Grupo Argos SA

Colombia, Cement

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Report date: February 24 2021
AGM: March 25 2021</td></tr>
<tr><td></td><td></td><td></td><td></td><td></td><td></td><td rowspan="2">Climate Action 100+ company, so seen by investors as key to driving global net zero emissions.</td></tr>
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<tr><td colspan="7">Summary view:
• Grupo Argos is an investment holding company, though it is significantly exposed to climate risk through its investments in businesses producing cement and cement products, responsible for approximately 94% of its Scopes 1&2 emissions.
• It is beginning to make progress on group-level commitments, though this is still developing.
• The Integrated Report highlights climate risk having been elevated to a strategic risk, outlines initial steps being undertaken to address it, and even goes as far as highlighting that in 2021, progress will be continued on quantifying risks and their implications for the financial statements. The inconsistency is laid out, but it remains.</td></tr>
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Background

<u>The Business</u>

- Grupo Argos SA is an investment holding company, and the parent company of Grupo Empresarial Argos which, through its subsidiaries, participates in several sectors including: cement, energy, concessions and large-scale infrastructure, coal, and real estate.
- The company says that under its working model, it participates in its investee businesses' strategic decisions and supports their disciplined implementation. It also participates in their capital allocation processes and facilitates access to capital, fostering increased financial strength.
- Its main segments are: Cement (through Cementos Argos SA), Energy (through Celsia SA), and Concessions (through Odinsa SA). Other separately reported segments include Real estate, Coal, and Portfolio (other investments). As a % of consolidated income, Cement was 64%, Energy 25%, and Concessions 8%. As a % of operating profit, Energy was 53%, followed by Cement at 43%. By location, 2020 sales were 44% Colombian and 38% US.
- Non-controlling interests are material, with the % of net assets attributable to NCI approximating 21% for Celsia, 10% for Cementos, 36% for Odinsa, and 36.5% overall.
- As with all cement producers, its processes are energy intensive and produce substantial CO2 emissions. This is particularly true of the production of clinker, produced through a chemical process that breaks down limestone by heating it to high temperatures in a kiln, splitting off CO2. This part of CO2 emissions – well over half of overall emissions for traditional cement production – cannot be avoided.
- Emissions from cement production are often assessed by the clinker factor[1]; a lower factor giving lower emissions. Argos does not appear to disclose the clinker factor of its products.
- Of the group's 2020 Scopes 1&2 CO2e emissions, 94% came from its cement business. Scope 1 amounted to 8.1m tCO2e, and Scope 2 was 0.5m tCO2e. Argos uses the financial consolidation approach according to GHG Protocol guidelines.

<u>Approach to climate change</u>

- During 2020 progress was made in the development of the company's risk model, further quantifying strategic risks on financial, reputational and human talent fronts, and the risk of climate change was elevated to being a strategic risk. The company targets meeting TCFD report recommendations in 2022. It identified three holding company-level climate change risks, two transitional and one physical: restricted access to capital due to climate change requirements; impairment of investment or asset value due to regulatory changes, operating

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

standards or other stakeholder requirements; and impairment of investment or asset value related to physical impacts. These are not further described, but work appears to be ongoing.

- It identifies a sustainability vision with short, medium and long-term elements set at group level. For the group, its short term (0-2 years) aims include: developing a financial CO2 compensation model with a view to achieving carbon neutrality by 2050; analysing the viability of achieving carbon neutrality for Grupo Empresarial Argos by 2050 (considering different existing alternatives); developing an in-depth analysis of the risks of climate change; and including ESG impacts in its financial and capital allocation models.
- In March, the company announced two climate change commitments by 2030: a 46% reduction in the intensity of its CO2e emissions for every COP million in revenues, using 2018 as a baseline; and a 37% reduction in its overall CO2e emissions, with 2015 as a baseline. To achieve these targets, it defined five drivers for reducing emissions: improved energy efficiency at installations; use of alternative materials and fuels (co-processing); reduced heat consumption in ovens; reduced clinker/cement ratio; and creation of an energy generation grid that includes at least 25% non-conventional renewable energy sources.
- It has also begun to integrate ESG factors into its borrowings. For example, in April it closed a loan for COP392bn which amended existing debt conditions such that interest rates could drop by up to 100 basis points, if the group meets two sustainability indicators: 1) increased participation of women in senior management to more than 35%, and 2) GHG emissions reduced by 37% by 2030.

