Korea ESG Performance 2010

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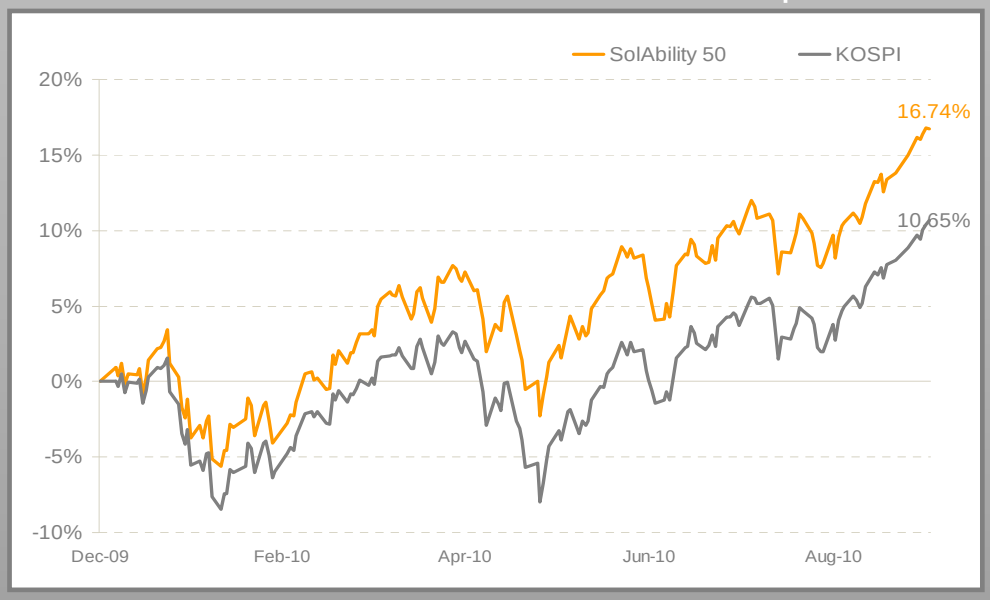
SOLABILITY
Sustainability Advice

Why Sustainable Investment?

Performance of Korea's 50 most sustainable companies vs. KOSPI



01/2010-10/2010: **7% outperformance** against the KOSPI

01/2006-10/2010: **72% outperformance** against the KOSPI

Its' the PERFORMANCE, stupid!

Andy Gebhardt
Chief Executive Officer

Dear reader,

A lot of water has gone down the Han River since SolAbility's first corporate sustainability assessment of Korean corporations back in 2007 – but not only water. Following the global financial/economic crisis and the Korean government's subsequent declaration of "green growth" in 2009 - albeit the "green" is subject to controversial discussions - we have seen remarkable changes in the corporate perception of "sustainability" and as a consequence, integration in corporate policies and management systems in a large number of corporations. The changing environment has also resulted in a sharply increasing number of sustainability publications and reports, making ESG research both more interesting and challenging at the same time, requiring analytical focus on key industry challenges and opportunities in order to identify outstanding sustainable value.

The results of SolAbility's 4th ESG assessment shows that the value of sustainable companies outperforms the market, both short- and long term, by significant margins. The performance of a portfolio of leading Korean sustainability companies also outperforms sustainability benchmarks such as the KRX SRI and the DJSI Korea. While we are naturally proud of outperforming such prestigious benchmarks, the failure of the globally most recognized sustainability benchmark - indicating that Dow Jones is not allocating sufficient resources to adapting its methodology to the development in corporate sustainability - is of concern in the wider context of further advancing corporate sustainability and sustainable investment. The results of SolAbility's ESG research is proof that the identification of sustainable value is possible.

While the changes observed - particularly since 2009 - are remarkable, only a few company have completely integrated long-term sustainability thinking into strategic decision-making and business development frameworks. It is also necessary to keep in mind that the average corporate sustainability level until that point was considerably below OECD level. In addition, Koreas' economy is more energy-intensive than OECD average, requiring further and stronger efforts to improve resource efficiency to maintain competitiveness in light of the nation's reliance on energy imports and the looming prospect of rising energy costs. However, if the current trends of integrating sustainability management is to continue, Korean corporations enjoy a decent perspective to secure long-term competitiveness.

Yours sincerely,

SolAbility is a consultancy specialising in sustainability management advice, founded in 2005. Internationally know clients are trusting in SolAbility's competence.

As a UN PRI signatory, SolAbility also performs ESG research & assessment on over 350 listed Korean companies and provides ESG research to institutional investors

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2010 Highlights

SolAbility 4th Korea sustainability assessment, based on an initial universe of 350 companies, reveals the financial bottom-line benefits of integrated long-term sustainable management thinking

Sustainable companies & portfolios outperform

Sustainable companies outperform

SolAbility's yearly sustainability assessment clearly shows that sustainable companies have a significant better financial performance than less sustainable companies - both short-term and long term – and proofs that inclusion of sustainability long-term management yields financial bottom line benefits.

