



QUARTERLY NEWSLETTER ON SUSTAINABLE AND RESPONSIBLE INVESTMENT (SRI)  
AND THE SUSTAINABILITY ANALYSIS OF COMPANIES.



# Looking Ahead

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Money does not perform. People do.



Asset Management

# Editorial

This first edition of 2009 touches upon a number of subjects very much in vogue. We start by looking into resource depletion. Despite the fall in crude oil and commodity prices, the longer-term challenges – which companies will have to take into account in their business models – have not abated. Our quarterly sector study then sheds some light on the Automobile sector, which, over the past few years, has not been the ‘easiest’ of sectors. The sector study tackles, inter alia, the need to reduce the sector’s environmental footprint, the increased importance of product quality and safety, responsible supplier relationships and the challenges related to an increased presence in the emerging countries. Finally, our quarterly interview focuses on microcredit funds: the different types, their evolution over the years and the perspectives for this double bottom line investment type.

We do hope you will enjoy reading this tenth issue as much as we enjoyed making it! All feedback is welcome.

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## Key Sustainability Challenge



### Resource depletion: **a challenge for decades to come**

Human wealth and progress is dependent on natural resources, which include energy, minerals, land, air, water, foodstuffs and commodities. Three basic factors determine the growth of resource consumption and the resulting environmental impact of human production and consumption patterns:

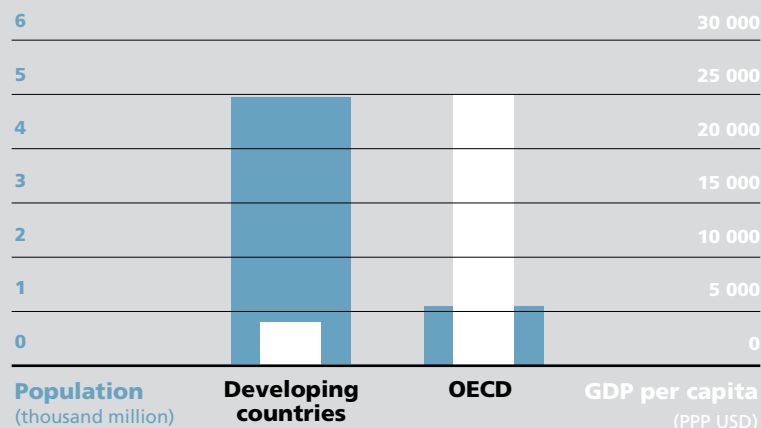
- Population size. The greater the number of people who need to cover their material needs, the greater the amount of resources consumed.
- The ways in which, and extent to which, we meet our needs.
- The level of development, broadly defined to include the level of technological sophistication, economic structure and patterns of production and consumption<sup>1</sup>.

The issue of sustainable resource use has been high on the agenda of many policy discussions for about two decades now, starting with the summit in Rio de Janeiro in 1992. In 2005, an EEA (European Economic Area) report stated that, "If, over the next fifty years, the population of the developing countries achieves levels of material wealth similar to today's levels in the industrialised countries, world consumption of resources would increase by a factor ranging from two to five. Without dramatic technological improvements or changes in patterns of consumption, growth in resource use and environmental impacts due to increased population and economic growth in developing countries are likely to outweigh the technological efficiency gains made in the industrialised countries<sup>2</sup>."

<sup>1</sup> Millennium Ecosystems assessment: <http://www.millenniumassessment.org/en/index.aspx>

<sup>2</sup> EEA Sustainable Use and Management of Natural Resources 2005: [http://reports.eea.europa.eu/eea\\_report\\_2005\\_9/en/EEA\\_report\\_9\\_2005.pdf](http://reports.eea.europa.eu/eea_report_2005_9/en/EEA_report_9_2005.pdf)

## Population and GDP per capita in OECD and developing countries.



Source: UNDP 2004.

It goes without saying that Dexia Asset Management has acknowledged the sustainability challenges that resource depletion raises and has therefore included this topic in its Macro Analysis, which looks at how companies position themselves with respect to long-term sustainability challenges.

We define natural resources as materials found in nature and essential or useful to human life and activity. Broadly speaking, natural resources are commonly divided into renewable and non-renewable resources:

- **Renewable resources** can be considered as living resources capable of restocking themselves. They comprise halieutic/sea resources (all sea-products including fish, cetaceans, crustaceans, corals and sea-grass), forestry resources (including wood and timber), freshwater resources and other land-, soil- and space resources.
- **Non-renewable resources** are generally considered as mineral resources, of which there is a finite amount on the planet. They are subdivided into fossil fuels, which include oil, coal and natural gas, and mineral commodities, which include uranium, aluminium, copper, iron, lead, nickel, silver, tin, zinc and steel (though steel is an alloy)

With respect to many renewable resources, such as fish stocks, forests and water, the key challenge is to ensure their sustainable regeneration by safeguarding the reproductive capacities of the ecosystems (a process also known as the 'maintenance of natural capital').

