



Does a company's ESG score have a measurable impact on its market value?

Is ESG performance perceived by the investment community as a risk and compliance topic or as a driver of value creation? Is there a “green” premium in market valuations? Are you looking for evidence to support a return on ESG investments? Why should sustainability be a key component in capital allocation strategies? This article will elaborate on all these questions and highlight the impact of embedding ESG criteria into corporate strategies.

Key findings

Increasingly, organisations are integrating sustainability and environmental, social and governance (ESG) criteria into their corporate strategies, operating models and management incentive plans. This has been driven by many factors, including regulatory requirements, consumer sentiment, competitive pressures and the aim of being an attractive employer.

There may be a perception that ESG-related investments are a net financial cost associated with risk management and compliance, and that they are not a means of value creation. In this article, we test this conclusion and consider whether corporates with higher ESG scores are rewarded with an “ESG-driven value premium” in the form of a higher EV/EBITDA¹ trading multiple.

Our findings support the existence of such an ESG value premium.

Using regression analysis, we find that a 10-point higher ESG score is associated with an approximate **1.2x** higher EV/EBITDA multiple. Furthermore, we also find that a company that increases its ESG score by 10 points experiences an increase of approximately **1.8x** in its EV/EBITDA multiple.

This leads to the conclusion that investing to deliver better ESG performance can drive value upside for a business beyond the associated net financial costs.

Discover our detailed analysis below to see how ESG scores have a statistically significant impact on a firm's EV/EBITDA multiple, and that market values respond positively to improvements in a company's ESG score.

Do ESG investments generate value?

ESG-related investments have a direct cost implication for organisations. However, the impact on value creation is less clear. Some outcomes, such as cost savings due to minimising energy or water usage, can be readily measured. But for other ESG-related efforts which do not have a direct P&L impact, it is more difficult to quantify the value creation potential.

Recent changes to the regulatory landscape, such as the Sustainable Finance Disclosure Regulation (SFDR) and Taxonomy Regulation, are leading to additional scrutiny of sustainability issues, and it is likely that achieving the required degree of regulatory compliance will entail additional costs for companies.

However, a core focus of our analysis is to assess whether costs associated with ESG compliance could translate into investments that create value for corporates.

In order to capture the potential of ESG performance on market value beyond its P&L impact, we have analysed the value creation effect of ESG performance on EV/EBITDA multiples.

How is an ESG score assessed?

Several commercial organisations have developed ESG scoring methodologies, which are used to provide periodic assessments of ESG scores for listed companies. These providers include Bloomberg, S&P, MSCI, Sustainalytics and Refinitiv. For the purpose of our analysis, given their global coverage and granular assessment criteria, we have used Refinitiv as the basis for our ESG scores.

Refinitiv captures and calculates over 500 company-level ESG key performance indicators (KPIs). The selected KPIs are then grouped into 10 categories to create three pillar scores:

Environmental Pillar		Social Pillar		Governance Pillar	
Resource use	11.0%	Workforces	16.0%	Management	19.0%
Emissions	12.0%	Human rights	4.5%	Shareholders	7.0%
Innovation	11.0%	Community	8.0%	CSR strategy	4.5%
		Product responsibility	7.0%		

Source: Environmental, Social and Governance scores from Refinitiv, February 2021

¹Enterprise Value to Earnings before Interest, Tax, Depreciation, and Amortisation

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Weightings of the Environmental and Social pillars differ between industries, but Governance weightings are consistent across all industries. Overall scoring outcomes are presented in percentages ranging between 0% and 100% as follows:

Score	Grade	Description
0-8	D-	'D' score indicates poor relative ESG performance and insufficient degree of transparency in reporting material ESG data publicly.
8-17	D	
17-25	D+	
25-33	C-	'C' score indicates satisfactory relative ESG performance and moderate degree of transparency in reporting material ESG data publicly.
33-42	C	
42-50	C+	
50-58	B-	'B' score indicates good relative ESG performance and above average degree of transparency in reporting material ESG data publicly.
58-66	B	
66-75	B+	
75-83	A-	'A' score indicates excellent relative ESG performance and high degree of transparency in reporting material ESG data publicly.
83-92	A	
92-100	A+	

Source: Environmental, Social and Governance scores from Refinitiv, February 2021

Based on the computed score, companies are assigned one of four ESG grades, varying from poor (0% or D) to excellent (100% or A). Each grade band covers a quartile of 25 points. For movements within grade, 8 points differentiate these advances.

