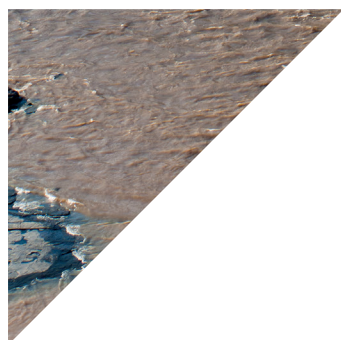


Surface Tension

CDP South Africa Water Executive Summary 2015

Written on behalf of 617 investors with US\$63 trillion in assets



Introduction

Water quality, quantity and access in South Africa is an issue that impacts all sectors of society and is something that requires complex, multi-stakeholder solutions.

This is the sixth consecutive year (2010 to 2015) in which the National Business Initiative (NBI) has partnered with CDP to distribute and analyse the CDP water information request. This request is sent to selected companies within the 100 largest companies by market capitalisation on the Johannesburg Stock Exchange (JSE) that operate in sectors believed to have the greatest impact on, or that are significantly impacted by, water resources. Given this criteria, only 59 companies received the water information request in 2015. The water questionnaire was sent on behalf of investors with over US\$63 trillion in assets under management. The questionnaire asks companies to disclose their company's response to water-related risks and opportunities throughout their value chain and hopes to drive changes in company behaviour to improve water performance and enhance data quality. It also provides a means to recognise leaders in water management.

In 2015 CDP water responses were scored for the first time. However the scores will not be made publically available. In 2016 the scores will be made available and appended to table 2 showing company responses. Scoring was completed by the South Pole Group, CDP's global water scoring partner. CDP approaches scoring by assessing responding companies across four consecutive levels which represent the steps a company moves through as it progresses towards water stewardship excellence. The levels are Leadership (A or A- scoring band), Management (B or B-), Awareness (C or C-) and Disclosure (D or D-).

The substantial changes made to the questionnaire (in 2014) to support online scoring make long-term analysis of the data challenging. As a result, the analysis shown here is on a limited data set but strongly reinforces the key findings of all previous reports. In considering the analysis in this report, it should be borne in mind that it is a relatively small sample and the impact of companies entering and exiting the sample is significant. In 2015 six companies were included for the first time. First time responders tend to have less complete and less mature responses and can therefore skew the data.

As with CDP climate change, the NBI has changed the way that we make CDP water data and analysis available. We no longer produce a full, long report, but rather a short executive summary, supported by infographics that visually communicate the core messages. The summary report and infographics complement a CDP online platform¹ that enables you to interact with the data drawing your own lessons and conclusions. This summary therefore provides the high level trends that the NBI see in the data and

the most critical data points. To understand a specific company context there is no substitute for reviewing the individual company response².

The NBI would like to thank the British High Commission Pretoria for their financial support of the CDP water program in South Africa through the 2015/2016 Prosperity Fund. Given the critical systemic challenges facing the water sector, combined with the drought across the country, with its devastating consequences for the economy and for communities, an accurate understanding of the state of water management in South Africa and specifically in the private sector makes this a critically important program. We would also like to thank Dave Baxter for his efforts in analysing aspects of the sample data and in reviewing the sustainability and integrated reports of companies who did not respond to the CDP water request.

Water is top of mind for the media, government and the public in South Africa at present. According to recent media reports, the current drought could cost South Africa more than R2 billion in trade losses³. Not to mention the potential negative impact on food security, hunger and service delivery in heavily affected provinces. Water quality, quantity and access in South Africa is an issue that impacts all sectors of society and is something that requires complex, multi-stakeholder solutions. Minister Gordhan gave special attention to the drought in the 2016 Budget Speech, allocating funds towards water infrastructure, support to farmers and disaster relief. In his State of the Nation Address, President Zuma recognised the efforts of the civil society coalition "Operation Hydrate" in delivering much needed water to communities devastated by the drought.

In this summary we report on how the analysis of company responses to CDP water compares with the views of a group of experts⁴ in order to provide an insight into the nature of water risk and the potential adequacy of the business response. This insight, paired with the analysis of the sample data, reveals several trends that pull in opposite directions, tensions that can only be resolved by much deeper analysis and collective consideration of the challenges and potential solutions for water in South Africa. It is for this reason that we have entitled the 2015 CDP South Africa Water Report: *Surface Tension*.

