good</b>
Decision-making:	<b>Good</b>

## ESG Evaluation

**51/100**

A higher score indicates better sustainability

# Component Scores

Environmental Performance			Social Performance			Governance Standards		
Sector/Region Risk Level	18/50		Sector/Region Risk Level	19/50		Sector/Region Risk Level	31/35	
 Greenhouse Gases	Good		 Workforce & Diversity	Lagging		 Structure & Oversight	Good	
 Waste	Good		 Safety Management	Lagging		 Code & Values	Good	
 Water	Lagging		 Customer Engagement	Good		 Transparency & Reporting	Strong	
 Land Use	Good		 Communities	Strong		 Cyber Risks & Systems	Good	
 General Factors (optional)	None		 General Factors (optional)	None		 General Factors (optional)	None	
<b>E Profile (30%)</b>	<b>45</b>		<b>S Profile (30%)</b>	<b>47</b>		<b>G Profile (40%)</b>	<b>72</b>	
<b>ESG Profile (incl. any adjustments)</b>						<b>56/100</b>		

## Preparedness Summary

ABC is less prepared for emerging and strategic risks to the business model from environmental and technological changes. This is stunting long-term demand growth projections. Although the company is very aware of these risks, it has not established an action plan. We believe its growth-oriented culture will transition to new business models, albeit slowly. However, despite a strong level of risk awareness, executive accountability for the long-term risks is still being identified. While the company has made one strategic acquisition to diversify its business revenue streams to aluminum, its overall strategy involves remaining in the same business without any major modifications to its existing strategy.

## Preparedness Opinion

**Emerging**

## ESG Evaluation

ESG Profile	56/100
Preparedness Opinion	Emerging (-5)
Further Adjustment (if any)	None

**51** /100

# ESG Profile

56/100

## Overview

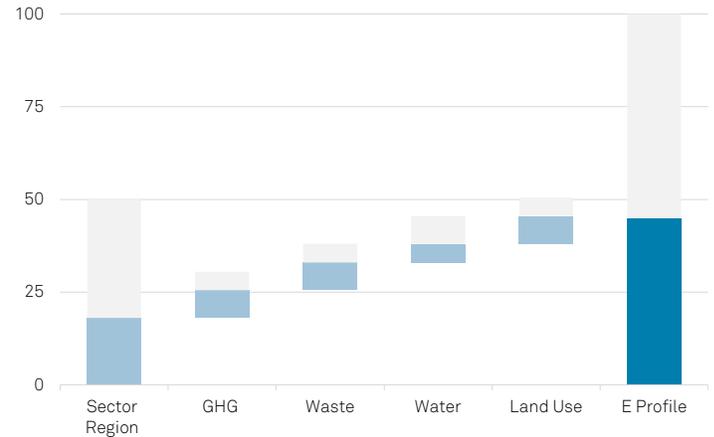
ABC continues to make efforts to reduce GHG emissions by recycling blast furnace slag, and setting reduction targets with clean energy and green technology. The CEO chairs and addresses climate change activities through the annual Environmental Management Committee, in which carbon dioxide (CO<sup>2</sup>), energy indices, and management notes are shared companywide. Although the company participates in industry-led water management initiatives, we view ABC's water use as lagging, given its historical trend of wastewater, which it discharges at lower quality than abstracted. The company's history of no material environmental events or controversies and, to a lesser extent, its focus on reducing GHG emissions, bolsters the score.

Our social analysis considers safety management a key risk, given the heavy use of large and dangerous equipment. Although ABC has many policies to manage exposure to some of the social risk categories, it is still in the process of allocating management roles and responsibilities and developing specific metrics. ABC recorded eight fatalities since 2015, but we have not observed any material chronic events or controversies that could suggest heightened risk level not already in our assessment. Within its Social Profile, ABC's community engagement is considered strong, given its ongoing commitment to enhance the social value of regional communities via charitable contributions and education systems.

