

JUNE 2024

ESG STOCKS - WHERE DOES TESLA STAND?

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INTRODUCTION

In April 2024, Tesla faced criticism about its status as an ESG stock. This is not the first time the issue has been raised. About two years ago, the company was taken off the S&P 500 ESG Index due to concerns about its working environment. However, before we assess Tesla's status in the stock market, we need to understand ESG stocks and how ESG investing works.

ESG Investing

As the effects of climate change become more real and impactful in our daily lives, individuals and companies have begun to prioritise environmental protection and sustainability. A key result of this shift is the creation of the ESG framework which stands for Environmental, Social and Governance. This tripartite concept invites companies to make decisions that showcase a strong value and appreciation for global sustainability.

The environmental component is quite straightforward. It requires companies to ensure that their decisions are good for the environment. This can be done through value chain decarbonisation initiatives or funding climate change adaptation or mitigation programmes in their countries of operation.

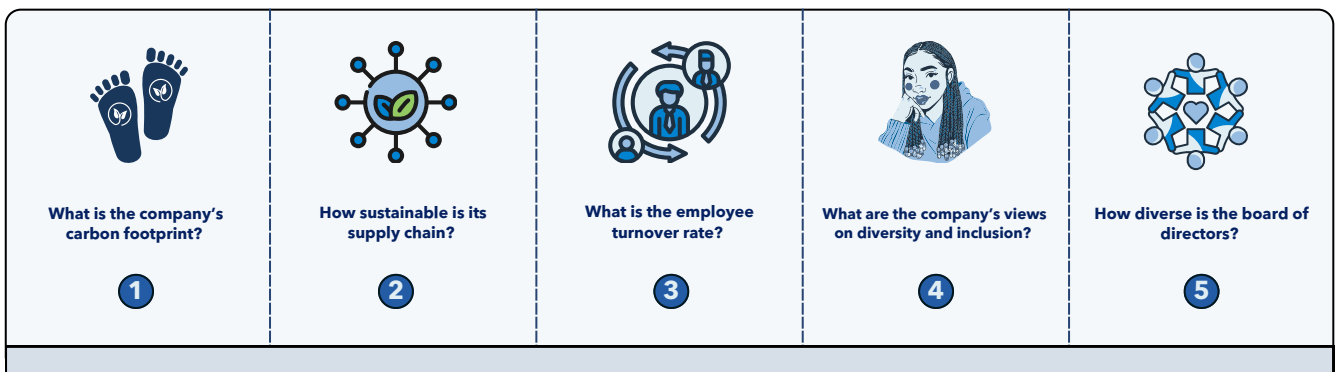
While the environmental component is focused on the planet, the social element is focused on people such as staff, customers and communities of operation. A company with a strong social framework ensures that staff are cared for and provided with the required benefits. It also ensures that people in their communities of operation are not disadvantaged by their work. For example, a water treatment facility that allows wastewater to pollute surrounding communities will have failed to meet the environmental and social components of the ESG framework.

The governance element is focused on decision-making, ensuring that management and the board make decisions through a sustainability lens, considering the environmental and social risks associated with their choices. This means that they should make decisions that benefit people and the planet, not just profit.

Typically, shareholders are the priority members of a company, but ESG invites us to consider operations beyond the lens of profit-making. It strives to ensure profits are complemented by a respect for safety and well-being. Maintaining the example of the water treatment facility, the violation described previously would also be a governance failure because management failed to provide or ensure adherence to appropriate waste disposal and management policies.

Companies such as Salesforce and Coca-Cola are leaders in ESG. Many investors today value this approach and participate in ESG investing whereby they invest in companies strongly willing to improve their performance in the three ESG areas. Some questions a potential ESG investor may ask during a due diligence process may include:

1. What is the company's carbon footprint?
2. How sustainable is its supply chain?
3. What is the employee turnover rate?
4. What are the company's views on diversity and inclusion?
5. How diverse is the board of directors?



Apart from the fact that supporting companies with ESG frameworks is good for the environment and well-being, an ESG framework also strengthens corporate governance. Companies that work hard to implement and maintain a strong ESG approach are likely to be well-run. Furthermore, ESG assessments allow investors to assess a company's environmental, social or governance risks in the short, medium and long term, all of which have financial implications and may affect profitability. Finally, through ESG investing, people can align their investment choices with their personal interests.

02 Identifying ESG Companies/Stocks

A number of research firms rate companies using different metrics to determine their ESG performance. Existing research firms such as Bloomberg and S&P Global typically provide ratings from between 1 and 100 with 100 being the highest score. A good ESG rating is somewhere between 60 to 100. These ratings are usually based on publicly available information and company disclosures. However, there may be extensive engagements with the companies in some cases. By looking at these datasets, investors can conduct some due diligence and determine whether to invest in a company and how much to invest.

