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It's a Matter of Trust

ESG: Catalyst for Enhanced Valuations and Profitability

In our previous article, we have explored Malaysia's government commitments towards attaining environmental, social and governance (ESG) goals. In fact, the government aims to deliver on renewable energy (RE) capacity of 31% over the next 3 years, 40% by 2035 and 70% by 2050. In fact, according to findings from PWC, in Malaysia, companies that prioritise ESG considerations find themselves in a favorable position to command for better valuations and investment returns in the long term, supported by higher shareholder returns and profitability. Examining the composition of the FTSE4Good Bursa Malaysia Index (F4GBM), it becomes evident that these companies command a notable 1.7x premium in terms of price-to-book value when compared with other Malaysia's listed companies not included in the index. In addition to that, on average, F4GBM companies achieved a remarkable 16.6% return on equity and a noteworthy 14.4% net profit margin, while the others recorded comparatively modest figures, yielding 9.5% and 8.5% for return on equity and net profit margin respectively.

We believe ESG stocks often command better valuation and profitability for several reasons:

1. **Risk Management**

ESG companies excel in risk management by addressing environmental (climate change and carbon emissions), social (labour rights and safety), and governance (transparency and disclosure) risks. By tackling these challenges, these companies may be able to avoid or minimise potential negative impacts on their operations. This enhances their long-term financial stability.

2. **Innovation and Operational Efficiency**

Many ESG initiatives involve adopting inventive technologies and practices. Companies that invest in energy-efficient solutions (for e.g., rooftop solar panels) and waste reduction, could benefit from cost reduction and improved operational efficiency. This could contribute to higher profitability. For example, earlier in 2021, Asian food specialist Kawan Food Berhad had invested RM7.28 million in a solar photovoltaic (PV) installation at their headquarters in Pulau Indah Selangor Halal Hub and this was expected to yield RM1 million savings a year.

3. **Regulatory Compliance**

ESG standards are frequently stringent and closely match regulatory requirements. Companies that prioritise ESG are better prepared to navigate evolving regulations concerning environmental protection, labour rights, transparency, and more. Avoiding legal and regulatory challenges contributes to enhanced profitability.

4. **Reputation and Brand Equity**

ESG-focused companies build a strong reputation and brand. This draws support from stakeholders who value responsible practices, leading to customer loyalty, higher sales, and broader reach.

Our investment portfolio focuses on quality companies that possess strong fundamentals, including stable earnings and a promising future outlook, and are led by capable management teams. Please click on the link to learn more or email us at phillipmutual@phillipcapital.com.my if you require any further information.