3 clients selected to the DJSI World

Three companies, for which SolAbility has designed sustainability policies, management systems and implementation strategy were selected to the DJSI World - the most prestigious sustainability benchmark around the globe.

Methodology

Characteristics

Purpose : Identification of sustainable value
Best-practice based, adapted for Korean characteristics
Universe : 350 Korean companies (KOSPI and KOSDAQ)

SolAbility's ESG methodology

- Identification of key sustainability challenges/opportunities for each industry sector
- Strength/weakness analysis of global sustainability benchmarks (DJSI, FTS4Good, GRI, UN PRI, Global Compact, etc.)
- Adaption to the characteristics and corporate culture of the Korean economy
- Strict analysis scheme and calculation of weightings based on bottom-line (financial) implications in each industry
- Taking into account company size
- Yearly reviewed and refined based on experiences, feedback, and new emerging trends
- Analyst expertise

Methodology

Tools

Systematic, IT-based assessment tools
Solving the puzzle: wide range of information sources
Unique experience

Assessment Processes

The SolAbility ESG assessment consists the application of three tools:

1. **Sustainability filter** : screening large number of companies according key sustainability indicators to eliminate laggards for in-depth Assessment phase.
2. **ESG Assessment tool** : analyzing and evaluating sustainability performance based on industry-specific sustainability indicators
3. **Verification** : investigation of company cases related to sustainability performance through media surveys and government documents

Information sources

SolAbility acquires a wide range of information through a variety of channels such as public announcements, websites, annual reports, sustainability reports, questionnaires, lawsuit records, stakeholder participation issues, media research, etc.

ESG portfolio performance

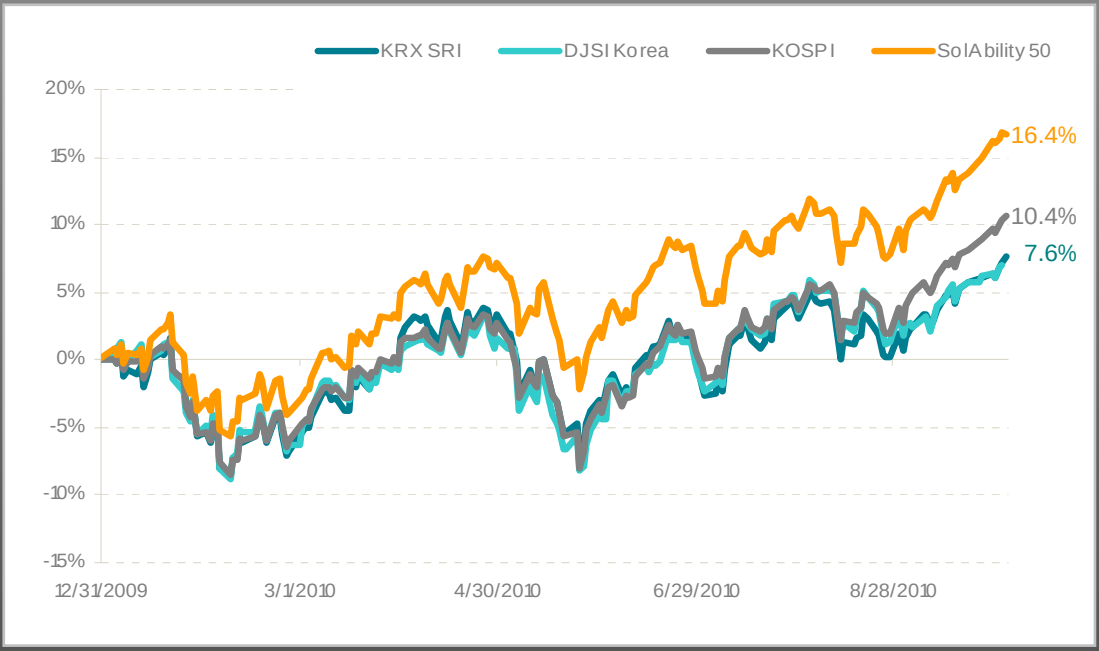
Short-term

Starting universe:350 stocks

The leading 50 Korean companies of the starting universe show a significant outperformance vs. the Korea Stock Performance Index

Short-term return of sustainable companies

A portfolio of the 50 most sustainable companies (market-cap weighted) achieved a return of 16.74% from January 2010 to early October 2010. For the same period, the KOSPI gained 10.65%, while KRX and DJSI Korea gained roughly 8%.