In the case of some non-renewable resources, including many metals and construction minerals, security of supply is not currently giving cause for concern; in the case of others, such as fossil fuels and land, availability is already becoming a problem which is almost certain to grow.

This article sets out to assess the current and future trends governing both these resource classes. We also examine their global impact. Finally, we look at how businesses are impacted by the resource depletion challenge.

## Renewable resources

The global population has tripled over the past 70 years and water use has grown six-fold as a result of industrial development and the increased use of irrigation<sup>3</sup>. Within the next fifty years, the world population will increase by another 40 to 50%. This population growth, coupled with industrialisation and urbanisation, will result in an increasing demand for water, possibly resulting in situations of water scarcity at local level.

Capture fisheries and aquaculture supplied the world with about 106 million tonnes of food fish in 2004, providing an apparent per capita supply of 16.6 kg (live weight equivalent), which is the highest on record (latest data available). Global capture fisheries production reached 95 million tonnes in 2004, with an estimated first-sale value of USD 84.9 billion<sup>4</sup>. Of this total, aquaculture accounted for 43% (2004). There is a decrease in the contribution of capture fisheries to human consumption, but this is offset by an increase in the aquaculture contribution.

Products derived from forestry resources include fuelwood, charcoal, timber, paperboard, and forest products such as natural rubber and cork. Between 1992 and 2002, the consumption of forest products in the EEA increased by between 15-45% depending on the product category<sup>5</sup>. The developed world accounts for most of the demand for forest products. However, the demand for fuelwood in less developed countries is also expected to continue, increasing along with the demand for industrial wood.

The impact of the high demand for renewable resources will cause stress over fresh water supply and river eutrophication. By 2025, more than 2.8 billion people in 48 countries will face water stress or scarcity conditions. By 2050, the number of countries facing water stress or scarcity could rise to 54, with a combined population of 4 billion – about 40% of the projected global population of 9.4 billion<sup>6-7</sup>. Moreover, as fishery resources are already being exploited at their maximum, this could also increase the strain

<sup>3</sup> UN FPA (Population Fund), 2001, 'State of the World Population 2001', [www.unfpa.org/swp/2001/english/ch02.html](http://www.unfpa.org/swp/2001/english/ch02.html)

<sup>4</sup> FAO Trends in capture fisheries production <http://www.fao.org/fi/website/FRRetrieveAction.do?dom=topic&fid=3458>

<sup>5</sup> European Environment Agency (EEA), 2005, 'Sustainable use and management of natural resources', [http://reports.eea.eu.int/eea\\_report\\_2005\\_9/en/EEA\\_report\\_9\\_2005.pdf](http://reports.eea.eu.int/eea_report_2005_9/en/EEA_report_9_2005.pdf)

<sup>6</sup> American Association for the Advancement of Science, 'AAAS Atlas of Population and Environment', <http://atlas.aaas.org> and UNEP

<sup>7</sup> World Water Council, [www.worldwatercouncil.org](http://www.worldwatercouncil.org)

on this resource type in the future. Finally, with regard to wood consumption, deforestation – mainly, the conversion of forests to agricultural land – continues at an alarmingly high rate: about 13 million hectares per year.

## Fossil fuels

Fossil fuels (oil, coal and natural gas) constitute a major component of global energy demand and consumption. Between 1980 and 2000, world energy production increased from 6,600 to 9,352 Mtoe (million tonnes oil equivalent), a 42% increase, with most of the growth attributed to fossil fuels. The world's primary energy needs are projected to grow by at least 55% between 2005 and 2030, at an average annual rate of 1.8%. Fossil fuels, expected to continue to be dominant, are estimated to account for 83% of the increase in energy use to 2030<sup>8</sup>. The developing countries, whose economies and populations are growing fastest, are expected to contribute 74% of the increase in global primary energy use, with China and India alone accounting for 45% of the increase.

The global impact of this trend is undeniable. Coal and natural gas reserves could run depleted earlier than 160 and 65 years respectively. The world's oil reserves are sufficient to meet a projected growth in demand to 2030, but there are three bottlenecks:

- the USD 22 trillion worth of investment needed worldwide;
- the growing difficulties and expense involved in producing energy as oil companies shift to more geopolitically unstable regions and oil reserves (deepwater, offshore, oil sands) become less easily accessible. This may also cause energy insecurity, as the world's oil reserves are concentrated in a small group of countries;
- any eventual supply crunch, which is likely to cause oil peaks.

## Mineral commodities

The human race has consumed more aluminium, copper, iron and steel, phosphate rock, diamonds, sulphur, and even sand and gravel over the past century than over all earlier centuries put

together. Moreover, the pace continues to accelerate, so that today the world annually produces and is consuming nearly all mineral commodities at record rates. The unprecedented demand for minerals in emerging economies such as China and India is placing increasing pressure on the global supply of commodities such as copper, iron ore and zinc. Most EU industries are facing dwindling global supplies of commodities. Japan, the US, Europe and China are competing for increasingly costly ores.