² <https://www.cdp.net/en-US/Results/Pages/responses.aspx>

³ <http://allafrica.com/stories/201601200781.html>

⁴ Experts consulted: Martin Ginster: Sasol, Nandha Govender: Eskom, Richard Holden: TCTA, Neil MacLeod: Independent, Sarah McPhail: National Treasury, Mike Muller: WITS, Nicole Kranz: GIZ, Mark Summerton: AECOM. The views expressed in this report however, are the NBI interpretation of the consensus arising from the expert discussion. It does not mean that each individual agrees with all the points raised.

¹ <http://globalwaterresults.cdp.net>

Key findings

In addition to the high profile political and media attention water is getting, the expert group convened by the NBI concluded that while the drought is a serious short-term water risk facing the country, there are more critical systemic issues in the water sector that need to be addressed to ensure long-term sustainability of supply in South Africa.

The key findings described below must be understood in the complex South African water context. In addition to the high profile political and media attention water is getting, the expert group convened by the NBI concluded that while the drought is a serious short-term water risk facing the country, there are more critical systemic issues in the water sector that need to be addressed to ensure long-term sustainability of supply in South Africa. The analysis of the 2015 CDP water data shows that 83% of respondents report that their direct operations are exposed to water-related risks, the highest of any sample in the world, with more than half of these risks expected to manifest within the next three years and with two thirds of those risks having a financial impact of medium to high. Furthermore, 70% of responding companies experienced detrimental water impacts in the reporting year (2015), with the next most impacted sample being Switzerland at 50%.

It is within this context of all stakeholders identifying water as a critical risk that we find several tensions.

Tension 1: When companies do respond to CDP, they find and disclose severe, urgent water risk and advocate for action. Yet we see very little uptake of water reporting and water management by non-responding companies and the response rate remains largely unchanged at 56%

It is of serious concern to us that the recognition of the critical need to carefully and proactively manage water risk in South Africa appears to be limited to a small group of companies. In particular it is inexplicable that while CDP responding companies who carefully assess water risk and conclude that it is a significant near term risk, many other companies outside the CDP reporting net appear to remain disengaged. Response rates (2013: 56%, 2014: 55%, 2015: 56%) and growth, lag that of the CDP climate change program (where response rates are roughly 80% each year). Intriguingly, sectors with low response rates are consumer discretionary, consumer staples and materials where our expectations and theory suggest that these sectors would be most exposed. This is especially so in an environment where, on a daily basis, we are seeing the impact of drought on food prices and on the food value chain.

Furthermore, 81% of companies who respond to CDP climate change identify linkages between climate and water risk and yet a third of those companies do not respond to the CDP water information request. Even where water is recognised as a risk in one disclosure program it does not necessarily result in a coordinated response from the company.

This tension between disclosers and non-disclosers could be explained by companies choosing to disclose their understanding of and actions around water risk and opportunity through other channels. However, in a high level review of the integrated and sustainability reports of companies who do not disclose to the CDP water program only:

- ▶ 32% report their awareness of their current state in relation to water risk;
- ▶ approximately half (56%) of the respondents are able to report a single data point on water (compared to 73% of the CDP sample reporting on the three categories of water withdrawal, consumption and discharge); and
- ▶ 32% have an environmental policy in place that mentions water.

The quality of water reporting of non-disclosers to the CDP water program does not provide the same level of detail and insight as provided by responding companies. Although, it is worth noting that within the set of companies who chose not to respond to CDP water there are companies with exceptional water disclosure.

It takes time to establish maturity in water management and reporting appears to be a key driver. The investigation of companies declining to respond, with some notable exceptions, shows that companies outside the CDP net are following a maturity path similar to that of early CDP disclosers. In 2011 the NBI reported an interesting pattern within responding companies. Over 90% of responding companies were able to provide specific targets for water management and were taking specific actions to deliver against those targets. However, fewer companies (roughly two thirds) were able to report that water was integrated into risk management and strategy. In our high level review of companies who declined to respond to the CDP water we see a pattern similar to that of responders in 2011. Only 32% report on governance and strategy integration, however 80% have targets and initiatives in place around water management.

The concern raised in 2011, and that applies to non-responders now, is that water action is potentially being directed by enthusiastic middle managers with very little connection made to the underlying strategic risk and to company leadership.

As companies mature there is a strong shift to understanding the nature of water risk and opportunity and how it should impact business strategy and operations. The maturity journey leads companies towards a greater degree of integration and a lower focus on data measurement and target setting in the medium term. Over the intervening

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years we have seen a significant shift in CDP water responding companies, showing that:

- 83% of companies have a water policy in place;
- 83% of companies have integrated water into their strategy; and
- 100% of companies have board oversight of water risk and opportunity.