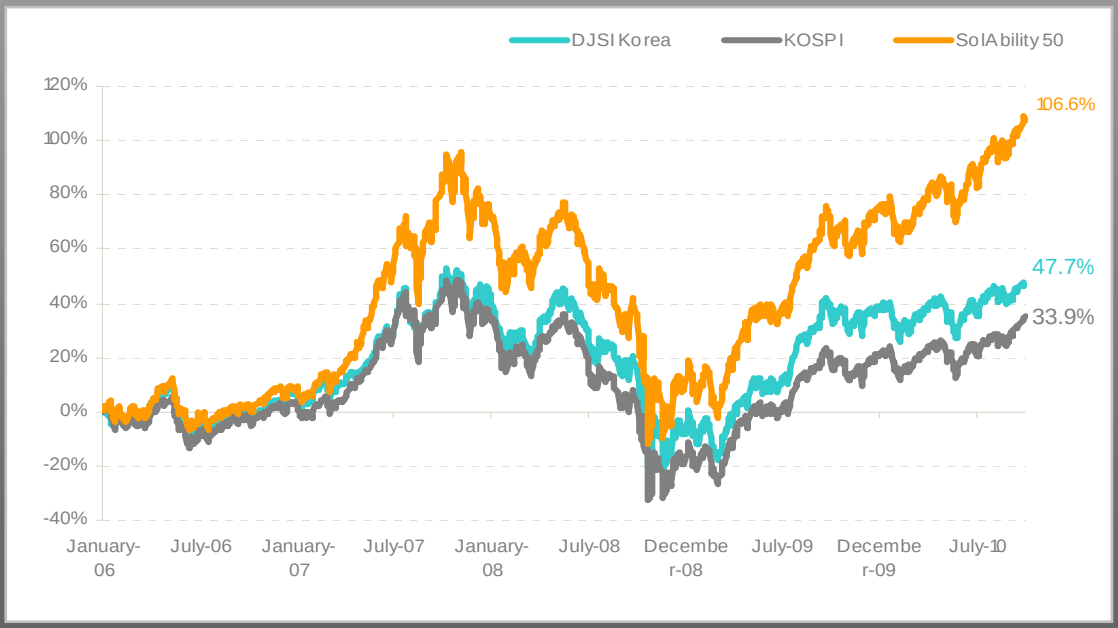
Data Sources: KRX, Dow Jones

ESG portfolio performance

Long-term

Long-term return of sustainable companies

Sustainable companies equally achieved high returns in the long-term. The SolAbility 50 portfolio gained 107% over 5 years (01/2006-10/2010), over three times higher than the Korea Stock Exchange Index (KOSPI), which gained 35%.



Data Sources: KRX, Dow Jones

Due to its global brand name and recognition, both the investment industry and corporate managers observe the performance and composition of globally recognized benchmarks. In this context, the failure to identify outstanding sustainable value of the global benchmark is of concern and an obstacle to further advance of corporate sustainability and sustainable investment.

The SolAbility assessment proofs that sustainable value can be identified.

Corporate Sustainability Performance

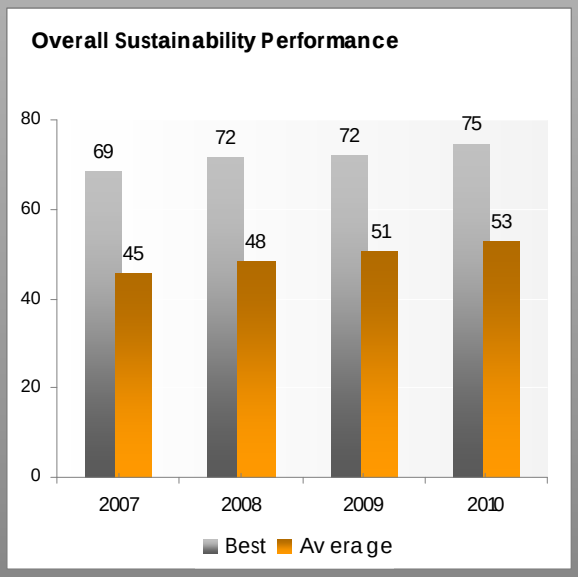
Developments

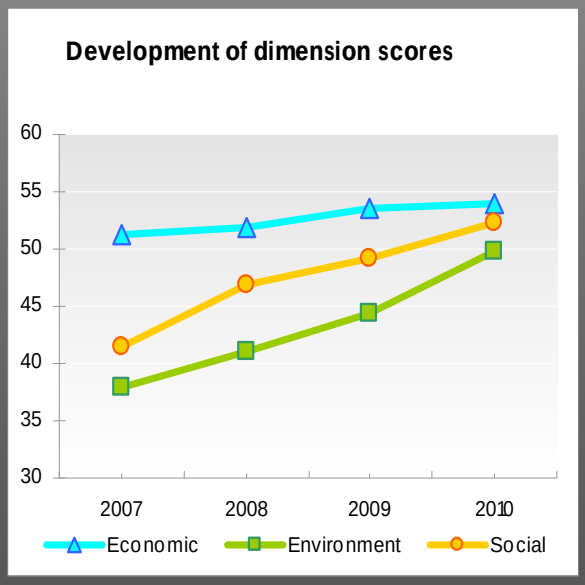
- The overall sustainability level of Korean companies is improving every year. However, top-performing companies advance faster than the average, implying that high-performing companies have further strengthened their sustainability level while a considerable number of companies are still reluctant to fully integrate sustainability management beyond compliance as a strategic management framework.

