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

# Automotive Holdings Ltd.

### Executive Summary

Automotive Holdings Ltd. (AHL) manufactures auto parts in multiple countries across the globe.

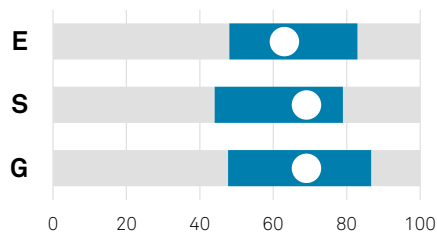
The company's ESG Evaluation score of 67 reflects its moderate approach in Preparedness (Adequate), with comprehensive systems to identify and monitor its emerging and ESG-related risks. As an auto parts manufacturer, AHL has plans to reduce greenhouse gas (GHG) emissions by transitioning away from carbon fuels; however the parts it makes are largely still for internal combustion engine vehicles. The company also stresses the importance of worker safety and replaces high-risk manual procedures by robotics. A comparatively strong governance framework and relatively low institutional risk exposure supports its ESG Profile of 67. However, we believe it has made moderate progress on emissions and water management, which aligns with its recent ESG improvement plans. In addition, the company is highly aware of the impact of its operations on the community and has ESG embedded into its culture at all staff levels through frequent dialogues. Observable progress and higher transparency on ESG reporting are required to improve its overall ESG Profile.

The company's operations have been relatively free from controversies for several years. No material score adjustments for General Factors were made.

<b>Entity</b>	Automotive Holding Ltd.
<b>Location (HQ)</b>	Asia
<b>Primary Operation Location(s)</b>	Global
<b>Publication Date</b>	April 11, 2019
<b>Primary Contact</b>	
<b>Secondary Contact</b>	

### Profile Score

**67/100**



Company-specific attainable and actual scores

### Preparedness Opinion

**Adequate**


















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

## ESG Evaluation

**67/100**

A higher score indicates better sustainability

# Component Scores

Environmental Performance			Social Performance			Governance Standards		
Sector/Region Risk Level	33/50		Sector/Region Risk Level	29/50		Sector/Region Risk Level	22/35	
 Greenhouse Gases	 <b>Lagging</b>		 Workforce & Diversity	<b>Strong</b>		 Structure & Oversight	<b>Good</b>	
 Waste	 <b>Lagging</b>		 Safety Management	<b>Strong</b>		 Code & Values	<b>Leading</b>	
 Water	<b>Good</b>		 Customer Engagement	<b>Strong</b>		 Transparency & Reporting	<b>Good</b>	
 Land Use	<b>Leading</b>		 Communities	<b>Strong</b>		 Cyber Risks & Systems	<b>Good</b>	
 General Factors (optional)	<b>None</b>		 General Factors (optional)	<b>None</b>		 General Factors (optional)	<b>None</b>	
<b>E Profile (30%)</b>	<b>63</b>		<b>S Profile (30%)</b>	<b>69</b>		<b>G Profile (40%)</b>	<b>69</b>	
<b>ESG Profile (incl. any adjustments)</b>						<b>67/100</b>		

## Preparedness Summary

We view AHL’s preparedness as Adequate. In our view, AHL is aware of the impact of its operations on environmental pollution and has strategic plans to invest in more parts for new energy vehicles (NEVs) in the face of more stringent industry requirements and transitions. In particular, the company has a strong culture in which it emphasizes ESG factors at all staff levels through communications, which stresses its aim to become the industry leader and bring positive environmental and social change to the community. We expect the company to be well prepared for technological upgrades and innovations and improving energy consumption efficiency going forward.

### Preparedness Opinion

**Adequate**

### ESG Evaluation

ESG Profile	<b>67/100</b>
Preparedness Opinion	<b>Adequate (0)</b>
Further Adjustment (if any)	<b>None</b>

**67** /100

# ESG Profile

67/100

## Overview

AHL is improving its GHG emissions, waste, and water usage by seeking renewable energy sources. Although results are still below industry average and improvement remains slow, we expect the company to demonstrate further advancement in the near future via its mitigation plans to procure renewable energy for its manufacturing and commitments to elevate environmental issues in the workforce.