The impact of the strong demand for mineral commodities primarily entails rising prices and declining stocks. Although, in the context of an economic slowdown, prices for base metals such as zinc, copper and lead have declined significantly, in the long term continued strong commodity-intensive growth is expected for China, which has been one of the main drivers of the demand for mineral commodities. At the same time, relatively low stocks and likely ongoing production difficulties suggest that most commodity prices can be expected to average well above their long-running historical trend over the next few years.

## Impact on companies

Assuming that the long-term trends of population growth and economic development continue, the long-term challenge of resource depletion will create numerous risks and opportunities for companies and their business models. At macro level, companies providing a solution (commodity recycling, green chemistry, and alternative renewable materials) to the resource depletion issue will be positively impacted. On the other hand, water-intensive, highly polluting and commodity-intensive business models will feel the pinch. At micro level, the challenges comprise, for instance, with regard to Training & Career Management, the greener techniques that require an up-to-date workforce, thus increasing the need for training. At "Society" level, rising commodity prices and/or resource depletion (notably water) are harming the purchasing power of the poorest populations, reinforcing the need for a sustainable relationship between firms and local communities.

## Two companies that score well on the resource depletion challenge

**One company** whose business model provides solutions to the resource depletion challenge is **Suez Environnement**, which offers innovative solutions to millions of people and industries with regard to drinking water, wastewater treatment and waste management.

**Another company**, good at managing resource depletion in its production process, is **Intel**. Intel's Fab 32 is described as one of the company's "most environmentally friendly" factories, incorporating a number of energy and water conservation measures. The bigger wafers that are produced at the plant lower the production cost per chip while diminishing the overall use of resources. The 300-mm wafers result in a 40% reduction in energy and water use per chip compared with a 200-mm wafer factory.

<sup>8</sup> International Energy Agency (IEA), [www.iea.org/Textbase/subjectqueries/keyresult.asp?KEYWORD\\_ID=4107](http://www.iea.org/Textbase/subjectqueries/keyresult.asp?KEYWORD_ID=4107)



The world's automobile industry manufactured over 73 million cars, vans, trucks and buses in 2007, equivalent to a global turnover of €2 trillion. The automobile industry brings individual mobility to the masses, participates in the economic and social development of the world's citizens, and – with more than eight million people working for vehicle manufacturers, i.e. over five per cent of the world's total manufacturing employment – makes an important contribution to the global economy.

In addition to these direct employees, about five times more are employed indirectly in related manufacturing and service provision, translating into more than 50 million people earning their living from cars, trucks, buses and coaches. The automobile industry is also a major innovator, investing annually almost €85 billion in research, development and production.

The automobile sector covers:

- automobile and motorcycle manufacturers;
- auto parts and equipment manufacturers; and
- manufacturers of tyres and rubber<sup>1</sup>.

The sector is inherently a cyclical business, closely tied to the fortunes of the international economy. Roughly speaking, the demand for passenger vehicles is positively correlated to the short-term evolution of GDP/capita, and negatively correlated to fuel prices and interest rates. This leads the industry to regularly restructure, cutting jobs, cancelling production shifts and shutting down production lines. In the light of the current difficulties facing the Big Three (GM, Ford and Chrysler), the sudden shift in consumer expectations surprised manufacturers, triggering massive job cuts and plant closures. Generally speaking, the automobile industry also tends to overestimate sales volume when designing cars and the related production facilities. This leads to systematic production-overcapacity, which often results in price reductions, margin erosion and bigger job cuts when the markets go downwards.

<sup>1</sup> MSCI Standard & Poor's: "Global Industry Classification Standard" (2002).

# The world's automobile industry manufactured over 73 million cars, vans, trucks and buses in 2007, equivalent to a global turnover of €2 trillion.

## The automobile sector's key sustainability challenges

The automobile sector is facing a series of sustainability challenges with a significant environmental, social and governance impact. We have identified five main challenges:

1. The need to reduce the environmental footprint of its products will force the sector to rethink its business model and operational processes as the political momentum is on the rise and fuel prices remain structurally high;
2. Product safety and quality: the emergence of low-cost players from emerging countries with improved product quality is making the industry increasingly competitive and, in this respect, quality has become even more important for existing car manufacturers;
3. The growing importance of suppliers in car manufacturing increases the need for responsible supplier relationships;
4. With the saturation of the western markets, a presence in the growing and developing countries is of strategic importance for those carmakers intent on being a future industry leader;
5. The need to sustainably manage human capital.