- The level of environmental reporting has improved dramatically, while economic reporting has been stationary, and social reporting mostly remains limited to the areas of Human Resources Development and social contributions.

- Visible improvements in terms of sustainability performance are seen in the environmental and social sectors. The average environmental performance has improved by 12% compared to last year, and social performance by 6%. On the other hand, the economic performance has improved by only 1%, but remains the highest average performance.

- While a significant number of Korean corporations are now introducing sustainability management, the proportion of sustainably managed companies is still somewhat below OECD levels.

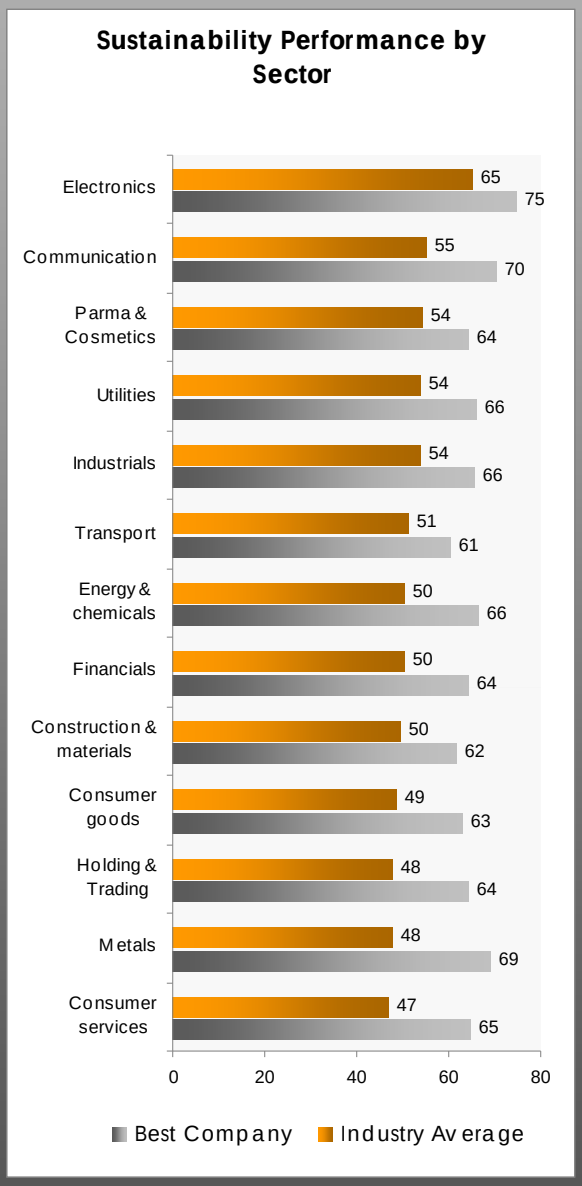




Corporate Sustainability Performance

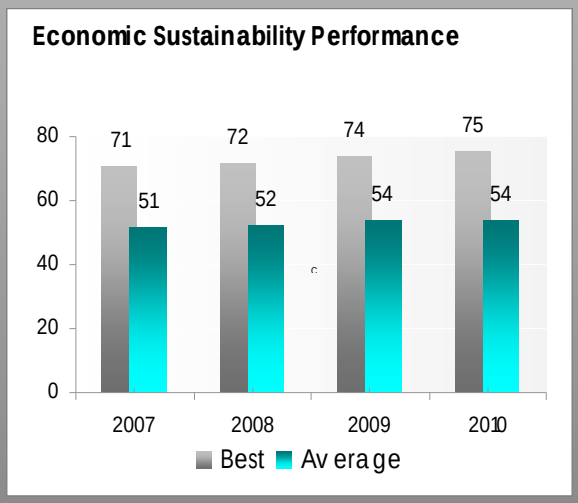
Sector trends

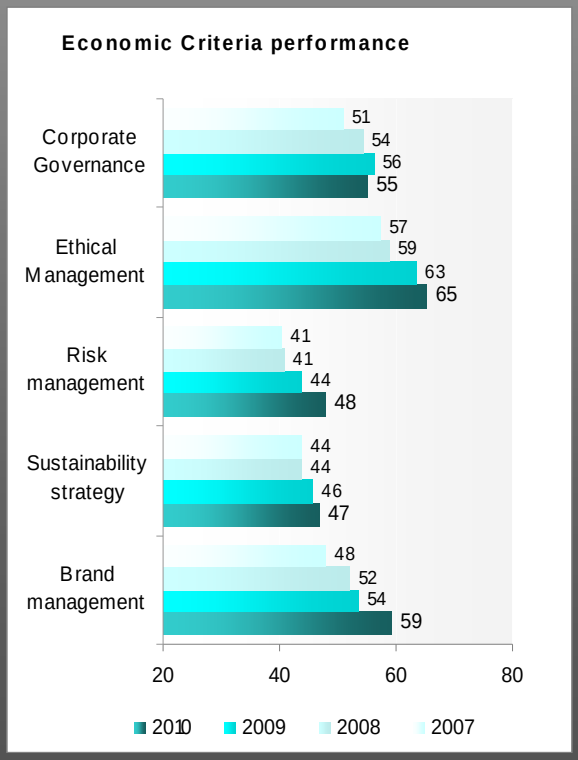
- SolAbility categorizes companies by 13 sectors (composed of 29 industries, according the main business line) to allow for sector comparisons.
- The industry scores of Electronic companies are outstanding compared to other industries. The score gap between Industry Best and Industry Average has also narrowed.
- The most year-on-year improved industry is the Construction & Construction Materials sector, with the performance improved by 8.5% compared to last year.
- On the other hand, industries such as Holdings & Trading, Steel & Metal, Media, Leisure & Services are characterized with low sustainability levels compared to other industries, improved by only 1.4% from last year's score.
- For Steel/Metal industries, there is a large score gap between Industry Best and Industry Average, reflecting the phenomena that leading companies have been consistently improving their performances while the companies not or less exposed to global markets are not actively involved in sustainability management.