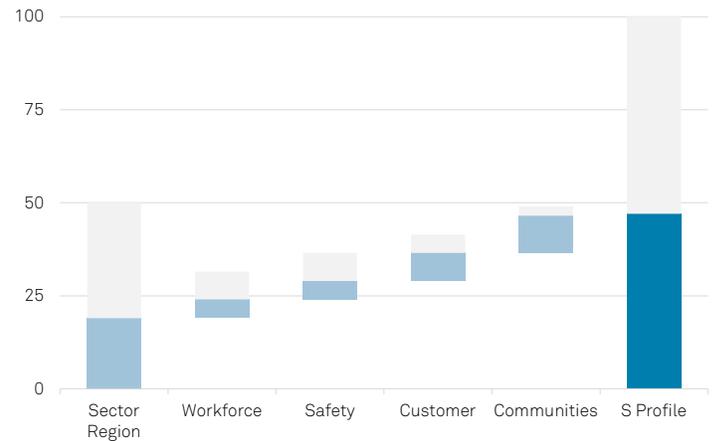
ABC's strong governance framework is characterized by transparent reporting, directors with vast experience and expertise in various areas (such as accounting, legal, and public affairs), and up to eight outside directors (currently seven) and five inside ones constituting the board to ensure its independence. Transparency meets leading standards in our view because the company clearly and transparently communicates and discloses its values and code of conduct with respect to environmental and social issue internally and externally. ABC has been selected as one of the world's most competitive steelmaker from industry associations for several years, which further supports its good Governance Profile.

■ Component score (incl. adjustments)    ■ Potential score    ■ Profile score

### Environmental Profile (30%)



### Social Profile (30%)



### Governance Profile (40%)



# Environmental Factor Analysis



## Greenhouse Gas Emissions

Good

- Emission intensity for Scope 1 has been consistently above 80 million tons of CO<sup>2</sup> equivalent, and is in line with industry average emissions of 1.83 tons of CO<sup>2</sup> per ton crude steel cast (ABC reported 1.82 tons in 2017).
- Management has clearly committed to reduce GHG emissions, including with initiatives to invest in projects with potential environmental risk factors, and the CEO chairing the annual Environmental Management Committee to share key emissions indices companywide.
- A third-party-verified sustainability report and business reports transparently discloses the information on ABC's efforts in carbon-related risk and opportunity management is transparently disclosed to stakeholders.



## Waste

Good

- ABC recycles more than 60% of wastes to minimize hazardous waste outputs, which is in line with industry peers.
- Separately, the company has made efforts to conserve and sustain use of oceans, and restoring marine ecosystems by using steel slag.
- ABC continues to audit its plants regularly to strengthen environmental management and executes special inspections to prevent environmental accidents that can occur in the springtime or holiday period.



## Water

Lagging

- Although ABC has internal targets and commitments to reduce water usage and wastewater discharge, the inherent steel industry's wastewater discharge keeps the company from scoring a higher assessment, because it continues to discharge more than 50% of water usage as wastewater at a lower quality than abstracted.
- ABC is participating in industry-led groups focusing on water management, which could enable the company to improve its near-term performance.
- ABC manages an environmental group to improve water treatment efficiency. It does this by diagnosing wastewater from worksites to minimize water pollutant discharge and prevent chemical accidents. However, this is in a pilot phase and therefore lagging behind industry peers.



## Land Use

Good

- ABC includes its biodiversity policy in its code of conduct, in which the company strives to protect and preserve the environment and ecosystem by means of establishing an Environmental Management System.
- For example, ABC has taken the initiative to restore marine ecosystems by using steel slag on areas affected by rising seawater temperature. This is effective on marine organisms such as seaweed, fish, and shellfish given steel slag's high mineral content, particularly calcium and iron.



## General Factors (None)

- We have not made any adjustments to the Environmental Profile.

# Social Factor Analysis



## Workforce & Diversity

Lagging

- The bulk of the workforce are full-time employees with some benefits. Maternity leave lags global standards, but is in line with that of local peers.
- ABC lags in diversity, with less than 3% of senior management and only 5% of the workforce being women.
- Training programs facilitate work improvement, and although ABC fosters job stability and security as evidenced by no company-led large-scale layoff over the years, ABC does not disclose other diversity in the workforce at the operating level.