As each of these trends has critical implications for automobile companies, Dexia AM's Sustainability Analysis assesses the issues from both a Macro and Micro point of view:

### Macro Analysis:

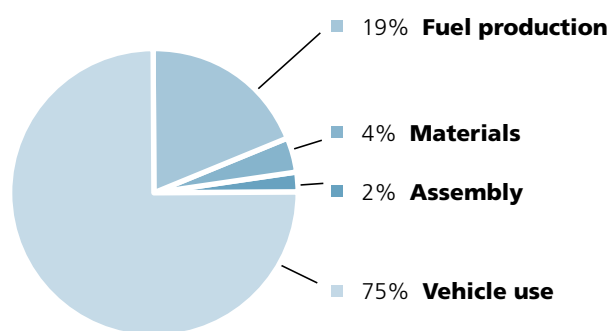
From a top-down perspective, automobile companies are differently exposed to the various KSCs (Key Sustainability Challenges): Climate Change, Resource Depletion, Ageing Populations, Growing and Developing Populations, Interconnectivity and Health & Wellness. In the automobile sector, some business models are benefiting or suffering more than others from those KSCs. Dexia AM's Sustainability Analysts identify the best-positioned companies within the sector in this respect.

### Micro Analysis:

At the same time, those challenges need to be addressed by individual companies in the interactions with their stakeholders. From a bottom-up perspective, Dexia AM identifies the companies that are best managing their stakeholder relationships through policies and management systems designed to deliver the best ESG (environmental, social, governance) performance.

## The need to reduce the environmental footprint of automobiles

The automotive sector is a major source of CO<sub>2</sub> emissions, which represent approximately 14% of global anthropogenic greenhouse gas emissions<sup>2</sup>. In the typical life cycle of an automobile, 75% of automotive-related emissions occur when the vehicle is being driven.



Fuel economy and CO<sub>2</sub> emission standards offer the best prospect for reducing vehicles' contribution to climate change. Taking into account the mounting political pressure to address climate change, and the likelihood of rising fuel prices in the mid-long run, all major automakers have begun to tackle the carbon footprint being left by cars: in the short term, by stressing fuel efficiency using conventional technologies (see Micro Analysis) and, in the longer term, by building up and developing alternative power trains (see Macro Analysis). Although carbon dioxide is the main culprit, the automotive sector is also responsible for the emission of many other atmospheric pollutants such as carbon monoxide, sulphur dioxide, hydrocarbons, lead, ozone and particulate matter. The automobile industry – mainly dependent, as it is, on steel, aluminium, platinum, glass, copper and rubber – is also a significant consumer of raw materials and natural resources. However, since we believe that carmakers will be impacted more homogeneously by the increasing steel, aluminium, glass, copper and platinum prices, our analysis emphasises oil efficiency and vehicles' atmospheric emissions.

<sup>2</sup> European Federation for Transport & Environment: "Reducing CO<sub>2</sub> emissions from new cars: a study of major car manufacturers' progress in 2007" (2008).

### Macro Analysis:

In addressing **Climate Change** and **Resource Depletion**, the major automakers have begun to tackle the environmental footprint of cars by developing alternative power trains for use in the long term. In our Macro Analysis, we look at various alternative technologies and rate them according to their GHG footprint and resource efficiency. For instance, we are more positive on full hybrids (such as the Toyota Prius) and pure electric vehicles than we are on gasoline-run vehicles, which, although technologically the cheapest vehicles to produce, are also the least advanced and amongst the most polluting on the road. Vehicles' atmospheric emissions will eventually also impact the **Health and Wellness** KSC. According to the World Bank, between 500,000 and 1 million premature deaths worldwide each year result from severe air pollution. Motor vehicles are responsible for a large share of the air pollution in the cities and surrounding metropolitan regions. Gasoline- and diesel-fuelled engine exhausts contain a range of toxic substances that can have a serious impact on health. Once released into the air, these substances are breathed in and transported via the bloodstream to the body's vital organs. New technologies such as hydrogen combustion engines and hydrogen fuel cells are more positively assessed than, for instance, diesel engines – the main source of direct particulate matter emissions from motor vehicles.

### Micro Analysis:

As the electric power train and fuel cell technologies still require fine-tuning to become competitive, the internal combustion engine remains the dominant technology in use in today's vehicles. Until the advent of zero-emission vehicles, automobile companies will need to manage the environmental impact ensuing from the use of their products, both at GHG-emission level and at air pollution level (nitrogen oxides, hydrocarbons, carbon monoxide and particulate matter). With regard to greenhouse gas emissions, after years of quasi- 'laissez faire', the US, Japan and the EU are now drafting new standards governing CO<sub>2</sub> emissions and fuel efficiency. Following December's vote at the European Parliament, EU fleets of passenger cars will have to average 130g CO<sub>2</sub>/km, with a gradual implementation from 65% of the fleet in 2012 to 100% as of 2015, and an adaptation of the limit depending on vehicle weight. Japanese fuel efficiency standards are also becoming more stringent, with a new target of 16.8 km/l for passenger cars in 2015 as opposed to the current objective of 13 km/l. The most awaited effort will come from the US, with the new administration's plan to make fuel efficiency standards for passenger cars and light trucks more than 25% more stringent by 2020. For passenger cars, the limit would change from 27.5 mpg today to at least 35 mpg (8.5l/100km). The fuel efficiency target for light trucks would rise from the current 22.2 mpg to 28 mpg. These standards are to be finalised before the end of March 2009. For the moment, as there remain serious technological barriers to the development of fuel cell vehicles, we believe that the most promising technology will be electric vehicle-related.