Management & Governance Developments

- The sustainability level of the economic criteria has not shown any significant changes, with a minor improvement of 1.53% compared to 2009 last year's performance.
- The corporate governance score remained at 2009 level, with the know weaknesses of Chaebol board structure in terms of professionalism, independence board effectiveness still witnessed today. Transparency has weakened due to the deregulation of corporate disclosure requirements.
- The majority of companies have established ethical management system and reinforced monitoring, but the number of non-compliances reported such as price fixing practice has not dropped.
- Risk management performance has improved, reflecting company's efforts to better predict future risks and turn them into business opportunities. Nevertheless, domestic company's risk management is still below global level.
- Korean companies have steadily improved in the areas of R&D, brand management, and innovation. However, there is still room for improvement in the areas of integrating sustainability management strategy in management thinking.

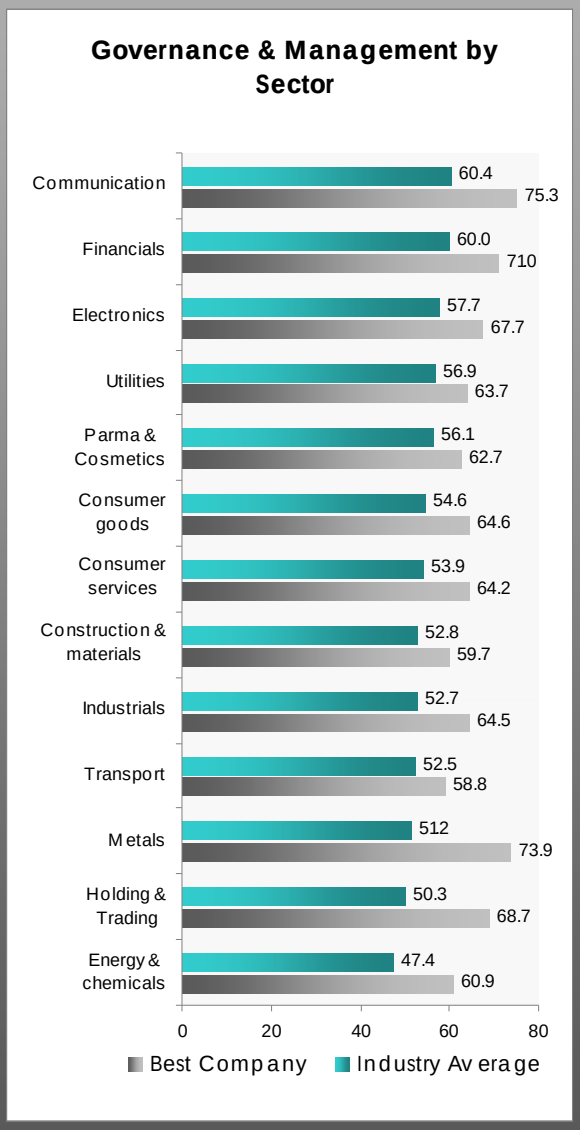




Management & Governance

Sector trends

- Communication, financial, and electronic industries are associated with high sustainability level compared with other industries.
- The industries with the greatest improvement are Food & Beverages (+6.8%) and Construction/Materials (+6.3%). Particularly in the Construction & Materials industry, a significant number of companies have newly published sustainability reports.
- Even though the industry averages of Holdings& Trading and Steel & Metal have improved, the sustainability levels are still low compared to other industries.



