

## **Financial Wonks Meet Treehuggers: New Tool Places Valuation on Corporate Sustainability**

SocialFunds.com, 14 February 2006 - Financial geeks and environmental and social activists alike will love the middle section of the [report](#) accompanying the launch of [sdEffect](#), a new Pilot Analytical Framework that translates corporate sustainable development (SD) practices into financial valuation. This section includes lots of numbers and percentages and acronyms for financial analysis techniques, including ratio analysis (such as price to earnings, or P/E), discounted cash flow (DCF), rules of thumb valuation, economic value added (EVA), and option pricing. It also includes terms rarely if ever seen on financial analysts' spreadsheets, such as greenhouse gas (GHG) emission reductions, diversion of non-hazardous waste from landfills, respect for Aboriginal peoples/First Nations, and awards for environmental reporting.

While socially responsible investing (SRI) and corporate social responsibility (CSR) have long been integrating SD considerations philosophically and in practice, the sdEffect marks the inaugural effort to "show direct causal links between SD and financial factors."

"In the world of financial analytics, there is no better measure than impact to the bottom line," writes Don Reed, president and CEO of Franklin Templeton Investments in the report's Foreword. "The challenge is how to translate the concept of sustainable development to the bottom line performance of a company."

"The report provides the first steps in using financial language to measure the impact of sustainable development on the bottom line," he adds.

Ron Yachnin, principal of Yachnin & Associates and one of report's authors, confirms the seminal nature of the framework.

"As far as we know, this is entirely new," Mr. Yachnin told SocialFunds.com, though he acknowledges that firms such as Goldman Sachs (GS), Citigroup (C), Merrill Lynch (MER), and Generation Investment Management have been integrating SD factors into their financial analysis. "It's hard to know what financial analysts at Goldman Sachs are doing behind closed doors, but we suspect they are not doing this."

The sdEffect framework makes public its analytical techniques, so that mainstream financial analysts can finally quantify the financial implications of issues they previously ignored because they considered them "soft" or did not understand how to value them.

"Financial audiences often are unfamiliar with the environmental and social language of SD, but they are extremely adept at assimilating information when it is expressed in terms of revenue growth or free cash flow (magnitude of cash flows, timing of cash flows, risk of cash flows)," states Mr. Yachnin and co-authors in the report.

The report focuses on five Canadian mining companies--Alcan (ticker: AL), INCO (N), Falconbridge (FAL), Placer Dome (PDG), and Teck Cominco (TEK-MVA.TO)--in part to limit scope to one sector, and in part because all five have produced recent sustainability reports. The report notes the challenges of extracting sufficient data even from these reports.

"It was a surprise finding that the data in the sustainability reports isn't predisposed to dealing with quantitative analysis," said Mr. Yachnin, who estimates that only about 10 percent of the information in sustainability reports can be translated into financial valuation. "What we found in looking at these sustainability reports is that they are very descriptive about what companies are doing, but when it comes to providing information about how sustainable development initiatives add value to their businesses, they stop short."

Despite the small amount of quantitative data, sdEffect methodology still yielded seemingly significant results. For example, the report uses discounted cash flow as well as price-to-cash-flow-per-share (P/CFPS) valuations to determine that Falconbridge's GHG emissions reductions (six percent energy consumption reduction per unit of output) results in increases per share value of \$1.62 to \$2.44.

Labeling the framework "pilot" acknowledges the early stages of development, and the report maps out next steps and recommendations.

"To facilitate the identification of additive value and translation into financial valuation, it is therefore recommended that companies report key SD metrics and related valuation information in a single summary table; preferably appearing early in related reports and communications," states the report. "Two main types of additional investigation are required to advance

this field over the immediate term [including] 1) conducting comparable analyses for other sectors and additional metrics, and 2) working with companies to apply the framework."

"We have already had a number of expressions of interest to join the initiative including from an multilateral organization, a major mining company and a Canadian based bank," said Mr. Yachnin.

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