



## How will Climate Change and Carbon affect your organisation's value?

Climate change refers to the effects of the weather and greenhouse gas (GHG) emissions on global warming.

Carbon is often used as the shorthand notation for the issue – currently carbon is the base measure which is effectively traded in the European system. The other greenhouse gases are converted to carbon equivalent units, depending on their global warming potential.

For some, this carbon “thing” may seem esoteric. For others it may seem that it is a bubble of interest and if we close our eyes it will all pass over. Unfortunately no. Climate change, greenhouse gas emissions and related regulations will have profound implications for almost all businesses (even though, at least initially, the mandatory auditing requirements are restricted to large emitters – over 125,000 tonnes of carbon dioxide equivalent).

On 15 December 2008 the Federal Government released the White Paper on CPRS (Carbon Pollution Reduction Scheme). The National Greenhouse and Energy Reporting Act 2007 (Cth) (NGER Act) provides a national framework for the reporting and audit of information related to GHG emissions, energy consumption and energy production.

Irrespective of what may occur in the regulatory regime in Australia, there are urgent needs to address the impact of climate change from a strategic viewpoint. The potential value effects are very significant.

The Carbon Trust, in its publication *Climate Change – A Business Revolution?* states

***“tackling climate change could create opportunities for a company to increase its value by up to 80% if it is well positioned and proactive. Conversely, it could threaten up to 65% of value if the company is poorly positioned or a laggard.”***

### Level of Carbon Emissions

A GHG audit separates emissions into 3 levels:

**Scope 1**– emissions over which a company has direct control via ownership of activities

**Scope 2** – purchase of electricity, heat or steam

**Scope 3** – indirect emissions from activities or services purchased from other third parties and indirect emissions associated with Scope 1 and 2 emissions.

The assessment of future effects is not that simple and requires review. There is a need to address the upstream and downstream effects of emissions.

There will be substantial value effects and if you are concerned about total shareholder return, you cannot ignore consideration of climate change and its impact on shareholder value. Whilst each company is different, there are some general schematics which can be applied and which every organisation should consider. They are as follows:

## ***Physical Impacts***

With increasing volatility of weather patterns, there is increasing risk. Australia has just experienced dramatic bushfires, floods and drought.

- If you are in insurance, is this being appropriately priced? How have the probabilities changed?
- If your business is in a flood prone area, what protective measures will you take?

## ***Customers and Stakeholders***

- Does it matter whether you are seen to be “green”?
- All things being equal, will your customers stay with you or will they prefer an organisation that is “greener”?
- How green do you need to appear to be? Where does the marginal cost equal the marginal benefit?
- How will your investors react?

## ***Regulatory Regime***

There are costs associated with any regulatory regime.

- Should you be working with governments and regulators to influence how and when regulations are introduced?
- What system do you have in place to comply with regulations?
- How quickly and easily can they be updated?
- Do you know what they are and how they are being handled within your organisation?
- Are you able to benefit from regulation; if so, have the appropriate steps been taken?

## ***The Price of Carbon Abatement***

The price of carbon has varied dramatically over the last 9 months and, whilst no-one has a crystal ball; it is difficult to see, once the global financial crisis abates, that the price of carbon will not begin to rise again. Thus any potential apparent honeymoon on price may be short-lived.

- Is the cost of abatement (in your organisation) greater or less than the price of purchasing credits in lieu of abatement?
- Strategically, will you abate or purchase? Or does it depend on the price point? In which case, what is your hedging strategy?
- If you do purchase rather than abate, what credit do you buy? Do you buy a cheap credit to simply offset or do you buy a gourmet credit that has other co-benefits associated with it?

### **Secondary Effects**

- With whom do you do business and what are their carbon footprints and to what extent will they try to, and be able to, pass on their carbon cost to you?

### **Pass Through Costs**

- First, can you identify specifically the cost of greenhouse gases/carbon for your organisation?
- Secondly, will you be able to pass these on? To what degree? And how?
- To what extent will there be an effective tax on your organisation's activities?

### **Competitor Reaction**

Business does not take place in a vacuum. There are competitors and they will react.

- How can you make an opportunity out of a potential problem?
- How big is first mover advantage?
- Will you be like a car manufacturer that will move into new hybrid cars to take advantage of potential future consumer demand? Or if packaging is a large part of your costs, can you switch the type and nature of packaging? Or modes of distribution?

The critical issue is to realise that there will be significant value effects as a result of climate change and the introduction of regulations by whatever system. Ignoring this is not an option unless you want to suffer a significant detrimental competitive disadvantage.

### **Value Effects**

One could argue that if all companies are affected to the same degree and if there is no specific allowance made to future cash flows as a result of changes and if the cost of equity is the same and investors make no distinction, that it remains a level playing field and thus nothing needs to be done. However, there are so many ifs in that previous statement that it will not happen.

Even if the world was to collude and agree not to do anything, simple game theory analysis shows breaking the collusion would be too profitable to resist. There will be changes. There will be competitive advantages and disadvantages. There will be differences. Therefore, you cannot ignore it.

## Next Steps

Review your corporate strategy, considering how climate change will affect you from a physical viewpoint, and then work through the regulatory and competitive framework. Relegate the carbon abatement or purchase issue to lower down the list – consider the strategic issues first.

There will be long term shareholder value effects. The valuation profession in Australia is just beginning to address these issues.

There will also be a need for education and involvement of customers and stakeholders.

**To discuss your valuation effects through climate change and carbon, contact Tim Lebbon on 08 8385 2200, [tlebbon@leadenhall.com.au](mailto:tlebbon@leadenhall.com.au)**

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