Environmental Sustainability

Developments

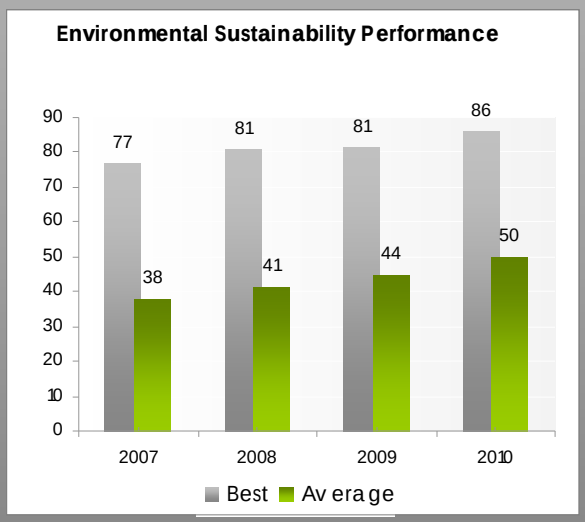
- Average environment performance showed the largest increase, rising by11.95% compared 2009, indicating that Korean companies have woken up to the challenge of global climate change and the prospect of high energy costs.

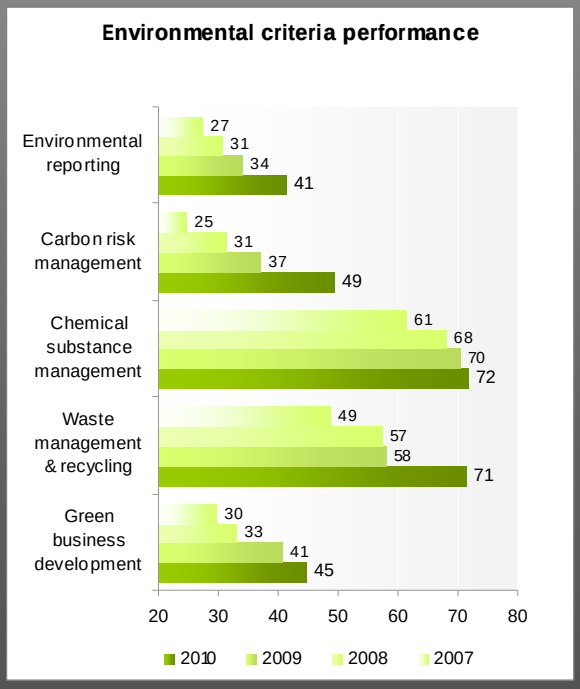
- Average environment reporting improved by 21.27% due to the increased number of companies disclosing environmental information.

- Carbon Risk Management increased by 32.41% due to efforts to improve energy efficiency and establishing GHG inventories.
  However, considering Koreas 97% reliance on energy imports and the energy intensity of the economy (considerable above OECD average), efforts undertaken so far are still highly insufficient to secure future competitiveness.

- Waste management improved by 23.11%. Adapting LCA, waste minimization in the production stage and recycling account for this development.

- Green business lines saw a surge of 10.15%, reflecting the fact that companies are starting to develop new business lines (products & services) related to clean-tech and green growth





Environmental Sustainability

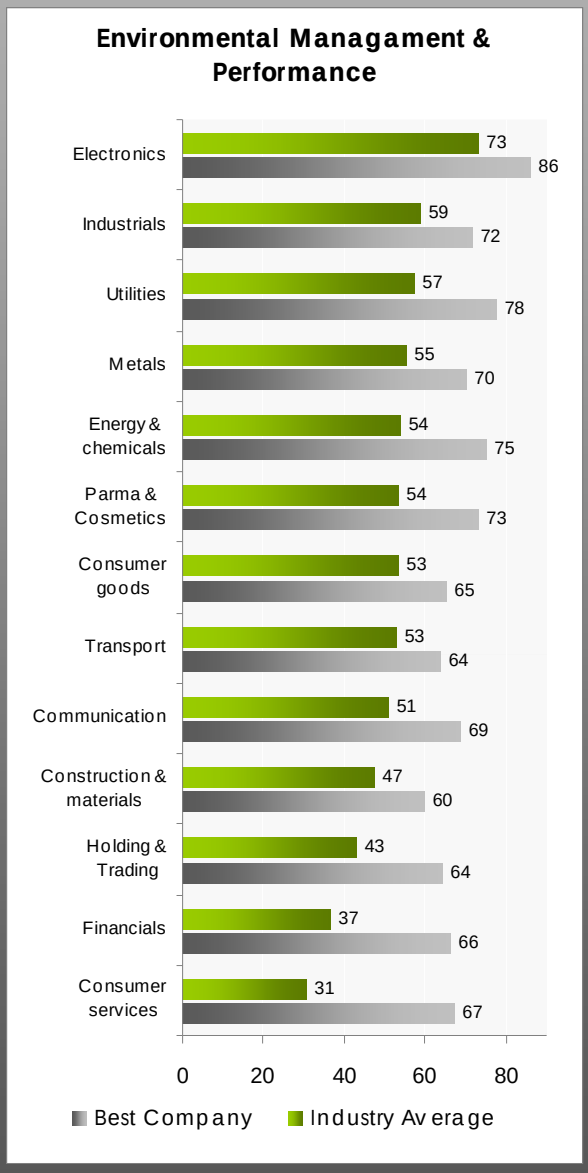
Sector trends

- The assessment reveals Significant differences between the different industry sectors in environmental sustainability performance. While some sectors improved by nearly 30% compared to 2009 levels, other sectors remain at the same level of previous years.