With regard to the atmospheric emission of non-greenhouse gases, in Europe, the Euro 6 emission standards, scheduled to enter into force in January 2014, should mainly reduce emissions of nitrogen oxides from diesel cars even further, possibly from 180 mg/km to 80 mg/km. Such emission standards require the adaptation of conventional technologies and imply considerable costs for the

automobile sector. Also, the lack of proper impact assessment has led to a significant underestimation of the Euro 5- and 6- related costs for manufacturers and consumers. The European Commission estimated that Euro 5 and 6 would raise the cost of a diesel car by about €200 on average. However, an independent panel set up by the European Commission concluded that the actual price of diesel cars would rise by up to €900 as a result. Also, with regard to product disposal and recycling, the requirement for components to be recycled, and for the weight of non-recyclable parts to be reduced, may exert increased pressure on both manufacturer and supplier product development. Further information on supplier issues is provided below.

### Safety and quality challenges

In 2000, approximately 1.2 million people worldwide died as a result of road traffic injuries, and another 7.8 million were seriously injured. In Europe, road traffic accidents are, annually, the most frequent cause of death among young people aged 5 to 29<sup>3</sup>. Although car safety has improved by leaps and bounds over the last decade, lethal car accidents remain a major issue. Technology has improved safety but automobiles remain a relatively unsafe means of transportation.

### Macro Analysis:

Growing mobility among people is posing new challenges to the sector. The rising number of cars and trucks, etc., increases the chances of accidents happening. With regard to the traffic injuries taken into consideration in the **Health & Wellness** KSC, we consider that all cars have a general negative effect and thus do not distinguish between business models where road safety is concerned.

### Micro Analysis:

"Road accidents" is one of the most costly sustainability issues for societies, and public authority decision-makers are increasingly regulating car safety. Leading the trend is the European Union, which has asked vehicle manufacturers to design vehicles that would minimize fatalities in accidents and make cars safer for drivers, passengers, pedestrians and cyclists<sup>4</sup>. As regards the safety issue, Dexia AM's Sustainability Analysis assesses, in particular, carmakers' efforts to include active and passive safety devices in their products, as well as the performance of vehicles in various crash tests. As cost-competitive carmakers emerge from Korea, China and India, mature-market carmakers are seeking product differentiation, in which context **Quality and Safety** has become a requirement for them. The financial impact of sub-standard product quality and safety is high. The numerous recall programmes launched by car manufacturers have put a heavy financial burden on the sector (principally in North America) and damaged brand reputation. Sustainability Analysis examines, in particular, carmakers' performance in various customer satisfaction surveys and quality and dependability studies. Also, safety and quality issues require the establishment of sound **sustainable supplier relationships**. Improper management of the relationship with suppliers is likely to result in quality issues and lower operational efficiency. The financial impact of well-managed supplier relationships is important. Interruptions and deficiencies in the supply chain impact suppliers, other suppliers downstream in the supply chain, and vehicle manufacturers.

<sup>3</sup> Eurosif: "Automobile sector report 3rd quarter" (2006).

<sup>4</sup> ILO: "Automotive Industry Trends Affecting Component Suppliers" (2005)

# The sector is inherently a cyclical business, closely tied to the fortunes of the international economy.

## The need for a well-managed supply chain

Car manufacturers increasingly rely on suppliers to manufacture accurate components and systems on a just-in-time basis. Although the auto equipment companies no longer produce parts, they do develop modules (increasingly fitted with electronic devices). This involves intensive interaction between assembler and supplier, from the design phase to the production phase, and a continuous synchronisation of the production processes. Since automakers have more brand equity than other sectors, a trustworthy supply chain, where suppliers' operations meet high social, environmental and quality standards, is a crucial feature in guaranteeing product quality and minimising the financial and/or reputational risks of unmanaged opaque supply chains.

### Macro Analysis:

Information technologies, assessed under the virtual mobility pillar of the Interconnectivity KSC, enable increased cooperation among vehicle manufacturers and their suppliers. General Motors, Ford, Daimler, Renault-Nissan and Peugeot-Citroën have launched a common online procurement company, Covisint. This system, and other similar ventures, is an information channel and facility enabling the co-design of parts. This was seen as a way to conduct auctions for parts, organise a global purchasing network and turn a profit. In the near future, information technologies are also expected to revolutionize the sector's sales and distribution activities, which currently account for up to 25% of the cost of a new car. It is said by some to be the only part of the supply chain that is not yet 'lean'. Although the Interconnectivity KSC is important to the sector, it is difficult to distinguish groups of companies (business models) with regard to this macro-trend. In our view, the industry is, on the whole, being positively impacted by the opportunities afforded by this KSC as regards supply chain management.