Judging by the differences between responding and non-responding companies within the CDP water sample, the reporting process (especially through CDP water) appears to be an important influence on integration and maturity in water management and we encourage more companies to respond to the CDP water information request.

Tension 2: Despite low response numbers, the companies that do respond are global leaders in water management

There are a number of companies operating in South Africa that are genuinely global leaders in water management. Two companies in South Africa, Harmony Gold Mining Co Ltd and Kumba Iron Ore, made it on to the CDP Global A list for water management. This is prestigious as they were among only eight companies internationally to achieve an A. Harmony Gold was one of ten companies (roughly a third of the official sample responses) who responded despite not being part of the JSE sample and were therefore not included in the analysis. These are companies who understand the impact of water on their business and deliberately choose to engage. Many of these companies have responded for the second or third time.

The aggregated scores in the South African sample tell a positive story about responding companies with 80% of companies achieving a B or B- (Management Category) and only 17% achieving a C. None of the responding companies achieved a C- or D. Once again, where companies from the South African sample respond to the CDP climate change or water information request, disclosure and performance levels are high.

Tension 3: Despite the urgency expressed by other stakeholders, leading companies view water as a less material risk than in 2014

The companies that respond are inspired to invest energy into integrating water into strategy, risk management and governance and to invest in risk mitigation and are demonstrating genuine, global leadership. Companies are disclosing experiencing detrimental impacts (70% up from 50%) and 83% of companies have facilities exposed to direct risk (216 facilities around the country). Yet those same companies, despite the drought, media attention, government priority and concern expressed by the water community have decreased their estimate of the urgency and severity of water risk since 2014. The number of risks identified as both high impact and highly likelihood declined from 22% (2014) to 12% (2015). The total number of highly probable risks declined from 28% to 15% and the number of physical risks with a high impact declined from 51% to 44%. The number of identified regulatory risks with both a high likelihood and high impact declined from 19% to 14%. The number of regulatory risks with a high likelihood declined from 34% to 24% with a marginal increase in the number of risks in the high impact category (53% in 2014 to 55% in 2015).

Table 1: Self-selected respondents to the CDP water program

Company	GICS Sector	2015	2014	2013	CDP climate change 2015
Allied Electronics Corporation Ltd (Altron)	Industrials	SSR	SSR	AQ	SSR
Aveng Ltd	Industrials	SSR (np)	AQ (np)	AQ (np)	SSR
Distell Group Ltd	Consumer Staples	SSR	SSR	/	SSR
Herdmans South Africa (Pty) Ltd	Consumer Discretionary	SSR	/	/	/
Harmony Gold Mining Co Ltd	Materials	SSR	AQ	DP	SSR
Royal Bafokeng Platinum Ltd	Materials	SSR	AQ	AQ	SSR
Sanlam	Financials	SSR	SSR	/	AQ
Scaw South Africa (pty) Ltd	Materials	SSR (np)	SSR (np)	SSR (np)	SSR
Sheraton Textiles	Consumer Discretionary	SSR (np)	SSR (np)	/	/
Transnet	Industrials	SSR	/	/	SSR

SSR – Self-selected respondent

SSR (np) – Self-selected respondent (not public)

AQ – Answered questionnaire

AQ (np) – Answered questionnaire (not public)

DP – Declined to participate

An analysis of the risk data provides us with some insight as to why the risks may have been categorised this way. Analysis shows that risk in the South African water space is driven predominantly by physical risk and not regulatory risks. If we compare the spread of physical and regulatory risks between the CDP water and CDP climate change responses we see that only 19% of risks identified in the water space are regulatory, much lower than the 44% in climate change. Climate change however identifies 33% of all risks as physical risks compared to a staggering 70% of all identified risks in the water response relating to physical risk (the remaining identified risks are classified as other). Given the experts view on the state of water infrastructure in South Africa this may be a short-sighted perspective (only 27% of companies identify inadequate infrastructure as a risk in 2015). The fact that only 40% of companies engage on national policy compared to 93% in climate change illustrates the low priority given to regulatory risk in water.

It is also arguable that companies focus narrowly on their operational risks and not on the risks that will manifest through social and economic systems.

A company's evaluation of risk may simply be underestimated and incomplete. The NBI convened expert group specifically raised their concerns regarding the possibility of companies underestimating water risk, especially in their supply chains. The top risks identified by the expert group were municipal water supply challenges (driven by infrastructure and institutional capacity issues), water cost increases, declining water quality, regulatory incoherence in water licencing and complex water institutions with conflicting objectives. While there is some correlation between the risks identified by companies the differences in substance and priority is worth discussion and investigation.