- High ranking sectors include Electronics, Industrials, Utilities (manufacturing industries and other industries subject to environmental regulation). The waste majority of Electronics, Industrial companies are pursuing environment management, and invest to reduce energy usage, green house gases, water usage and waste.

- The construction & materials (+31.7%) and Consumer goods industry (%28.7%) showed the highest progress rate year-on-year.

- The Pharmaceutical & Cosmetics industries and service providers improved only marginally. Within these sectors, only few companies implement environment management systems without regulatory requirements.



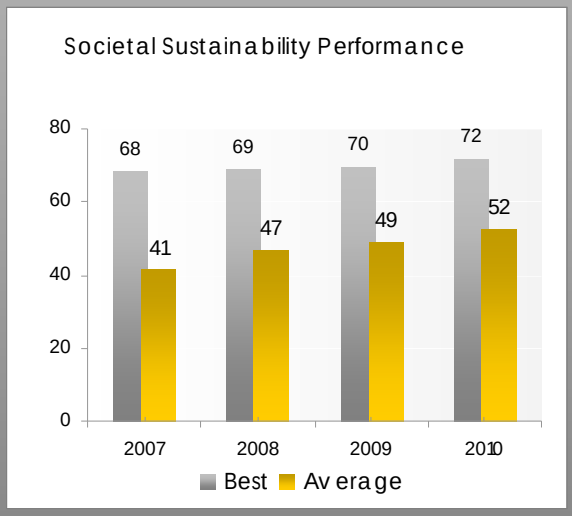
Human & Society
Developments

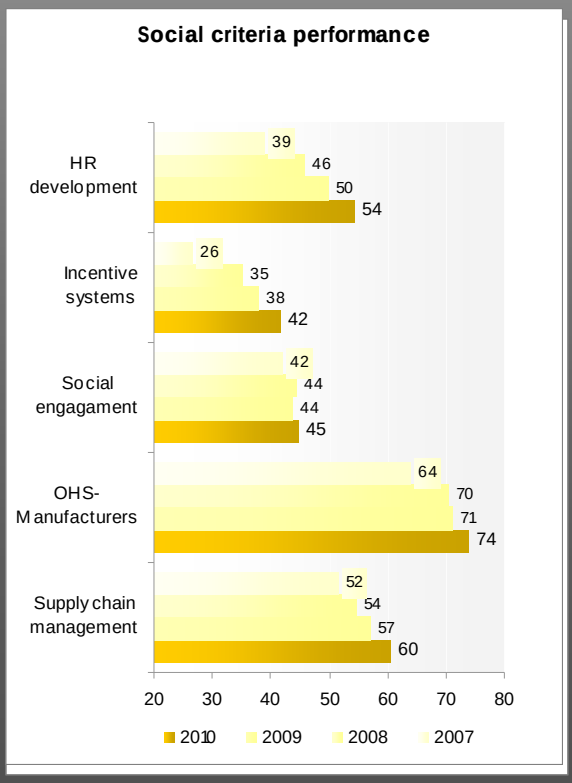
- With an increase of 6.3%, societal performance showed general improvements across all sectors, exhibiting a tendency of gradual improvement.

- HR development increased by 8.82% year on year. This indicates the corporate realization of the importance of HR management to improve global competitiveness by attracting and retaining the best staff and strengthening internal training.

- Social activities and contributions remain at a similar state compared to 2009. While social activity rates are generally increasing, companies may not have a formulated strategy for social activities and alignment of strategic corporate citizenship activities with core business capabilities

- Supply Chain Management and OHS management exhibit gradual development. In particular, the manufacturing sector has been emphasizing "win-win" and "together growth" as well as "green purchasing". However, supply chain management system at most companies are focused on domestic suppliers at this point in time and fail to recognize supply chain risks in less developed markets