### Micro Analysis:

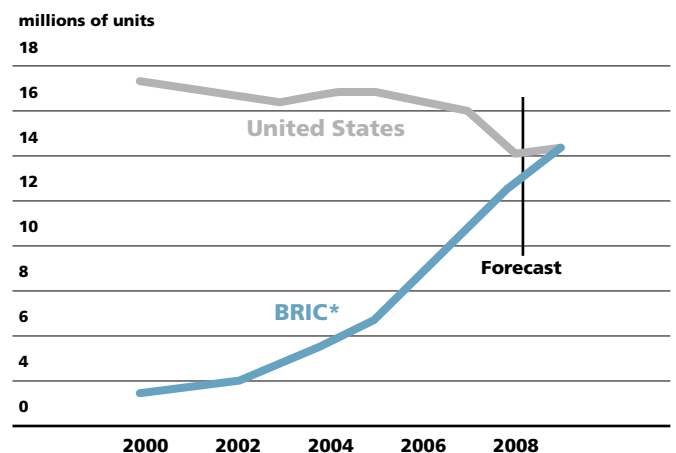
With regard to **sustainable relationships with suppliers**, the complexity of the product makes it necessary for suppliers and carmakers to work alongside each other from the car design stage to the close of production<sup>5</sup>. Suppliers play a key role in improving vehicle fuel efficiency, limiting emissions and enhancing safety. Developing modules (e.g., the Stop & Start system at the core of micro-hybrid vehicles) that are eventually sold to several carmakers, suppliers increasingly boast the technological expertise that carmakers need to meet legal standards. More and more, the growing importance assumed by suppliers in car manufacturing increases the need for a well-managed collaboration with carmakers. Interruptions and deficiencies in the supply chain impact

all parties: the primary supplier, other suppliers downstream in the supply chain and vehicle manufacturers. Carmakers' relationships with suppliers are also important in the light of the latest European and Japanese regulations on product recyclability (theme: **product disposal & recycling**). The requirement for 95% of a vehicle's mass to be recyclable or reusable forces carmakers and suppliers to coordinate with each other during the product design phase.

## Stronger focus on growing and developing markets

Like other global manufacturers, automotive companies once regarded the emerging markets primarily as low-cost locations where the basic components could be produced. Now, attracted by the enormous business opportunities and the necessity to assemble close to markets, more and more automotive manufacturers are locating their complex production facilities, R&D and sales/marketing operations in these rapidly growing economies. The emerging markets, especially BRIC, are now synonymous with growth potential. PricewaterhouseCoopers forecasts that, in terms of vehicle assembly, nearly one-third of the global automotive industry's growth over the period 2004-2012 will come from China. India and Eastern Europe are also rapidly emerging as strong growth markets.

## The BRIC markets are already overtaking the US in terms of volumes sold<sup>6</sup>



\* Brazil, Russia, India and China

<sup>5</sup> McKinsey: "Global sourcing in the auto industry" (2004).

<sup>6</sup> Novascottia Bank: "Global Auto Report Global Auto Sales Lose Momentum – But BRIC Nations Remain In The Fast Lane" (July 2008), available at: [http://www.scotiacapital.com/English/bns\\_econ/bns\\_auto.pdf](http://www.scotiacapital.com/English/bns_econ/bns_auto.pdf)

# Macro Sustainability Analysis

The most relevant, and equally weighted, Key Sustainability Challenges (KSCs) for the automobile sector are:

- Climate change,
- Resource depletion, and
- Growing and developing populations.

## Macro Analysis:

The relevance of companies' exposure to the **Growing and Developing Populations** KSC is obvious, with a few manufacturers benefiting from the first-mover advantage of early arrival on those markets (e.g., VW in China, FIAT in Brazil). There are also strong links with the **Interconnectivity** challenge, as products and services (including cars) become more globalised. The more frequent exchange of information leads to the converging social and consumption patterns which enable the marketing of global products. Until recently, western and Japanese carmakers were only offering outdated products on the Chinese market. Volkswagen Jetta and a local version of the Peugeot 306 were among the best sellers. For carmakers, this was a way to market cheap vehicles (design costs were for a long time amortized) while protecting their latest technology from copy by unreliable local partners in a country where patent right is not enforced. However, as this promising market gradually began to attract more and more competitors, carmakers were led to offer the latest models, in addition to low-cost vehicles. VW now offers its latest Passat to Chinese consumers whereas PSA recently announced plans to market its 407 and C5 on the Chinese market.