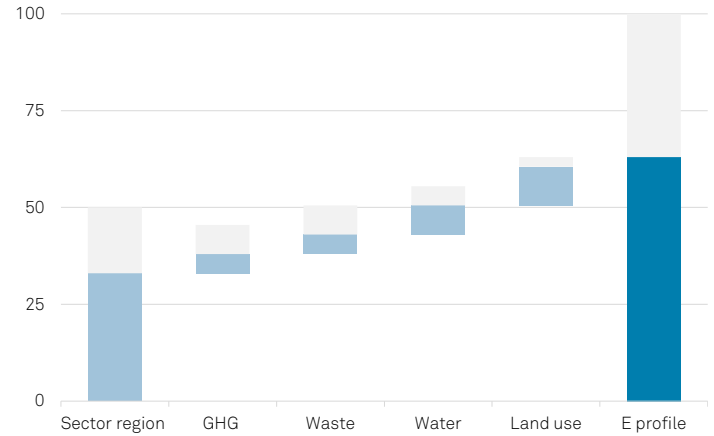
The company is one of the leading industry players to take initiative to restore and decontaminate brownfield sites in two countries where it has most of its operations before building its manufacturing facilities, which is unique in the industry. The restoration of polluted lands is both good for financial performance and benefits the environment. We can see that AHL is highly committed to and acts upon environmental improvement initiatives.

We believe AHL greatly emphasizes its workforce safety. There have been no fatalities in recent years in part because the company has replaced more dangerous routines by robotics. In terms of diversity, the company is doing well-- 40% of workforce are women. The company also values its customers' feedback by tracking and analyzing its clients' complaints, followed by timely responses. The company has consistently met its delivery times and has a strong reputation among its customers.

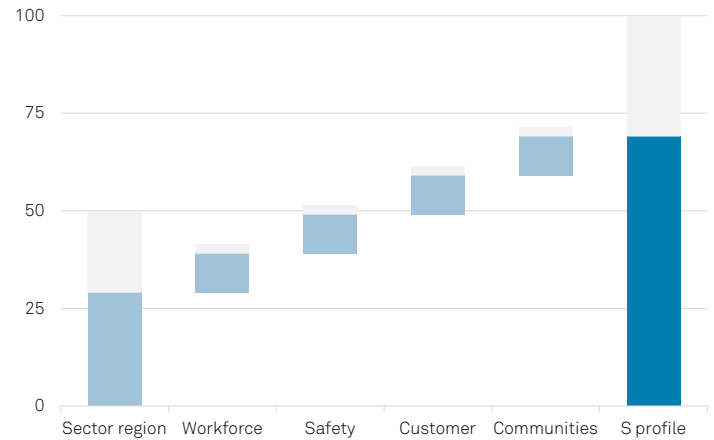
AHL has a good governance structure and standard approach to oversee corporate ESG events. The company has a clear public written code of conduct and value proposition and discloses the remuneration of its senior management, with disciplinary actions in cases of violations, which adds transparency. The company hasn't disclosed its ESG targets and historical figures (e.g. waste, worker's turnover rate, percentage of suppliers, etc.) in its sustainability reports.

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

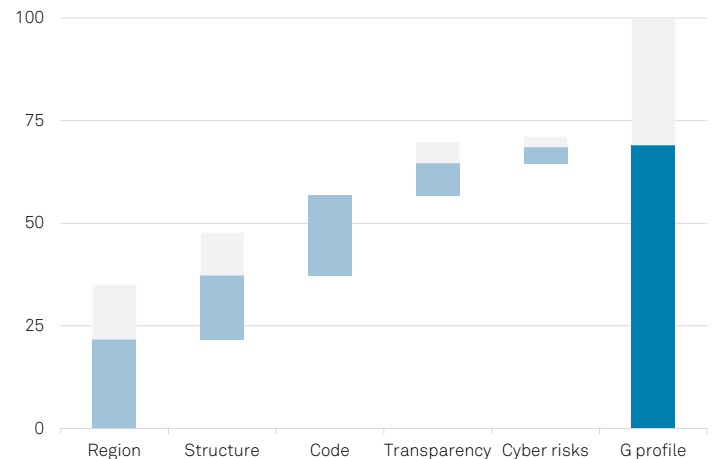
### Environmental Profile (30%)