It is also arguable that companies focus narrowly on their operational risks and not on the risks that will manifest through social and economic systems. This hypothesis is supported by a number of data points suggesting that fewer companies consider risk within their supply chain. While 19 (63%) companies consider risk in their supply chain, only 40% of companies require water reporting from their supply chain (although up from 23% in 2014). Companies identify 218 direct risks and yet identify only 70 supply chain risks. Of the 50 water-related goals set by 24 companies only 13 (55%) companies set goals outside their direct operations.

Ultimately however this may boil down to an issue of cost. While water remains inexpensive with very little indication that regulation will drive a significant price increase in the short term, climate change indicators are dominated by price pressures from closely related energy price increases and the potential imposition of a carbon tax. The dominant direct water risks in 2014 were declining water quality, increased water stress and flooding, which shifted to drought, increased water stress and water scarcity in 2015. The dominant supply chain risks shifted from water scarcity, higher water prices and climate change in 2014 to drought, increased and projected water scarcity and increased water stress in 2015. From a strategic perspective we would expect some consistency in risk identification and yet, on the face of it the shift towards scarcity related dominant risks is a reflection of the short term impact of the drought. The fact that a higher water price is not a top risk in 2015 is potentially telling.

Tension 4: While all disclosing companies demonstrate leadership in disclosure, reflected in 80% of the sample scoring a B, the variance in data provides for no comparability

Company disclosure is improving year on year, rivalling the performance we see in climate disclosure. Yet assessing comparability and

completeness remains a challenge, as companies disclose widely varying data. 22 companies report water withdrawals, consumption and discharge and yet withdrawal to consumption ratios across sectors vary from 41% to 88%. Within sectors the water data disclosed also varies greatly, with the smallest difference within a sector being 62% (industrial sector water discharged) and the largest difference over 200 000% (consumer staples water consumption). 75% of all reported withdrawals come from the consumer staples sector and 92% of those withdrawals are disclosed by two companies. It is clear from the differences in data, even between comparable companies in the same sector, that the differences in water accounting methodologies and assumptions are significant. The lack of a standardised approach (in contrast to climate change) means that attempting to draw conclusions from reported data or benchmark data is futile.

At a risk identification level there is also an enormous variation in approaches. Companies responding to CDP water, use over 30 different methodologies. The most common water risk assessment methodologies are internal company knowledge (19 companies in 2015, up from 17 in 2014), the WRI Aqueduct (15 in 2015 up from 7 in 2014), regional government databases (9 up from 6), the WBCSD Global Water Tool (6 up from 3) and the FAO/AQUASTAT (5 up from 2).

Conclusion

In conclusion, we are not seeing the types of changes in CDP water that we witnessed during the evolution of CDP climate change. While companies who do disclose, report well, we see only incremental improvement and almost no change in response rates. Our analysis of companies not disclosing, with some exceptions, suggests that the quality of water reporting outside of the CDP water program is poor and it is therefore a concern that companies are not adequately addressing water risk in South Africa.

It is clear from consistent responders that companies who do investigate water risk tend to invest significant capital and effort into integrating water into governance structures, strategy and risk management and mitigation processes. We therefore believe that reporting is a critical first step in water stewardship and encourage all non-disclosing companies to improve the quality of their reporting and join the CDP water program. We strongly encourage all companies to carefully consider their exposure to water risk and opportunity, and to improve the scope of their assessments to understand the social and economic systems that underpin water in South Africa.

Table 2: Responses to the CDP water program (2015, 2014, 2013, 2012) and CDP climate program 2015