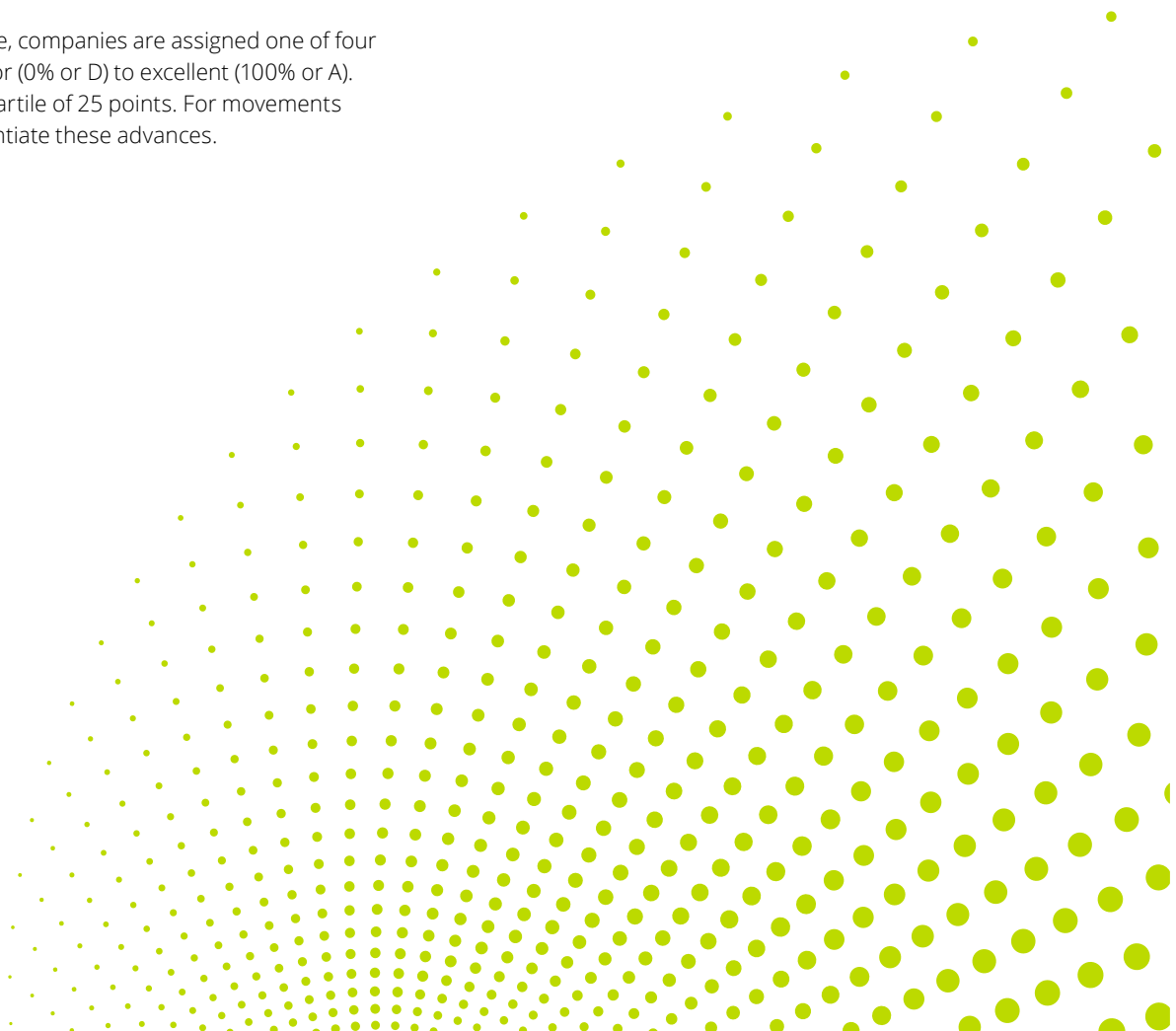
Regression methodology and analysis

Instead of identifying the relationship between P&L performance and ESG performance, we address the impact of ESG performance on market value. With this in mind, we consider two key questions:

- i. Does a company's ESG score have a significant impact on its market value?*
- ii. Does market value respond to improvements in a company's ESG rating?*

