Anhui Conch Cement

China, Construction materials

Accounting		Climate Assumptions		Audit		Date of analysis: May 17 2021
Judgements	Consistency with other reporting	Visibility	Paris alignment	Visibility in KAMs	Consistency check	Year end: December 2020 Report date: March 25 2021 AGM: May 28 2021
						CA 100+ company, so seen by investors as key to driving global net zero emissions
Significant concerns	Significant concerns	Significant concerns	Significant concerns	Significant concerns	Some concerns	

Summary view:

- As the largest cement company in China, which is by far the world's largest producer of cement, Conch Cement faces a number of material climate risks, particularly as Chinese policy-makers increase their focus on carbon emissions. A transition away from the use of coal as its primary energy source will require capital expenditures while the practically unavoidable carbon emissions from the production of clinker may reduce consumption of cement in the longer-term.
- There is no apparent consideration of climate risks in the financial statements, while the narrative reporting includes only minimal discussion of climate issues. The Social Responsibility Report outlines the company's achievements and commitments on carbon emissions but is also silent on climate risks. Disclosures on carbon emissions lack any detail.
- Conch Cement does appear yet to have responded to President Xi Jinping's September 2020 announcements on carbon emissions targets, so the company may be formulating a more detailed strategy with more comprehensive disclosures in due course.

Background

The Business

- Anhui Conch Cement Co is the largest cement company in China. It produces cement (369m tonnes capacity), clinker (262m tonnes capacity) and aggregate (58.3m tonnes capacity).
- China currently accounts for over half of the world's cement production, with an estimated 2.2bn tonnes produced in 2020. This compares to India, the second largest producer, which produced 260m tonnes in 2020. Although Conch Cement is predominantly a domestic business, the company is actively expanding overseas, especially in Southeast Asia with operations in Indonesia, Myanmar and Laos among others. In 2020, these overseas businesses contributed only 1.8% of revenues but are set to grow faster.
- Conch Cement is incorporated in China with H shares listed on the Hong Kong Stock Exchange and A shares listed on the Shanghai Stock Exchange. The provincial government of Anhui is its controlling shareholder through Anhui Conch Holdings, which owns 36.4% of Conch Cement. A further 4.3% is held by other state-owned legal persons in China.
- The CAPEX budget for 2021 is RMB15bn, with plans to increase cement production by just under 2%. Energy conservation technology and residual heat generation are both mentioned in capital investment plans, but no numbers are given on the size of relevant investments.
- Total emissions in 2020 amounted to 202.8m tCO_2, a 1.3% year-on-year increase as clinker capacity was added, although CO_2 intensity – measured as tonnes of CO_2 per tonne of clinker produced – declined 0.3%. No breakdown of the total CO_2 emissions number is given, such as the split between Scopes 1&2 emissions, nor whether this includes Scope 3 emissions.
- With cement being a major source of CO_2 emissions – contributing around 8% of the global total – cement producers such as Conch Cement face material risks. The process of making clinker produces carbon emissions in two ways: first, the energy usage to heat limestone and other inputs at very high temperatures and, second, the release of carbon dioxide through the process of calcination. The former is aggravated by China's overwhelming use of coal, while the latter – well over half of overall emissions for traditional cement production – is largely an unavoidable aspect of cement production. Conch Cement faces material capex and increased energy costs to move away from its predominant use of coal. Calcination is an even harder problem to fix. As a result, Conch Cement must face the risk of stranded assets, increased operating/environmental compliance costs and, potentially, reduced demand as consumers and policy-makers begin to appreciate the carbon impact of cement production.

- Emissions from cement production are often assessed by the clinker factor[1]; a lower factor giving lower emissions. Conch Cement does not appear to mention the clinker factor of its products.