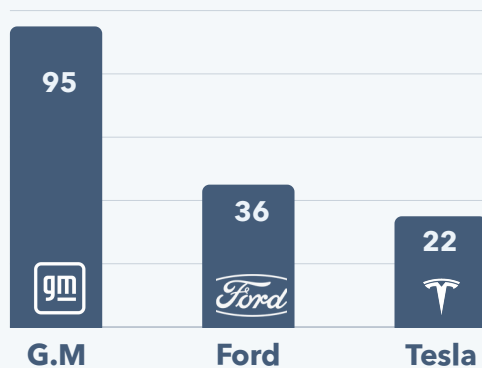
Additionally, an investor may choose not to invest in individual stocks and aim for ESG funds instead, bypassing the stress of looking for individual stocks.

Now that the terminology is clear, let us consider the debate about Tesla's eligibility as an ESG stock.

The Debate on Tesla's ESG Status

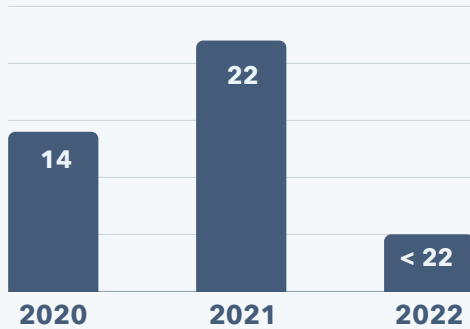
In May 2022, Tesla was removed from the Standard and Poor's 500 (S&P 500) ESG Index. The S&P 500 is a stock market index which tracks the stock performance of 500 of the largest publicly traded companies in the United States including Apple, Microsoft and Amazon. Its ESG Index which started in 2019 tracks the stock performance of companies with high ESG scores, effectively highlighting companies that investors should favour.

ESG Scores Tesla vs Industry Peers



It is updated annually, and some companies are removed from the list. In 2022, Tesla was one of such companies along with Berkshire Hathaway and Johnson & Johnson that were removed due to having lower ESG scores than other companies in their respective industries globally.

Historical ESG Scores - Tesla

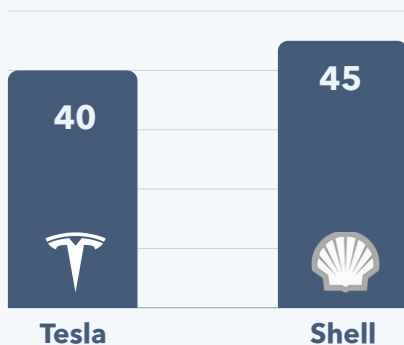


While Tesla's score was not disclosed, it was mentioned that the company did not achieve as high a score as in the previous year. This was particularly concerning because, unlike other companies on the ESG Index such as Meta, Microsoft or Apple, Tesla claims that its focus is "accelerating the world's transition to sustainable energy" meaning that ESG should be a driving force in operations and strategy.

In its statement on the 2022 update, S&P 500 stated that Tesla's removal may be shocking but justified as there were a number of violations ranging from a lack of a low carbon strategy or codes of business conduct alongside claims of racial discrimination and poor working conditions at a factory.

They also found that the company poorly handled the investigations carried out by the National Highway Traffic Safety Administration (NHTSA) following reports of multiple deaths and injuries linked to the autopilot feature it provides in vehicles. The fact that CEO Elon Musk is a wild card is also a factor as he has famously claimed that ESG is a scam.