## Safety Management

Lagging

- ABC's lost time injury frequency rate of 0.10 (per million hours) is well below the industry average of 0.91 as of 2017.
- However, the company has recorded eight fatalities since 2017 because of accidents such as gas leaks. Policies oversee occupational health and safety, but the recent fatalities demonstrate lackluster results to its safety management.
- We believe the management's focus on safety, through its extensive training program, should help avoid further accidents, and if improvements continue, we could revise our score to Good from Lagging.



## Customer Engagement

Good

- As one of the leading steel producers in the region, ABC maintains policies and procedures that outline approach to data privacy, managing overall operations and risks, and training stakeholders and employees.
- One notable result to better engage and meet customer demand and satisfaction, the company has increased offerings of high-end products, in combination with profitability, marketability, and quality to meet customer needs. This ensures the company is evolving to meet customer expectations and needs.
- Its high-end product mix steadily increased to more than 50% of total sales as of 2018 from less than 40% in 2015.



## Communities

Strong

- ABC has social and cultural opportunities to help improve quality of life. The company has constructed social infrastructure in its major markets that supports local development goals in impoverished communities.
- One project includes the construction of innovative steel houses resistant to disasters, providing long-term housing stock in otherwise vulnerable areas.
- In 2014, ABC developed child-friendly zones in regions surrounding its facilities, providing local opportunities for improved childcare. These are sizable investments that reach tens of thousands of people.
- The company engages in several other activities to support communities.



## General Factors (None)

- We have not made any adjustments to the Social Profile.

# Governance Factor Analysis



## Structure & Oversight

Good

- ABC's board and committee structure is sufficiently robust, in our view, and is mostly neutral to the governance structure. The company has sufficient board independence and does not have strong controlling shareholders.
- Key policies include anticorruption, anti-money laundering, and anti-fraud, which further supports our good assessment of structure and oversight.
- The company's board has several members departing in the coming year. We do not expect this to be disruptive, because succession plans reflect the need to replace skills in key areas and address some geographic gaps in knowledge from its overseas businesses.



## Code & Values

Good

- Although ABC has standards in setting a code of conduct for all of its employees while tracking senior management's remuneration, we believe the company can improve in areas to narrow the gap between the CEO and average worker.
- ABC tracks the gender pay gap but has a limited track record in narrowing it. Women continue to lag significantly in terms of numbers.
- Nevertheless, the company has a clear purpose and value statement with response to its environmental, social, and diversity values.



## Transparency & Reporting

Strong

- ABC's reporting practices and transparency serve to enhance the overall governance scores. The company continues to publish an annual ESG report and tracks relevant information critical in assessing its profiles.
- Transparency is somewhat weak for environmental metrics because it is difficult to track industry standards, but ABC continues to disclose past three years of records, which we can compare with industry benchmarks.



## Cyber Risks & Systems

Good

- ABC ensures complete compliance with local and international cybersecurity-related rules and regulations.
- The company has been certified in Information Security Management System (ISMS) and remains committed to continuously step up efforts to enhance its information security management capabilities.



## General Factors (None)

- We have not made any adjustments to the Governance Profile.

# Preparedness Opinion

Preparedness	Low	Emerging	Adequate	Strong	Best-in-class
Awareness	Developing	Good	Excellent		
Assessment	Developing	Good	Excellent		
Action	Developing	Good	Excellent		
Culture	Developing	Good	Excellent		
Decision-Making	Developing	Good	Excellent		

## Summary Opinion

ABC is aware of how climate change, political uncertainty, and the transition from high-carbon fuel could threaten its business model. This is one of the main reasons why it acquired an aluminum company: to diversify its earnings mix away from conventional steel. Although ABC is aware of the need to diversify, it has a difficult task to undertake as one of the largest steelmakers in the region.

While we believe ESG and long-term strategic risk culture is emerging in ABC's workforce, its inherent exposure into metals and mining sector constrains somewhat the company from being fully agile. Nevertheless, despite the sector that ABC engages in, we believe the company is making efforts to navigate strategic and emerging risks with senior management's excellent awareness and decision-making.