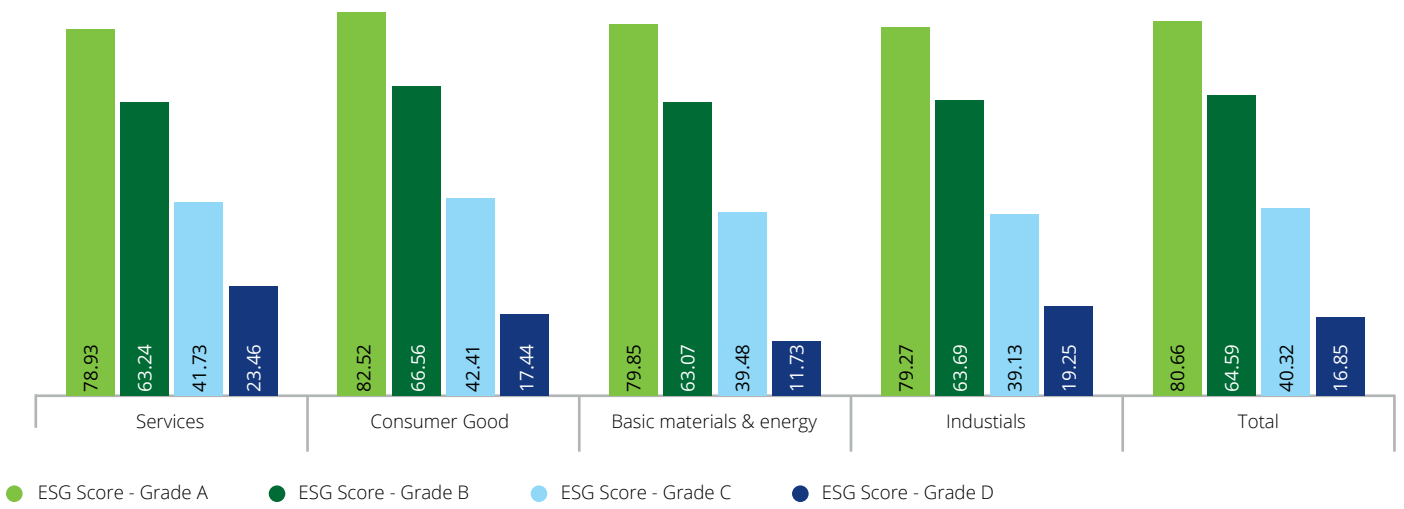
In our analysis, we have assessed changes in the ratio of Enterprise Value to Earnings Before Interest, Tax, Depreciation and Amortisation (the EV/EBITDA multiple) to measure the impact of ESG performance on company valuations.

We took a sample of over 300 listed companies across four industries: Basic Materials & Energy, Consumer Goods, Industrials and Services. As a starting point, we observed a **simple correlation** between ESG score and EV/EBITDA multiples across the four ESG categories:

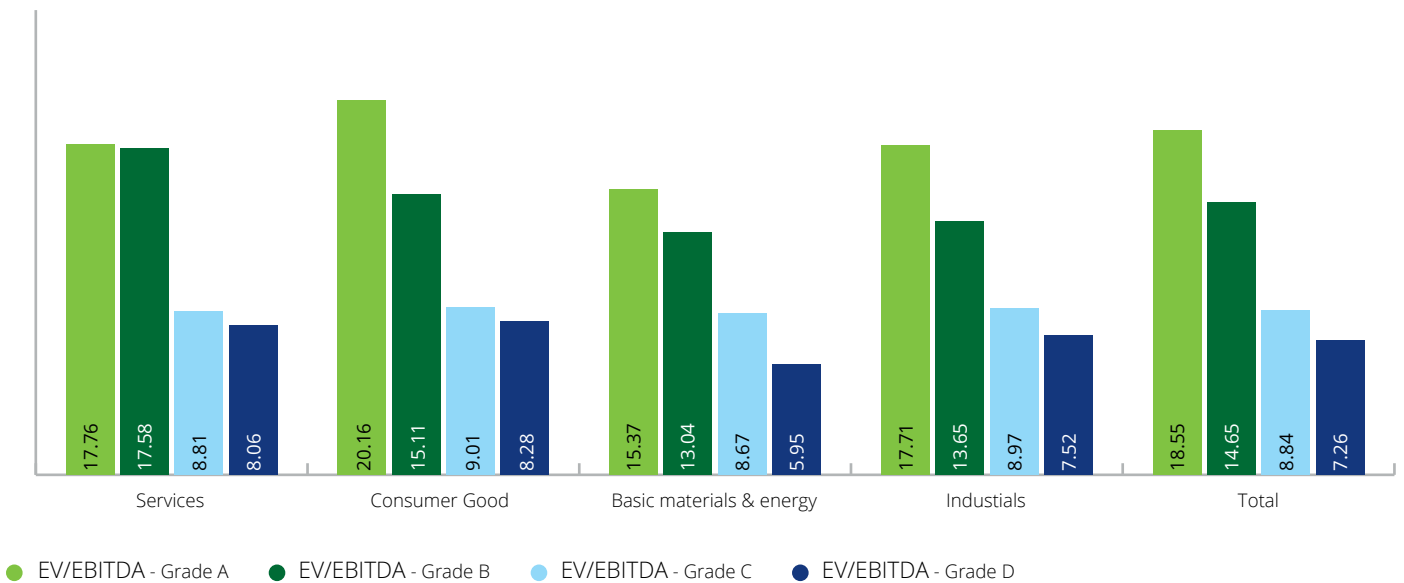


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ESG Score



EV/EBITDA



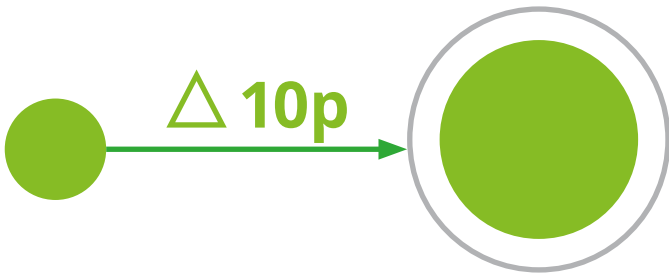
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The results of our analysis suggest that companies with higher ESG scores also have higher EV/EBITDA multiple for each of the four industries considered. However, it is important to note that there are several factors other than ESG scores that may have a significant impact on a company's EV/EBITDA multiple, which are not accounted for in this simple correlation analysis.

To isolate the impact of ESG on the EV/EBITDA multiple, we used multiple linear regression analysis to measure relationships between a dependent variable (the EV/EBITDA multiple) and a set of independent variables (see below). It also allows us to control for other variables that may impact a firm's EV/EBITDA multiple to identify the isolated impact of ESG scores. We considered several independent variables in our regression analysis, including, but not limited to, revenue growth and profitability.

Isolated effect of ESG score

The higher the ESG score at a point in time...

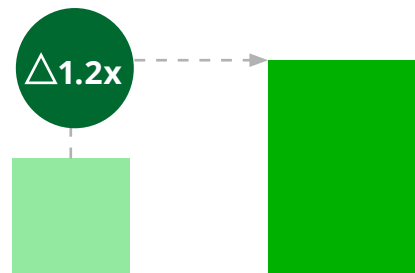


Results of analysis

We outline below two key results of our analysis: first whether companies with higher ESG scores have a higher valuation multiple; and second, whether a change in the ESG score of a company results in a change in its valuation multiple.

We observe that a company's ESG score **does** have a significant impact on its EV/EBITDA multiple, even after allowing for the impact of other variables generally considered to be value drivers of a business. The results of our analysis show that, on average across our sample, a 10-point difference in an ESG score is associated with an approximate **1.2x higher** EV/EBITDA multiple.

the higher is the EV/EBITDA

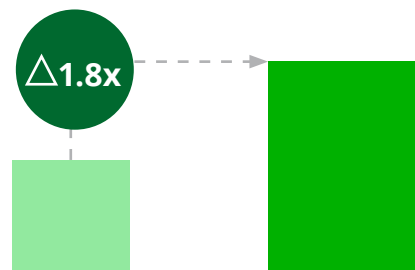


We also found that a 10-point improvement in the ESG score for the same company is associated with an approximate 1.8x higher EV/EBITDA multiple. The interesting conclusion from this analysis is the potential implication that the market rewards ESG performance improvements to a higher degree than status-quo peer performance.

The higher is the **change** in ESG score...



the higher is the impact on EV/EBITDA



Our analysis supports the existence of an "ESG value premium", and the notion that corporate investment and improvements in ESG practices within an organisation are reflected in higher valuation multiples.

Limitations

The conclusions from our regression analysis are specific to linear relationships for the sample of industries observed. This analysis was based on historical data and should not constitute a basis for future predictions. Although several variables were included in our regression model, there may be additional variables which could also contribute to variations in EV/EBITDA that have not been included.



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