Company	Sector	2015 CDP Water Response	2014 CDP Water Response	2013 CDP Water Response	2012 CDP Water Response	2015 CDP Climate Change
AECI Ltd Ord	Materials	AQ	AQ	AQ	AQ	AQ
African Rainbow Minerals	Materials	DP	DP	DP	DP	AQ
Anglo American	Materials	AQ	AQ	AQ	AQ	AQ
Anglo American Platinum	Materials	AQ	AQ	AQ	AQ	AQ
AngloGold Ashanti	Materials	AQ	AQ	AQ	AQ	AQ
Arcelor Mittal South Africa Ltd	Materials	AQ (sa)	AQ (sa)	AQ (sa)	AQ (sa)	AQ
Aspen Pharmacare Holdings	Health Care	AQ	AQ	AQ (np)	DP	AQ
Assore Ltd	Materials	DP	DP	DP	DP	AQ (np)
Attacq Ltd	Financials	DP	/	/	/	NR
Avi Ltd	Consumer Staples	DP	DP	DP	DP	DP
Barloworld	Industrials	AQ	AQ	AQ	AQ	AQ
BHP Billiton	Materials	AQ	AQ	AQ (sa)	AQ	AQ
Bidvest Group Ltd	Industrials	AQ	AQ	AQ	DP	AQ
British American Tobacco	Consumer Staples	AQ	AQ	AQ	AQ	AQ
Capital & Counties Properties	Financials	DP	/	/	/	AQ
Clicks Group Ltd	Consumer Staples	DP	DP	DP	DP	AQ
Compagnie Financière Richemont SA	Consumer Discretionary	DP	AQ	AQ	DP	AQ
Datatec	Information Technology	DP	/	/	/	DP
Exxaro Resources Ltd	Energy	AQ	AQ	AQ	AQ	AQ
Famous Brands Limited	Consumer Discretionary	DP	NR	NR	/	DP
Foschini Group Ltd	Consumer Discretionary	DP	DP	AQ (np)	AQ (np)	AQ (np)
Gold Fields Limited	Materials	AQ	AQ	AQ	AQ	AQ
Hosken Consolidated Investments	Industrials	AQ	DP	DP	/	AQ
Illovo Sugar Ltd	Consumer Staples	AQ	AQ	AQ	AQ	AQ
Impala Platinum Holdings	Materials	AQ	AQ	AQ	AQ	AQ
Imperial Holdings	Consumer Discretionary	DP	/	/	/	AQ
KAP Industrial Holdings Ltd	Industrials	DP	/	/	/	AQ
Kumba Iron Ore	Materials	AQ	AQ	AQ	AQ	AQ
Life Healthcare Group Holdings Ltd	Health Care	DP	DP	DP	NR	AQ
Lonmin	Materials	AQ	DP	DP	AQ	AQ
Massmart Holdings Ltd	Consumer Staples	DP	NR	DP	DP	AQ
Mediclinic International	Health Care	AQ	AQ	AQ	AQ	AQ
Mondi Limited	Materials	AQ (sa)	AQ (sa)	AQ (sa)	AQ (sa)	AQ (sa)
Mondi PLC	Materials	AQ	AQ	AQ	AQ	AQ
Mr Price Group Ltd	Consumer Discretionary	DP	DP	DP	DP	DP
Nampak Ltd	Materials	DP	DP	DP	DP	AQ
Netcare Limited	Health Care	AQ	AQ	AQ	AQ	AQ
New Europe Property Investments plc	Financials	NR	/	/	/	DP
Northam Platinum Ltd	Materials	AQ	AQ	AQ	AQ	AQ
Oceana	Consumer Staples	DP	DP	DP	DP	AQ
OMNIA HOLDINGS LTD	Materials	DP	DP	NR	NR	AQ
Pick n Pay Stores Ltd	Consumer Staples	AQ (np)	AQ (np)	AQ	AQ	AQ
Pioneer Foods	Consumer Staples	AQ	DP	DP	AQ (np)	AQ
PPC Ltd	Materials	DP	DP	DP	DP	AQ
RCL Foods Ltd	Consumer Staples	AQ	DP	/	/	AQ
Reunert	Industrials	AQ	AQ	AQ	AQ	AQ
SABMiller	Consumer Staples	AQ	AQ	AQ	AQ	AQ
Sasol Limited	Energy	AQ	AQ	AQ	AQ	AQ
Shoprite Holdings Ltd	Consumer Staples	DP	DP	DP	DP	AQ (np)
Sibanye Gold Ltd	Materials	NR	DP	/	/	AQ
Steinhoff International Holdings	Consumer Discretionary	DP	DP	DP	DP	AQ
Sun International Ltd	Consumer Discretionary	AQ (np)	/	/	/	AQ
Super Group	Consumer Discretionary	DP	/	/	/	DP
The Spar Group Ltd	Consumer Staples	DP	DP	DP	DP	AQ
Tiger Brands	Consumer Staples	AQ	AQ	DP	DP	AQ
Tongaat Hulett Ltd	Consumer Staples	AQ	AQ	AQ	AQ	AQ
Truworths International	Consumer Discretionary	DP	DP	DP	DP	AQ
Tsogo Sun Holdings Ltd	Consumer Discretionary	AQ (sa)	/	/	/	AQ (sa)
Woolworths Holdings Ltd	Consumer Discretionary	AQ	AQ	AQ	AQ	AQ

AQ – Answered questionnaire

AQ (np) – Answered questionnaire but declined permission to make this public

AQ (sa) – Answered questionnaire via parent company

DP – Declined to participate

NR – No response