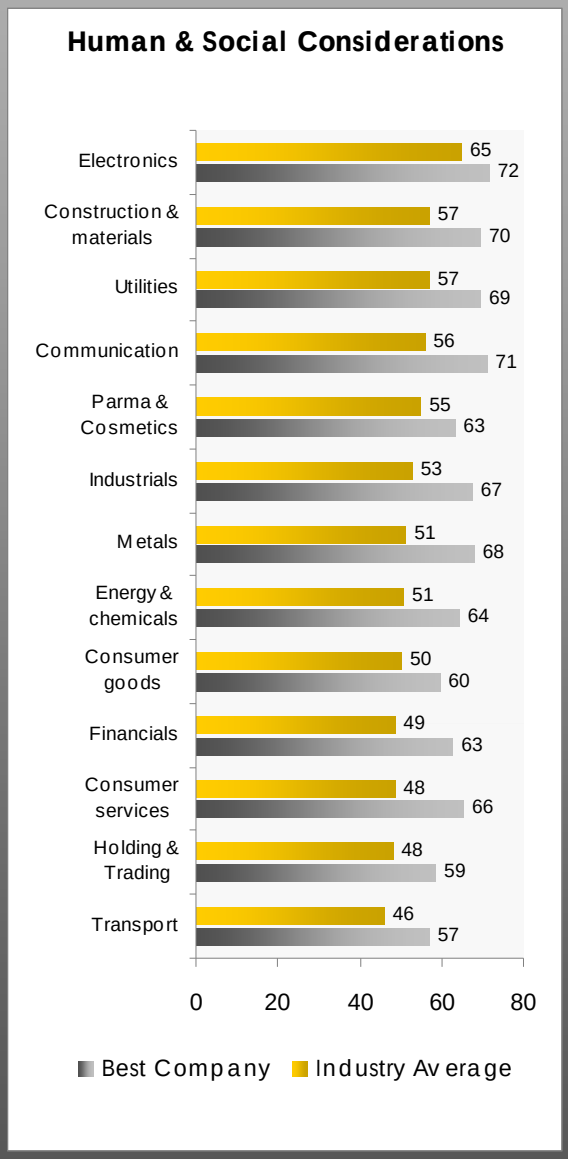




Human & Society

Sector trends

- Sustainability performance of Society criteria showed comparably equivalent progress amongst industry sectors due to improved management systems related to HR development and incentive systems.
- Again, the field is lead by Koreas most know export sector the electronics industry.
- Compared to 2009, significant improvement were made in the Steel & Metals (+16.4%), Utilities (+14.8%), and Industrials industries (+12.6%). This indicates that more and more companies make active efforts to improve OHS performance and Supply chain management
- Average Consumer Services and Holding & Trading performance remain at comparable low levels.



Conclusions

Corporate Sustainability

Increasing recognition of the business value of sustainability management
But – limited implementation in terms of strategic business development
Large differences between sectors, and within sectors

Increased recognition of sustainable management for business value

The increase In average ESG performance scores reflect the spread of interest and recognition for sustainability in Korea following the financial crisis 2008/2009 and the government's strategic focus on "green growth". The number of companies that have actively reviewed their management systems in light of sustainability integration has accelerated remarkably since 2009. Given that a large number of Korean companies are currently undergoing internal sustainability reviews, further rise of the average Korean sustainability performance is expected. Along with integration of sustainability considerations in policies and management systems, the number of companies disclosing sustainability performance and information has increased rapidly. However, while the developments have been encouraging, only few companies have formulated long-term strategies that integrate not only operational issues and considerations, but also strategic, long-term business development considerations based on sustainability trends.

Imbalance of sustainability levels amongst Industry sectors

Export-focused companies, namely in the manufacturing industry sectors such as electronics, automobiles, and ship-builders are leading Korean companies in terms of corporate-wide efforts to improve corporate sustainability level as a means of securing future competitiveness. In contrast, industry sectors focused on domestic demand such as finance and service sectors have been more reluctant in embracing sustainability management until recently.

Conclusions

Sustainable Performance

Sustainable companies outperform the market

Sustainability needs to be integrated further to secure long-term competitiveness

High sustainability performance equals high financial returns and stability

SolAbility's ESG assessment results proof that sustainable companies achieve significantly higher returns than the average investment over both short-term and long term periods. Despite the sharp fluctuations in the stock markets during 2009-2010, it is observed that the market value of sustainable companies was less elastic on the downturn compared to other companies. This observation strongly supports the claim that sustainability brings companies higher returns in times of prosperity and more stability in times of depression. Considering the growing uncertainty in the domestic an global economy, sustainability is now a MUST HAVE for a company's long-term business success.

Global sustainability benchmarks

While we are proud to outperform the global benchmark, the "SolAbility" brand carries only limited weight. In the wider context of advancing corporate sustainability and sustainable investment, it is paramount that the global benchmark is capable of identifying outstanding sustainable value. The current failure to do so is an indication of insufficient allocation of resources to adapt the research to the developments in corporate sustainability and needs to be addressed urgently.

Sustainability management as core management principle

Despite all the positive developments, sustainability management is still only partially recognised as a core management principle and strategic business development tool, and is not fully reflected in corporate culture. Korean companies need to consider sustainability issues from the highest decision-making levels in order to secure future competitiveness.

Korea ESG Performance 2010

Questions?

SolAbility Ltd.
802 Meritwin 856
Janghang, Ilsan, South Korea
Tel ++82 31 811 3578

contact@solability.com
www.solability.com

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