## Micro Analysis:

The increased activity in the emerging markets increases the relevance of **quality and safety issues**. The number of road deaths per inhabitant rises sharply in the early stages of motorization, when people's budget limits them to, first, motorcycles, and then relatively basic and cheap cars, as happens in India and China. The second stage sees road deaths being expected to decrease as the (more expensive) vehicles demanded will increasingly integrate safety devices. **Suppliers' labour and environmental practices** also need to be more closely monitored in the emerging markets as scandal can harm reputations. The denunciation, in the global media, of repeated violations of international labour standards has often triggered reforms from companies. To avoid controversy, reputation damages and financial penalties, companies must ensure that proper social and environmental standards are in place along the supply chain. Finally, **remuneration** is becoming more relevant in the emerging markets, as increasingly massive strikes lead to consequential pay rises. Some recent examples concern Renault (at its Romanian subsidiary, Dacia), Hyundai, KIA and Daewoo.

## The need to sustainably manage human capital

Automobile companies are very large employers of blue collars and engineers. The industry is also cyclic, with a correlation between the demand for new vehicles and consumer confidence, the latter, in turn, correlated with economic growth. A common habit within the industry is to overestimate the volumes sold when launching new models, thus entailing production overcapacity. When the cycle reverses and demand drops, manufacturers frequently shut down production lines or entire factories, and cut jobs massively.

## Macro Analysis:

Compared to other industries, auto industry demographics have an **older workforce**, at all employment levels, from shop floor to middle and top-level management. American automobile company competitiveness is penalized by the weight of rising pension and healthcare costs, which add between USD 1,100 and 1,500 to the cost of each vehicle made by North American vehicle manufacturers<sup>7</sup>. The "Ageing population" challenge is more of a risk in North America than in Europe due to the nature of the retirement systems.

## Micro Analysis:

Due to the sector's cyclical nature, changes and shifts in production capacity are inevitable. To achieve flexibility, flexible contracts and the use of temporary or agency staff is becoming more the norm. Temporary workers account for 10 to 30% (during peak production periods) of the total workforce<sup>8</sup>. A more sustainable way of managing market cycles is through labour agreements and **working time flexibility**, notably with respect to annual working time. For instance, BMW went decades without having to worry about restructuring plans, thanks to effective flexibility agreements with the unions. In both France and Germany, assemblers and suppliers have negotiated increased working hours, sometimes under the threat of relocation (e.g., Bosch, in France)<sup>9</sup>.

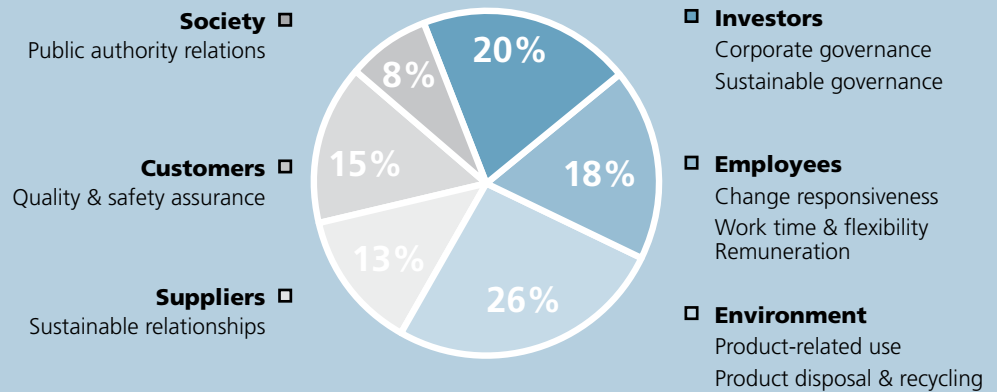
<sup>7</sup> Ernst & Young: "Strategic business risk automobile 2008" (2008).

<sup>8</sup> Eurosif: "Automobile sector report 3rd" (2006).

<sup>9</sup> "L'expansion: Bosch relance le chantage à l'emploi contre les 35 heures" (15 December 2005). Available at: [http://www.lexpansion.com/economie/actualite-entreprise/bosch-relance-le-chantage-a-l-emploi-contre-les-35-heures\\_112450.html](http://www.lexpansion.com/economie/actualite-entreprise/bosch-relance-le-chantage-a-l-emploi-contre-les-35-heures_112450.html)

# Micro Sustainability Analysis

Weighting of each stakeholder and major themes within the automobile sector:



## Three companies in the Automobile Sector

### EUROPE: PSA

Peugeot SA (PSA), one of Europe's leading mass-market car manufacturers, is, in fact, the world's eighth-largest, with revenues of €60.6 billion in 2007. The group sells its products under the Peugeot and Citroën brands in 150 countries, with manufacturing facilities in 10 of them. PSA remains a predominantly Europe-focused player, with 66% of its 2007 revenues originating in western Europe, even though the group is increasing its presence in the emerging markets. PSA also owns 70.85% of parts supplier *Faurecia*, is involved in the logistics and car transportation business with GEFCO, and is the third-largest European manufacturer of scooters and motorcycles in the 50 to 125cc range.

