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ESG Perspectives
The Sustainable 75

The Most Sustainable U.S. Companies: The Credit Story

Last month Barron's published a cover story entitled "The Most Sustainable Companies,"[1] which featured an equity-focused survey of the 100 Most Sustainable Companies in America based upon, among other things, the strength of their scores for "forward thinking and good behavior." Using a similar methodology and sustainability scoring framework, Sage evaluated these 100 companies from a credit perspective to identify their relative placement among this well-regarded ESG grouping. The result is the Sustainable 75.

Barron's Survey Methodology

The Barron's survey was based on the work compiled by Calvert Research and Management, a well-known and respected sustainable investing advocate. The Barron's list was compiled after reviewing data across the 1,000 largest U.S. publicly held companies. The survey scored the companies using a wide range of key metrics that were focused on environmental, social, and governance (ESG) related factors. The researchers then segregated the data into five key stakeholder categories — shareholders, employees, customers, planet, and community — to assess how each company scored (on a scale of 100) regarding metrics that would be considered material to each of these stakeholders. Finally, this information was weighted according its materiality for a given industry to help arrive at a total overall sustainability score.

According to Calvert's management, "companies can be differentiated based on how well they manage their environmental and social impact and the strength of their governance." They also believe that their research shows which management teams are creating better companies for the long term and for long-term investors in general. Reportedly, the lowest score among the 1,000 companies was 27 and the median score was 55. More importantly, the average score for the top 100 companies was 66.6, with a score range of 63 to 74. While the average score for the top 100 companies was lower than last year's 68.7 survey score, it is worth pointing out that this group achieved an equity return of -3.2% versus -4.2% recorded for the S&P 500 index over the same period.

It is also worth noting that the 20 most sustainable companies in the survey (see below) generated an average score of 71.05, well above that recorded for the rest of the group. Moreover, this group represented a diverse cross-section of the market, with six technology firms, seven manufacturers, three services firms, two communications companies, and a couple of retailers.

Company (Ticker)	2019 Rank	Score
Best Buy Co. (BBY)	1	75
Cisco Systems (CSCO)	2	75
Agilent Technologies (A)	3	74
HP Inc. (HPQ)	4	73
Texas Instruments (TXN)	5	73
Voya Financial (VOYA)	6	72
The Clorox Company (CLX)	7	72
W.W. Grainger (GWW)	8	71
Motorola Solutions (MSI)	9	71
ManpowerGroup (MAN)	10	71
Salesforce.com (CRM)	11	71
PVH Corp. (PVH)	12	70
Intuit (INTU)	13	70
Cummins (CMI)	14	69
Kellogg Company (K)	15	69
Tiffany & Co. (TIF)	16	69
Oshkosh Corp. (OSK)	17	69
United Parcel Service (UPS)	18	69
Colgate-Palmolive Company (CL)	19	69
Lam Research (LRCX)	20	69

ESG

The Sustainable 75

The Barron's survey offered an insightful, but largely equity focused, review of the 100 most sustainable public U.S. companies. Importantly, like their equity counterparts, fixed income investors are also looking to identify those organizations that are improving their long-term credit fundamentals through better ESG management polices and execution. We believe this in turn leads to better credit rating assessments, lower borrowing costs, and greater financial stability for investors. To fill this important research gap, Sage evaluated the same companies represented within the Barron's 100 survey to see how they stacked up from a credit perspective and to identify their relative placement within this well-regarded ESG grouping.

We observed that 75 of the companies listed in the Barron's 100 survey were rated by two or more of the leading U.S. credit rating agencies (i.e., Moody's, S&P, or Fitch). We reviewed the environmental, social, and governance scores achieved by each company rated by two or more of the credit rating agencies using Sage's internal sustainability scoring framework to arrive at an overall ESG score and percentile ranking for each organization. Like the Calvert process, our scoring system is based upon the assessment of financially material ESG data and key industry metrics to assess the relative strength of an organization's intentional and inherent sustainability. Collectively, the companies that were represented in this group had more than $1,038 billion of outstanding public debt at the end of 2018. This was not a trivial amount since it represented about 13% of the $8 trillion in outstanding U.S. investment grade debt at year-end.

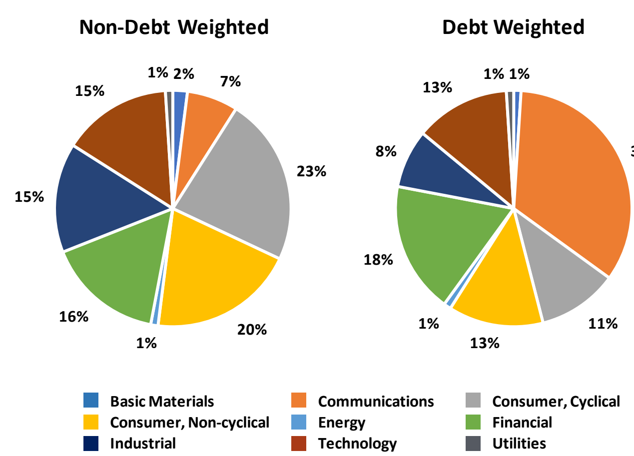
Like the Barron's 100 survey, the average scores for the Sustainable 75 universe were attractive. The average credit rating was in the high Baa/BBB+ range, the total ESG score reached was 65.45 out of 100, the percentile rankings were near the 70% mark, and the average controversy score was a low 1.99 on a scale of 5. However, as shown in the table, there were some distinct differences in the marks achieved between the top and bottom 10 companies within the Sustainable 75 universe. The differences in the quality of the credit ratings and strength of the ESG scores were significant across categories and much wider than the ranges identified in the Calvert equity research cited in the Barron's 100 article.