<u>Approach to climate change</u>

- Narrative reporting in the Annual Report pays only brief and high-level attention to climate risks, although carbon emissions are mentioned as one aspect of one of the four risks for 2021. Even this limited focus on carbon emissions appears to be driven by the government's September 2020 announcement that China will target carbon peaking by 2030 and carbon neutrality by 2060, while Conch Cement's own thinking and planning sounds like it is still at an early stage: "The introduction of new environmental protection policies such as peaking carbon emission and carbon neutrality puts forward higher requirements for low-carbon environmental protection management of cement companies…To address the above-mentioned risks, the Group will study thoroughly and comply with the state's laws and regulations in relation to environmental protection, continue to increase investment in environmentally-friendly technology modification… We will study and formulate a medium to long-term solution for lowering carbon emission."
- The separate Social Responsibility Report includes somewhat greater consideration of carbon emissions, although the emphasis is on achievements so far, while there is no analysis of climate risks. Since 2015 coal consumption for clinker production has fallen 3.5% while comprehensive power consumption is down 5.2% thanks to various measures ranging from improved energy efficiency to replacement of clinker with industrial waste residue.
- The coverage of emissions reductions, which the company says are incorporated into medium and long-term development strategy, is very focussed on sulphur dioxide, nitrogen oxide and particulate matters, where the company has made significant reductions in recent years and which are the main focus of the 2021 and 2025 Environmental Protection Goals. There is no mention of CO2 emissions goals.
- The approach to climate change appears to be top-down, in response to the 2020 government declaration seeking peak carbon emissions by 2030 and carbon neutrality by 2060. For its part, Conch Cement states that, "Under the principle of earnestly implementing the national carbon emission management policy, the Group will adhere to the green and low-carbon development strategy and strengthen carbon emission management with greater determination and strength." Going beyond this high-level commitment, Conch Cement plans a wide range of initiatives, including unspecified steps to: improve its carbon trading management system; implement technological improvements for energy conservation and consumption reduction; develop low-carbon cement products; increase use of residual heat power generation; increase use of industrial waste slag in place of clinker; increase use of biomass; increase use of clean energy (solar and wind) in place of traditional energy (coal); increase carbon sinks; and explore new technologies of CCUS (carbon capture, utilisation and storage).

Accounting: judgements and consistency with other reporting

Accounting judgements		Significant concerns

- Conch Cement reports under IFRS as issued by the IASB.
- There is no reference in the notes to the financial statements that accounting judgements have been impacted by climate-related considerations.
- PP&E accounts for RMB72.8bn, which is 83% of non-current assets and 36% of total assets (due to the large balance of bank deposits and financial assets on the balance sheet). The accounts show buildings having a useful life of 30 years and plant and machinery with 15

[1] Reflects the extent to which clinker is substituted with materials having lower CO2 emissions profiles.

years. Implied average useful lives of PP&E are approximately 23 years, and implied average remaining lives are approximately 15 years[2].

- These estimations of useful life and remaining life, the consequent depreciation expense and any impairments could all be impacted by management's expectations for climate-related risks, but there is no indication that these risks have been considered.

Consistency with other reporting		Significant concerns

- The apparent absence of climate considerations in the audited financial statements is inconsistent with the discussion – albeit limited – of climate issues and risks in the narrative reporting of the annual report.
- Conch Cement also produces a Social Responsibility Report that follows the guidelines of the Hong Kong Stock Exchange and Shanghai Stock Exchange. This Report discusses carbon emissions in greater detail although it does not highlight climate risks (in contrast to a number of Chinese companies whose ESG Reports do tabulate and categorize climate risks).

Climate assumptions in accounts: visibility and Paris alignment

Visibility of climate assumptions in accounts		Significant concerns

- There are no apparent climate-related assumptions. There is thus no sensitivity analysis.

Paris alignment		Significant concerns

- With no visibility, there can be no alignment with the goals of the Paris Agreement.

Audit: visibility in KAMs and consistency check

Audit firm: KPMG	Responsible partner: Au Yat Fo
Audit standards: Hong Kong Standards on Auditing (HKSAs)	

Visibility in Key Audit Matters		Significant concerns

- There is no reference to climate change in the auditor's report.
- There is only one KAM identified, which concerns revenue recognition, and does not appear to have any relation to climate risk.

Consistency check		Some concerns

- The apparent absence of climate considerations in the audited financial statements is at least consistent, in a narrow sense, with the minimal discussion of climate issues and risks in the narrative reporting in the annual report.
- There is no indication that the Social Responsibility Report was assured in any way.

The Climate Accounting Project is an independent investor-led project to reinforce the statements of the IASB and IAASB that material climate change issues are incorporated within their standards. This analysis seeks to understand the extent to which companies and auditors are delivering against this aspect of these standards and similar local standards.		**Key**
		Good practice
		Few concerns
		Some concerns
		Significant concerns

[2] In the absence of better data, implied lives are roughly estimated using depreciation expense and, for average lives – start of year productive asset values, for remaining lives – ending values net of depreciation.

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