### Social Profile (30%)



### Governance Profile (40%)



# Environmental Factor Analysis



## Greenhouse Gas Emissions

Lagging

- AHL's Scope 2 carbon intensity is substantially higher than global peers' given that its electricity supply is sourced from coal-fired generation, and the company has minimal Scope 1 emissions.
- Total GHG emission increases by a 4% compound annual growth rate because of the acquisition of a metal manufacturer. Excluding the acquired business, its GHG intensity has been shrinking. We anticipate this to continue due to management's initiatives to reduce emissions of its new and existing business in the long term.
- We expect total GHG emissions to reduce slowly in the medium term since AHL has started to source some renewable electricity suppliers (including solar and nuclear energy) with zero carbon emissions to replace the existing electricity supplier. We would improve the score to Good from Lagging if we observe a track record of reducing carbon intensity.



## Waste

Lagging

- The proportion of hazardous waste in total waste remains high at 65%-70%, well above the average of global industry peers. Total waste produced has also increased due to the acquisition.
- The company has lower recycling rates than the industry average, even though it has improved to 40% in 2017 from 20% in 2014 through standardizing operating processes and waste donation.
- Relative to peers, less training seems to be conducted on policies and procedures for hazardous waste management, which is a possible driver for its increasing exposure to hazardous waste.
- A commitment to significant waste reduction targets and public reporting would better position the company to manage its risk exposure.



## Water

Good

- Low water consumption solely for sanitary purposes, as compared to global automotive peers.
- Water intensity has begun to improve gradually since 2017, and is close to the industry median. With a clear allocation of water management responsibilities at the management level, we expect a continual improvement in this area.



## Land Use

Leading

- AHL's land use and biodiversity risk exposure is low given that its assets are mostly located in Country A and Country B, where population and endangered species densities are low. While risk exposure may be low, the company has strong public policies in place to minimize its impact on new land use.
- The company initiates environmental improvement projects to restore and decontaminate brownfield sites in Country A and Country B for future expansions. The land restoration projects also include creating natural habitats for local fauna to boost local biodiversity. We believe AHL's strategy and target to build 70% new plants on restored brownfield sites is unique among its industry peers.



## General Factors <None>

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

# Social Factor Analysis



## Workforce & Diversity

Strong

- AHL has demonstrated workforce diversity because 40% of its total workforce are women, which is unusual for the industry and reflects the company's efforts to attract top talent. The company also seeks to further increase gender diversity in the future.
- We believe the overall workforce is stable with low turnover. The company also encourages internal mobility through its talent management program, in which workers can self-nominate for promotion opportunities.
- There are extensive training programs and e-Learning platforms to develop employees' key business and soft skills.



## Safety Management

Strong

- We believe the AHL's management strongly emphasizes the importance of worker safety because it has replaced high-risk manual procedures by automation and robotics to further reduce injury rates, which is unique to the industry.
- We observe adequate policies and programs to oversee occupational health and safety, which speaks to AHL's lower injury and fatality rates than manufacturing peers.
- The company even extends to managing its contractors' safety by renovating their existing facilities--lost time accidents were no longer found afterwards.



## Customer Engagement

Strong

- AHL values its customers' feedback by having a feedback handling system to track complaints. Every logged complaint is analyzed by the company to prevent repetitive faults.
- We anticipate high customer satisfaction with AHL's products and feedback systems, with speedy responses within two calendar days.
- We believe AHL's management has sufficient oversight of data privacy evidenced by the absence of any material customer data privacy breach.