	Sustainable 75	Top 10 Cos.	Bottom 10 Cos.
Moody's Rating	Baa1	A3	Baa2
S&P Rating	BBB+	A-	BBB
ESG Score	65.45	77.73	52.78
ESG % Rank	69.97	93.68	33.33
E Score	68.12	83.23	48.58
S Score	63.23	77.08	54.32
G Score	65.81	77.15	56.98
Controversy Score	1.99	1.90	1.90

Balancing ESG Optimization with Debt-Weighted Market Realities

The Baron's 100 survey was not market cap weighted, with each company individually assessed based upon the merits of its ESG scores. In the Sustainable 75 survey we took the same approach but also evaluated the universe based on each company's relative amount of debt outstanding to gauge the concentration levels of corporate public debt available to investors from these sustainability leaders. Our distribution analysis revealed that 89% of the companies in the Sustainable 75 universe were largely concentrated in five sectors: consumer cyclicals (23%), consumer non-cyclicals (20%), financials (16%), industrials (15%), and technology (15%). However, as shown below, when adjusted for debt outstanding the sector distributions shifted significantly. The overall weighting of these five sectors dropped to 63% of the total universe with a notable five-fold increase to 34% for the communications sector along with considerable declines in the consumer cyclical and non-cyclical sectors' percentage shares.

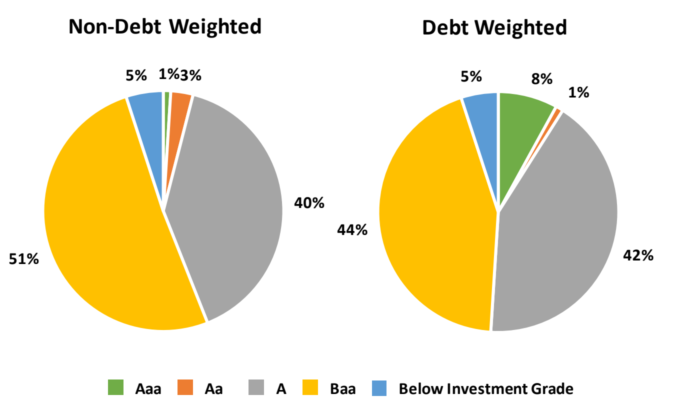
Industry Sectors



These adjustments are important to consider because the amount of issuance and availability of ESG-qualified investment grade corporate debt can place significant constraints on an investor's portfolio construction and diversification efforts. Unlike the equity markets, the amount and availability of a company's debt is an important risk factor to consider when building a well-diversified and sustainably optimized fixed income portfolio.

Our review of the present credit ratings for the Sustainable 75 found that while the universe attained an average Baa1/BBB+ status, there were some notable shifts in the rating quality distributions of the universe when evaluated on a debt-weighted basis. For example, 44% of the universe was rated within the AAA to A categories on a non-debt weighted basis; but when each company's respective amount of debt was considered, this distribution shifted. When viewed on a debt-weighted basis the average rating was and A3 and the percentage in the AAA to A rating categories jumped to a 51% share of the universe. This suggests that for the Sustainable 75 there is some alignment between the quality of a company's credit ratings and the strength of its ESG score profile.

Rating Quality



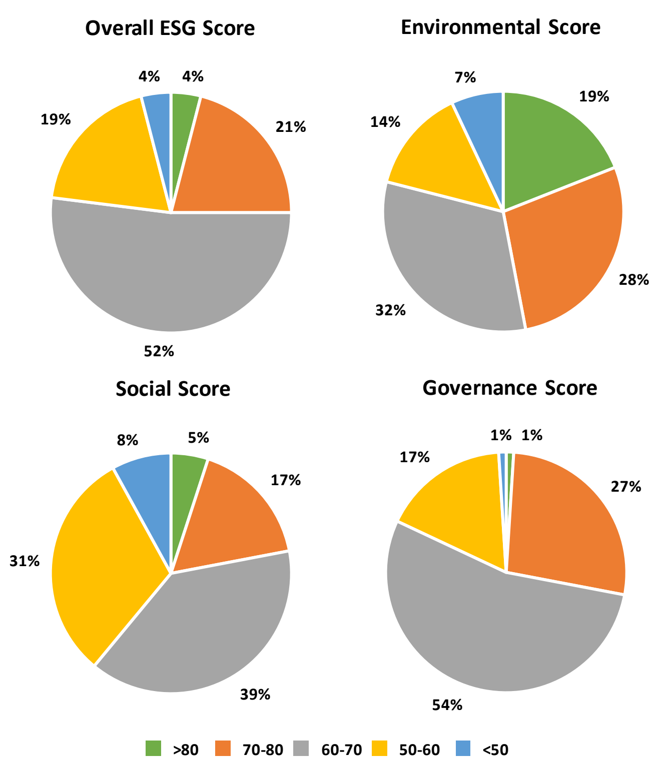
ESG Score Distributions: How They Measured Up