Awareness	Developing	Good	Excellent

The company is actively engaged with global industry associations and the board meets regularly to discuss emerging and strategic risks. As the global economy looks to decarbonize the supply chains, demand for steel is becoming more challenging to predict. In addition, the company recognizes the sector's political trade uncertainties. Therefore, ABC is aware that it might require a more diversified business model. Senior management and the board closely monitor advancements in material science through interactions with leading university departments, including the onset of 3D printing and manufacturing in line with circular economy principles. A dedicated risk management system function is responsible for identifying long-term risks and opportunities through internal and external challenges and methodically classifies all processes in the operations and strategy across the company, for the risk selection and assessment. The board review risk annually and reviews the full set of identified risks for potential disruptions.

Assessment	Developing	Good	Excellent

ABC's corporate planning process uses traditional assessment tools, including a materiality matrix and stress testing to assess the impact of identified risks. The company also uses scenario analysis to explore potential outcomes and uncertainties to interpret external factors, such as technical, economic, political, and governance trends facing its industry. Scenario assumptions are plausible.

**Action**

Developing

Good

Excellent

ABC has near-term targets and plans for current risk exposures in its operations, but has not established long-term targets or contingency plans to navigate them. Despite a strong level of risk awareness, clear accountability for long-term risks is still being identified. While the company has made one strategic acquisition to diversify its business revenue streams to aluminum, its overall strategy involves remaining in the same business without any major modifications to its existing strategy. ABC's knowledge on how to address and respond to the full suite of risks and opportunities continues to constrain the company.

**Culture**

Developing

Good

Excellent

The sector's recent history, with major growth from a boom in China, has resulted in a growth-oriented mind-set in ABC's workforce. This could make the uncertainty of changes in demand difficult to navigate. Should demand change and the company need to pivot toward a new sector or embrace a new business model, we believe that the organization as a whole will adapt, albeit slowly. However, there is strong evidence of internal communication and training on corporate strategy, which is raising employees understanding and execution of strategic changes.

**Decision-making**

Developing

Good

Excellent

The board and senior management have made qualitative commitments to improving long-term sustainability performance and the most material long-term risks. ABC has been swift to address one of its strategic risks by acquiring an aluminum business, but its underlying sustainability strategy is unclear. Executive compensation is linked to safety metrics in line with the industry standard.

# Sector/Region Risk

Primary Sector(s)	Metals and Mining
Primary Operating Region(s)	Southeast Asia

## Sector Risk Summary

### Environmental exposure

By nature, mining threatens the environment and competes with other businesses and communities for water and electricity. It can also release toxic elements to the air, water, or soil. Open pit and underground mining involve crushing and treating large amounts of ore, resulting in tailings that may alter ecosystems if containment isn't proper. Other types like heap leaching use toxic fluids (cyanide or sulphuric acid) that are devastating when leaked to the environment. Alloy production such as steel or aluminum are extremely power-intensive and heavy air polluters. Steel mills generate significant carbon dioxide, nitrogen oxide, and particular matter that need proper treatment before being released to open air. Finally, coal-fired power plants are heavy air polluters, so governments are increasingly limiting them and incentivizing greener forms of energy.

### Social exposure

Safety management for the metals and mining sector is key since large and dangerous equipment is used, and some mining sites are located in remote and sometimes hostile environments. Companies typically track and manage incidents and have specific programs to educate their work forces. Social cohesion is another key risk, specifically social license to operate, given the land use and disruptions that mining sites can create for nearby communities. Governments worldwide increasingly need miners for social infrastructure and other forms of social responsibilities to concede or renew operating licenses. Poor management of these factors typically leads to reputational issues, license suspension and termination, adverse litigation, staffing issues, and unrest.

# Sector/Region Risk

## Regional Risk Summary

We have included a summary of our ESG Risk Atlas view of regional risk in Indonesia as a sample for this hypothetical South East Asia-based company.

Social standards are in line with most other major developing economies, but there is significant disparity among Indonesian society. Rules for worker protection are strong but enforcement is patchy. Corporate governance standards are generally weak, particularly for smaller or unlisted companies. Indonesia's financial services regulator Otoritas Jasa Keuangan did release a roadmap to improve corporate governance in 2014, but the implementation of best practices is still lacking. This exacerbates the fact that many listed companies often fail to comply with mandatory regulations. Boards often lack independence and diversity, while compensation disclosures are scant. Transparency is limited and ESG disclosure is below other developing

countries. Corruption remains an issue like many other countries in the region. The judicial system is inefficient and outcomes can be unpredictable.

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