## Communities

Strong

- The company emphasizes giving back to the community by providing technical education to underprivileged children in Country X and Country Y.
- AHL does have an antislavery policy and requires its suppliers to comply with its code, while its peers only limit the policy to their own manufacturing processes. This is monitored through audits.
- We believe AHL values human rights because its management has formal oversight of and tracks potential human rights violations.



## General Factors <None>

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

# Governance Factor Analysis



## Structure & Oversight

Good

- The board consists of independent members with diverse skills. In our view, AHL's committee structure is sufficiently robust and is mostly neutral to the company's governance structure.
- We believe AHL has most key policies in place, including anticorruption, anti-money laundering, and whistleblowing. Some are missing (public donations and business cyber security) in public statement but the company has internal procedures for these areas.



## Code & Values

Leading

- AHL has a clear and public code of ethics and business conduct. It provides detail as to internal responsibilities for oversight and implementation, as well as disciplinary procedures. Further, the company tracks and reports on breaches of the code, of which there have been none in the past five years. The company has a well-established training program for all employees and contractors to ensure understanding and promote adherence to the code.
- AHL is actively tracking the pay gap between senior management and average employees and between genders to minimize any unfair differences. Over the past several years the gaps have narrowed because of deliberate actions the company has taken.

The company has a well-defined purpose statement addressing environmental and social issues such as diversity and inclusion,



## Transparency & Reporting

Good

- AHL publishes an annual corporate social responsibility report to disclose relevant ESG related indicators and regularly tracks governance-related fines and regulatory penalties.
- The company's transparency is relatively weaker than global peers in that it doesn't publicly disclose targets and statistics on social and environmental aspects, even though we believe it internally tracks these areas.



## Cyber Risks & Systems

Good

- AHL has good operating standards to manage cyber risk. The risk exposure level to attacks is relatively low given the extent of the company's network and the data it holds.
- Even though AHL does not publicly reveal its policies and performance relevant to cyber risk management, we expect chances of future breaches to remain limited. However we continue to monitor this area as part of preparedness should the risk profile change.



## 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

We assess AHL's preparedness as Adequate. In our view, AHL is aware of the impact of its business operations on environmental pollution in the long run and has plans to make strategic changes in the face of industry transitions to NEVs. In addition, the company has comprehensive systems to monitor short- and long-term risks. However, its assumptions and systems are not as extensive and robust as global peers with best-in-class practice in terms of preparedness.

One of the highlights of AHL is its culture of strongly promoting ESG at all staff levels through frequent communications and campaigns. Still, we believe the communication and policies could be more effective and efficient by linking pay and ESG incentives at the management level to facilitate the decision-making process.

Awareness	Developing	Good	Excellent

In our view, AHL is highly aware of its opportunities and the long-term risks it would encounter going forward. It has comprehensive systems and collaborates with industry experts to continuously monitor internal and external environments to detect signals that could translate into emerging and strategic risks.

We expect the company will continue to supervise the day-to-day management of its sustainability issues and review all risks holistically through its Enterprise Risk Management Steering Committee. The committee meets twice a year to discuss strategic risks and developments.

Assessment	Developing	Good	Excellent

We believe AHL regularly tracks and assess its exposure to both short- and long-term risks using scenario analysis, including constraints on fossil fuel usage. The scenario process enables the company to explore the potential outcomes and uncertainties when facing changes in external factors, such as technical and economic trends in the industry. The company has identified risks that could affect its business and made key assumptions including growth of NEVs, which will be used to align its strategy with the simulated results of the scenario analysis. The risk management process encompasses various factors and uses scenario planning, including a range of fossil fuel prices and the transition to NEVs, in their downstream to assure robust decision-making.

## Action



AHL illustrates its effectiveness and efficiency in mitigating the short- and long-term risks regarding the transition to NEVs in the auto industry. We believe the company will execute its plans to increase research and development expenses and capital expenditures to 10%-13% of revenue to provide electrified products. Long term, the company has also formulated strategic plans to gradually diversify its product offerings to at least 60% of products contributing to NEVs to align with industry transition. Most product lines currently support internal combustion engines, and the company has identified risk tolerances for when they will ramp up currently fledgling alternative businesses.

