



# Flagging memo

## **CRH plc**

Annual general meeting: 27 April 2023

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## Organisation requesting a 'flag' on votes

- As lead investors of the CRH plc Climate Action 100+ engagement, Sarasin & Partners LLP supports the flagging of 3 resolutions.
- Public statement link: <https://sarasinandpartners.com/stewardship-post/crh-2023-agm/>

## Resolution text

Sarasin & Partners LLP is flagging 3 resolutions and stating their intention to vote as follows:

- Resolution 1. To review the Company's affairs and consider the Company's financial statements and the Reports of the Directors (including the Governance Appendix1) and Auditors for the year ended 31 December 2022. **AGAINST**
- Resolution 4e. Re-elect Shaun Kelly as Director. **ABSTAIN**
- Resolution 6. Ratify Deloitte Ireland LLP as Auditors. **AGAINST**

## Summary of why votes are being flagged

CRH's vision is to transform itself away from merely supplying construction materials to providing sustainable construction solutions that enable customers to meet tightening environmental regulations. This is potentially transformative.

A key pillar of this strategy is CRH's ambition to get to net zero carbon emissions by 2050; by 2030 it has promised to cut all its emissions (covering scope 1 to 3 emissions) by 30%. In essence, by aligning the business with global efforts to tackle climate change, CRH is positioning itself to take market share and grow margins. We are fully behind this plan.

The problem is, when we examine in greater detail CRH's financial statements, there seems to be a disconnect between CRH's bold vision and the lack of acknowledgement of tightening carbon emission regulations in critical accounting assumptions.

As investors, we need CRH's financial statements to give us clarity on its capital strength given the planned transformation, including the investments they expect to make to deliver falling carbon emissions. We also need to know that they are reflecting the expected tightening of climate-related policies, in particular the higher cost of carbon, when they test their asset values for impairment. If they don't they risk understating the risks to capital linked to ongoing investments into carbon-intensive assets. The further out management expects climate rules to bite, the slower they will be to pivot the business.

While we note some improved disclosures in the financial statements, we continue to lack visibility, or have questions, on:

- **Consistency with CRH's decarbonisation roadmap?** CRH has said that the \$150 million per annum will be required to deliver the 2025 carbon-intensity target, and this is integrated into the financial statements. There is no detail on how this was calculated, or what it covers. Moreover, this is only part of their decarbonisation plan. Any other investments beyond 2025, notably to deliver on carbon capture use and storage requirements, appear to be left out.
- **Low carbon price assumptions support goodwill valuations** (\$9.2bn on balance sheet)
  - While there is no disclosure of the numbers used, they state in Note 14 on Intangible assets that they have used existing carbon prices they pay under the European Emission Trading System, and make no allowance for expected tightening of allowances until 2030. Here they helpfully indicate they undertook a stress test for prices rising after 2030 in line with the IEA's NZE2050 scenario (a 1.5C scenario) but concluded that *"there was no material impact on any of the CGUs [Cash Generating Units] primarily due to the levels of headroom in these CGUs and an assumption of cost recovery through pricing"*. So, in other words, this impairment test ignores potential rising prices before 2030, and then after 2030 they assume that they will increase prices to cover rising costs, so there would be no problem.

- **Inconsistency with TCFD scenario analysis for a 1.5C scenario** – with regards to the narrow 1.5C stress test for intangible assets above, we note the conclusion that there is no risk seems at odds with their conclusion in the climate risk assessment undertaken in the front half of the Annual Report, which concluded higher carbon prices associated with a 1.5C scenario would be a ‘high impacts’ and ‘high probability’ risk.
- **Plants, property & equipment (PPE) (\$18.9bn)**– they say they concluded that the planned decarbonisation targets and associated capital expenditure would not reduce asset value or asset lives but provide no detail on how this was established. Presumably, they use similar carbon pricing assumptions as detailed for intangibles above.
- **Discount rates unadjusted** – according to the Financial Statements, discount rate assumptions are a ‘major source of estimation uncertainty’ as they are critical to impairment testing, amongst other things. There is no sign that they considered how tightening carbon emission regulations might push up the risks associated with key carbon-intensive assets used by CRH and thus the discount rate they use. A higher discount rate for carbon-intensive business lines could increase the risk of write-downs.
- **Environmental and remediation provisions (\$0.6bn)** – Here CRH states that it has considered climate risks, and *“Changes to legislation, including those relating to climate change, are factored into the assessment of provisions when the legislation is virtually certain to be enacted.”* There does not appear to have been a stress test for a 1.5-degree Celsius pathway that they are committed to.

## Auditor

Deloitte says they have reviewed all the assumptions considering climate related risks and managements’ decarbonisation targets. This year, they indicate they paid particular attention to the potential for climate-related factors to result in impairments to goodwill. No comment is made on the partial 1.5C stress test performed on goodwill, or the carbon price assumptions used. Deloitte makes no mention of how they considered CRH’s longer term capital expenditure requirements to deliver decarbonisation.

## Specific vote rationales

- **Audit Committee Chair (Shaun Kelly) – Abstain:** Despite ongoing concern with the actual financial statement disclosures, we are abstaining on Kelly's reappointment in recognition of our engagement and the efforts made, as detailed in the Audit Committee report to shareholders. However, we continue to lack visibility for 1) how material climate risks are reflected in critical accounting assumptions, notably the carbon price and discount rates used in impairment testing, 2) how precisely CRH's medium to longer-term decarbonisation targets are integrated into its financial statements, and 3) the implications of a 1.5°C pathway for its financials given the results of the 1.5C scenario in CRH's TCFD disclosure suggests this is high probability and high impact.
- **Auditor (Deloitte Ireland) – Against:** While Deloitte provides additional commentary in its UK report on how climate risks have been considered, and the consistency between the financial statements and climate targets, they offer no disclosure on how the medium to longer term decarbonisation targets are accounted for, or views on the carbon price assumptions used. No comment is provided on the sensitivity to a 1.5°C pathway, despite CRH's net-zero ambition.
- **Financial Statements: Against:** Despite some improvements, we cannot approve CRH's financial statements where there remain questions over critical accounting assumptions such as the carbon price and discount rates used, and where they fail to provide the requested visibility for a 1.5°C pathway.

## Conclusion

In summary, while we welcome the improved disclosures relating to climate risks in CRH's Annual Report & Accounts, we have questions over critical accounting assumptions, how these are consistent with the company's climate targets, and how a 1.5°C scenario could impact its financial position.