The companies within the Sustainable 75 had much in common when it came to their respective environmental, social, governance, and controversy scores. They generally had strong scores for environmental factors, with 47% scoring above 70 on a scale of 100, and 19% of the group reaching scores that exceeded 80. On social factors, 61% of the group was comfortably above average, but only 5% received scores north of the 80 mark. We also note that the group's governance scores were exceptionally strong, with 82% of the companies receiving score assessments of 60 and higher.

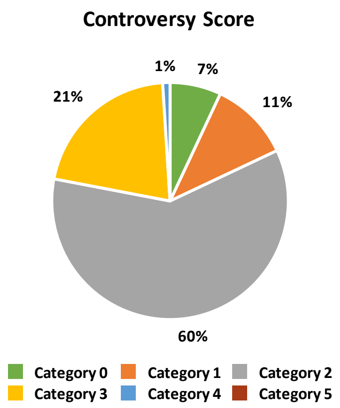
There is an abundance of academic research and industry evidence that supports and demonstrates the link between a variety of material ESG factors and the long-term financial performance of companies. However, most of the empirical evidence on sustainability factor assessment suggests that the strength and maintenance of the "G" component of ESG is the dominant force behind better corporate returns and outcomes for all stakeholders.

Good governance can be identified by evaluating corporate management structures, codes of conduct, internal reporting requirements, external community communications, governmental policy influence efforts, executive compensation methods, and management ownership interests. These efforts also extend to assessing supply chain management policies and oversight, as well as management's risk and crisis management preparedness capabilities.

ESG Scores for The Sustainable 75



Lastly, good governace can be observed in a company's efforts to measure the impact and outcomes of their respective programs for social needs and stakeholder relationship management efforts as part of their brand and reputational management. The benefit of these initiatives is indeed measurable through metrics such as a company's controversy score.



The controversy score reflects the frequency and severity of ESG news reports, such as dubious social behavior and consumer product-harm scandals, that could place a firm under the media spotlight and, by extension, induce adverse investor and credit rating agency attention. These forms of controversial reports often raise doubts about a company's future operating prospects, can constitute a risk for the corporation's reputation, and may have a measurable impact on the company's financial value. A review of the controversy scores shows that 78% of the Sustainable 75 had scores at 2 or below (on a scale of 0 to 5). In our view, these low scores were a compliment to the strength of the group's governance metrics and superior scores.

Final Thoughts

At Sage, we have long recognized that ESG factor scores are important measures for assessing company valuations, risk management, and even regulatory compliance. These scores do not necessarily reflect judgments about whether an entity has positive or negative ESG practices, but rather disclose and illustrate how material environmental, social and/or governance issues specific to a company may influence its current and future credit rating. This is supported by both Moody's and S&P Global Ratings, which have provided clear guidance on the importance and pivotal nature of ESG factor assessment within their respective credit assessment processes.

"ESG considerations are part of the holistic assessment of credit risk that we undertake for a rated entity. They are an important element in our assessment of an entity's creditworthiness where they represent a material credit risk."

- Moody's Investors Service[2]

"Since all rated entities operate in the natural and social worlds, we regard these risks as ubiquitous across the ratings spectrum…managing environmental and social risk is included in the business and financial risk profile assessment for corporate ratings, as applicable and when environmental and social risks are ratings significant."

- S&P Global Ratings[3]

The companies within the Sustainable 75 are largely sustainability leaders within their respective industries, and our ESG score assessments, like those of Calvert Research and Management, are testament to that. We also recognize that while strong ESG score assessments are important to the long-term financial strength of an organization, they do not necessarily guarantee superior credit ratings and fixed income market assessments. However, what they do provide to us, and hopefully to investors in general, is confidence in the commitment of these companies to sustainability leadership practices that will help mitigate future investment risk for long-term fixed income investors.

Sources:

[1] *The 100 Most Sustainable Companies, Barron's, Feb. 11, 2019; pg. 19*

[2] *Environmental, Social, and Governance Risks — Global: Moody's Approach to Assessing ESG Risks in Ratings and Research, Sept. 8, 2015*

[3] *ESG Risks in Corporate Credit Ratings — An Overview, S&P Global Ratings, Nov. 16, 2015*

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Sustainable 75	Industry Sector	Moody's Rating	S&P Rating	Total ESG Score	ESG % Ranking	E Score	S Score	G Score	Controversy Level
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	AVERAGE	Baa1	BBB+	65.51	70.16	68.19	63.24	65.87	2.00

ESG