## Culture



The company aims to be the industry leader in bringing positive environmental and social changes to the community. Environmental and social accountability is embedded in AHL's culture through communications, starting at the board of directors' level, with initiatives to improve regional environmental and social standards. We believe the company will continue frequent dialogues with staff about how to take action from the bottom up to improve environmental and social factors, as evidenced by the ongoing improvements in these two areas. The company has a process whereby employees can raise innovations that provide solutions to the long-term strategic objectives set out by the board, which is conducted by management and employee roundtables at the various global facilities.

## Decision-making



We believe that AHL has clearly incorporated ESG factors in its strategies and decision-making process, particularly environmental given the company's high exposure to environmental risks being an auto parts manufacturer. In our view, KPIs relevant to ESG factors will continue to be in place and consistent with the company's strategy, which are regularly reported to senior management. Nonetheless, even with an understandable link between strategy and KPIs for ESG factors, there is a lack of evidence that ESG factors are embedded in pay and incentive systems, which could restrain the incentives and effectiveness of implementing ESG factors at the executive level in their daily operations.



# Sector/Region Risk

Primary Sector(s)	Auto Parts
Primary Operating Region(s)	China

## Sector Risk Summary

### Environmental exposure

The automotive sector is directly exposed to GHG emissions. In China and Europe, which together account for about 50% of annual global auto sales, environmental regulation is leading the auto industry toward carbon dioxide (CO<sup>2</sup>)-neutral vehicle production. In China, regulations limit average fleet CO<sup>2</sup> emission to 117 grams per kilometer (g/km); Europe is looking for 95 g/km by 2021. Compliance with these targets involves sizable investments in technologies and new products over the next three years. We expect the return on these investments to be lower compared to petrol or diesel vehicles until demand for electric vehicles reaches sufficient scale and battery costs decline further. In the meantime, we see stress operating margins and free cash flows as research and development and capital investments increase as a share of sales. Furthermore, consumer acceptance of electric vehicles will depend upon the level of government incentives, evolution of battery costs and range, and infrastructure suitability. The increasing consumer aversion to diesel, particularly in Europe, adds to the problems in achieving CO<sup>2</sup> emissions targets and exposes automakers to potentially significant fines. In 2018, many European carmakers reported a wider gap between those targets and actual result, partially due to lower diesel engine sales.

### Social exposure

The auto sector's sensitivity to social risks focus on changing consumer habits and preferences for mobility services that would alter the traditional vehicle ownership model. Consumer demand for cars is unlikely to diminish given the global trends of rising incomes, but its form and nature will continue to evolve, resulting in risk and opportunities for the sector. The auto sector has been subject to trade tariffs throughout the years and various governments such as Germany, the U.S, China, the U.K., and South Korea have politically supported local companies. Therefore, the sector is vulnerable to shifting political landscapes that can disrupt otherwise highly efficient supply networks. Subsequently, the workforce is vulnerable to sudden plant closures, so the sector has greater incidents of strikes from the highly unionized workforce.

# Sector/Region Risk

The summary below reflects our country risk summary for China.

## Regional Risk Summary

Social standards are in line with most other major developing economies. The government recently strengthened legal protection for workers and consumers. Chinese corporate governance standards are also on par with other economies at this stage of development. The central government's recent push to reform state-owned enterprise structures in line with good governance practices is a major development. In 2018, China revised its Code of Corporate Governance for listed companies, accounting for the OECD requirements and particularly focusing on ESG disclosure and board diversity. Hong Kong also amended its Corporate Governance Code in 2019 and issued its guidance for board directors. Hong Kong-listed listed companies have been required to report on their ESG performance on a comply-or-explain basis since 2017. Official corruption has been less of a problem over the past few years due to the central government's anti-corruption drive. This effort has also been extended to government-related companies and financial institutions. Still, corruption among private enterprises remains an issue. Although judicial reforms are ongoing, the private sector has yet to trust that the rule of law is significantly improving.

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