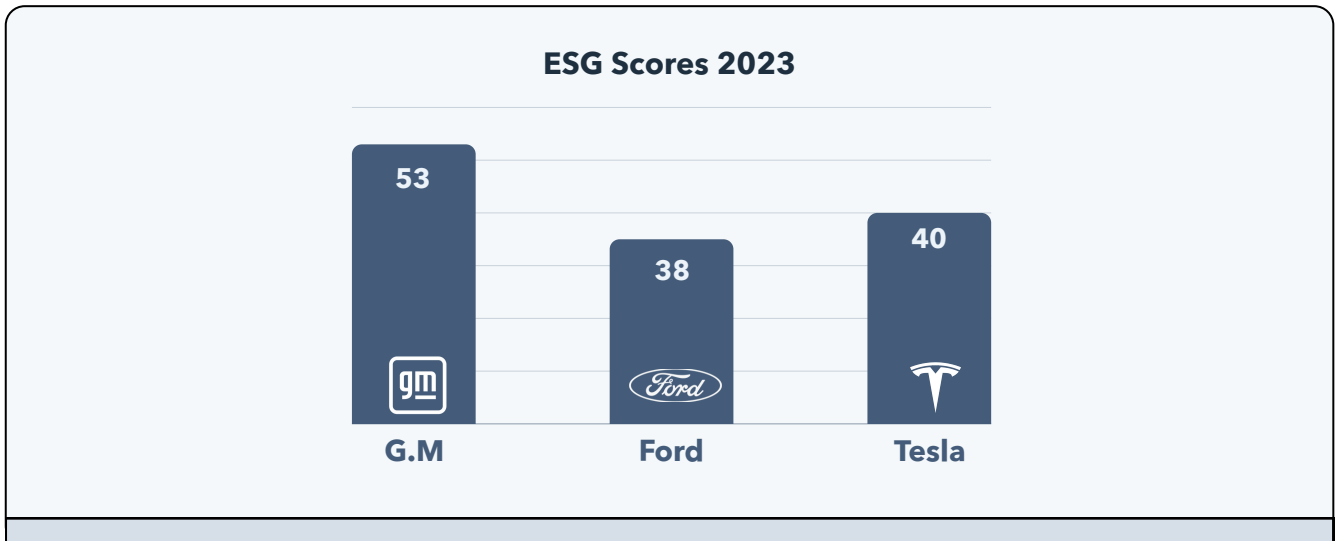
ESG Scores - Tesla vs Shell



The truth is Tesla is performing arguably well on the environmental front, leading the energy transition within the automobile industry despite reports showing that lithium batteries used in electric vehicles are not sustainably produced. After all, electric vehicles still have lower emissions than internal combustion engine vehicles. Social and governance is where Tesla fails.

The company's performance in these areas remains so poor, it currently ranks below Shell in ESG scores.

Tesla was restored to the ESG Index last year after making additional disclosures on the issues raised and currently has an ESG score of 40 on the S&P 500. While this is good news for Tesla, it still scored below one competitor in the automobile industry that's also on the ESG Index and only two points above another competitor.



This is quite interesting when you consider that Tesla produces only electric vehicles, unlike its competitors. Furthermore, looking at each ESG component, Tesla was not the top performer in any category.

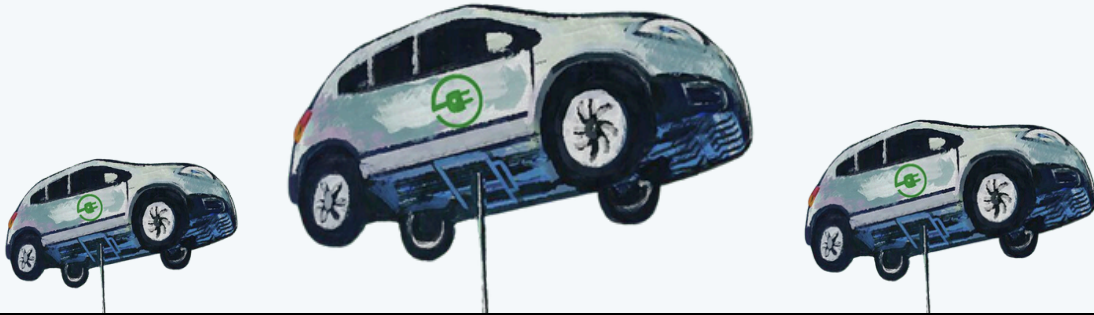
Score Breakdown Across ESG Components

| Company | Environmental | Social | Governance |
|----------------|---------------|--------|------------|
| General Motors | 56 | 53 | 51 |
| Tesla | 53 | 29 | 40 |
| Ford | 49 | 34 | 33 |

Analysts at Bloomberg Intelligence have reported that the company is still on shaky ground in terms of its status as an ESG stock. Their review of 15 of the largest ESG funds in the United States revealed that 6 do not hold any stock in Tesla. Regardless, the company is quite popular with ESG fund managers.¹

The bottom line is Tesla's status as an ESG stock is arguable and each investor will simply have to conclude on their own.





Halting climate change requires sustainable investment practices, which have become increasingly critical in the modern financial landscape. In today's market, many investors are no longer driven solely by profit but also consider a company's value system and its broader impact on the world. This shift has given rise to the prominence of Environmental, Social, and Governance (ESG) investing, a strategy that incorporates these three essential criteria into the investment decision-making process.

As ESG investing gains prominence, investors must carefully evaluate a company's strengths and weaknesses to determine if they align with their own interests and values. This comprehensive analysis involves looking beyond traditional financial metrics to assess how a company manages its environmental footprint, addresses social issues, and maintains robust governance practices.

Tesla, Inc., often highlighted as a significant player in the ESG landscape, presents a compelling yet complex case for investors. On one hand, the company's innovations in electric vehicles have positioned it as a leader in reducing carbon emissions and promoting cleaner technologies. However, Tesla's status as an ESG stock remains subjective and highly dependent on individual investor priorities. While the company excels in environmental initiatives, those who place significant weight on the social and governance aspects of ESG criteria may find Tesla lacking.

Therefore, the decision to invest in Tesla as an ESG stock involves balancing these factors. Investors must weigh the company's environmental achievements against its social and governance challenges. For some, Tesla's positive environmental impact may outweigh its shortcomings in other areas. For others, the social and governance issues may be a deterrent, leading them to seek alternatives that better align with their comprehensive ESG criteria.

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