Accounting: judgements and consistency with other reporting

Accounting judgements		Significant concerns

- The company applies Accounting and Financial Reporting Standards accepted in Colombia NCIF (Colombian Financial Reporting Standards). These are described as being based on IFRS together with their interpretations, translated into Spanish and issued by the IASB, as of the second half of 2018 and the endorsement of the amendment to IFRS 16 Leases: COVID-19-Related Rent Concessions issued in 2020.
- There is no explicit reference to climate change in the notes to the financials. It is not apparent that any consideration of climate has been built into the numbers.
- Consolidated group PP&E was COP19.7bn at the end of 2020, plus another COP0.8bn in leased PP&E. While difficult to evaluate at group level particularly given the diversity of businesses, taking the category of 'mines, quarries and ore deposits' of COP2.1bn, we estimate based on 2020 depreciation expense average lives of 63 years, with an average of 61 years remaining.[2] While this ignores any residual, these appear to be relatively long given the climate risks faced. Impairment was insignificant and no changes in useful lives or residuals were apparent.
- Dismantling and environmental provisions were a modest COP120,000 and COP21,000 respectively.
- Goodwill at the end of 2020 was COP3.1bn (58% Cement, 31% Energy, 11% Concessions). No impairment resulted from the annual testing. The company discloses that cash flow projections for 5-10 years are used given that the operating segments require long recovery periods. It discloses the specific growth rates for periods following the projections, and the range of discount rates applied. No mention is made of climate risk, assumptions or steps to address emissions.
- Intangibles at the end of 2020 were COP4.6bn, predominantly COP3.5bn service concessions and COP1.9bn airport concessions. Again, no impairment resulted from testing, and no reference was made to climate risk or assumptions.

[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.

Consistency with other reporting		Significant concerns

- The Integrated Report highlights climate risk having been elevated to a strategic risk, outlines initial steps being undertaken to address it, and even goes as far as highlighting that in 2021, progress will be continued on quantifying risks and their implications for the financial statements. The inconsistency is laid out, but it remains.

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 S.A.S.	Responsible partner: Johana Novoa Cucunubá
Audit standards: International Standards on Auditing (ISAs) accepted in Colombia	

Visibility in Key Audit Matters		Significant concerns

- There is no explicit reference to climate change in the auditor's report.
- The auditor identified 4 KAMs, having in common long or indefinite asset lives with complex measurement, material balance sheet values, and involvement of professionals with relevant knowledge and experience in the industry (or in real estate valuation for the IP item): (i) assessment of goodwill impairment; (ii) assessment of the valuation of the service concession agreements; (iii) assessment of the recoverability of assets related to airport concession agreements; and (iv) assessment of the valuation of investment properties in accordance with the provisions of IAS 40 - Investment Properties.
- The use of specialist input from professionals having industry or real estate valuation expertise is mentioned, but not climate expertise.
- We also note that in each of the four KAMs the auditor has cited the corresponding balance sheet amount of the related assets. However, the amounts are cited by the auditor as being in $m, whereas the identical numbers are stated in the accounts as being in Colombian pesos.

Consistency check		Significant concerns

- The auditor identifies the 'other information' read in connection with the check for material inconsistency or misstatement as comprising information in the separately published Integrated Report. The auditor had nothing to report in this regard.
- The Integrated Report highlights climate risk having been elevated to a strategic risk, outlines initial steps being undertaken to address it, and even goes as far as highlighting that in 2021, progress will be continued on quantifying risks and their implications for the financial statements. The inconsistency is laid out, but it remains.

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

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