Peugeot's key sustainability challenges and opportunities are outlined below:

#### Macro Analysis

- **Climate change/Resource depletion** – PSA is one of Europe's leading vehicle manufacturers with comparatively low CO<sub>2</sub> emissions and improved fuel efficiency. Over the last three years, PSA has sold more than 1 million vehicles emitting less than 140gCO<sub>2</sub>/k; about 40% of group revenues (the highest ratio in the industry) are derived from fuel-efficient cars. PSA is well-positioned to meet future European CO<sub>2</sub> standards as a comparatively high share of its revenues is derived from sales of compact vehicles with downsized diesel engines and a noticeably small share from SUVs and larger vehicles.
- **Growing & developing population**: PSA exposure to the non-European markets is satisfactory and improving. The group enjoys good exposure in China thanks to its joint venture with Dongfeng (estimated at 6% of revenues in 2007) and in South America, with Brazil and Argentina accounting for more than 5% of group revenues. PSA also has an interesting foothold in the promising Russian and Eastern European markets.
- **Human Health & Wellness**: PSA, one of the first manufacturers to introduce Diesel Particulate Filters into its line-up, remains a leader in the field of clean diesel (estimated 13.5% of revenues from diesel with particulate filters). The PSA product range also boasts one of the top industry performances in product safety, with an estimated 46% of its 2007 revenues derived from vehicles scoring 5 stars at the Euro NCAP crash test assessments.

#### Micro Analysis

- **Environmental impact of product use** – In comparison to its peers, the PSA product boasts excellent environmental performances. The group products integrate some of the industry's most fuel-efficient downsized diesel engines and a partnership with BMW has resulted in state-of-the-art direct-injection gasoline engines entering the line-up. PSA is also an industry pioneer in the area of micro-hybrids (vehicles equipped with a Stop & Start system) on the European markets, and the group remains thus far the only mass manufacturer to market these products. Thanks to its technological expertise, the PSA fleet has the lowest average CO<sub>2</sub> emission/km in Europe: 141gCO<sub>2</sub>/km in 2007 (T&E). PSA is one of only four carmakers on track to comply with the industry's commitment to reduce fleet emissions to 140gCO<sub>2</sub>/km by 2008. PSA is also set to be one of the first to market diesel hybrids in Europe by 2012.
- **Quality & safety**: PSA scores the industry average in the J.D. Power customer satisfaction surveys and in the J.D. Power assessments of vehicle initial quality and dependability. While the group's vehicles were formerly reputed, quality-wise, as lagging behind the best German carmakers, the group seems to be living up to its recent commitment to quality enhancement, and figures indeed show serious improvements on this front in the last two years.
- **Change responsiveness**: Although PSA has been conducting a substantial restructuring plan for the last three years, the group has been exposed to no major controversy, thanks to a comprehensive set of social measures covering, in particular, early retirement, proper financial incentives for voluntary departures coupled with, for example, job search assistance and the organization of job fairs. Interestingly, the five biggest unions have signed a 'Human Resources Planning and Development Agreement' with management, which covers the whole restructuring plan.
- **Product disposal & recycling**: As regards product disposal and recycling, PSA fully complies with European standards, with a minimum of 95% of the vehicle weight being reusable and recoverable, and 85% recyclable. With respect to green materials, PSA cuts a rather encouraging figure, with 6% of the polymers used in the vehicle being either from a recycled source, or from natural organic material or biopolymers (i.e., not from the petrochemical industry). The group has set itself the challenging objective of a "green" polymer weight of 20% by 2011.

## EUROPE: MICHELIN

Michelin is a French company specialized in the manufacture and distribution of tyres for passenger vehicles, trucks (including light trucks), tractors, handling equipment, industrial and construction earthmovers, two-wheel vehicles, aircraft, subway trains and trams (87% of revenues in 2007). The group also markets a range of travel guides, maps, GPS devices and associated website, as well as car accessories and suspension and tyre monitoring systems. The group sells its products worldwide, with only 25% of group revenues generated by the European markets (2007).

Michelin's sustainability challenges and opportunities are outlined below:

### Macro Analysis

- **Resource depletion – Green tyres:** Michelin initiated low-rolling resistance tyre technology in 1992, since when the group has developed its range of products further than any other competitor (ca. 50% of passenger car tyres sold in 2007), making it the world leader in low-rolling resistance tyres. The group's latest-generation green tyres improved rolling resistance by up to 25% in comparison with conventional black tyres, thus allowing fuel savings of up to 5%. The group's technological and market leadership in low-rolling-resistance tyres is particularly interesting in the perspective of the new European 130gCO<sub>2</sub>/km emission standards on passenger cars, implementable as of 2012.
- **Growing and developing populations:** Michelin – with a production network of 69 plants in 19 countries and a sales network covering 171 countries – is a true industry-(world)wide

player. The company has a notable presence in North America (ca. 33% of revenues in 2007) and in the BRIC countries, with China accounting for more than 4% of group revenues in 2007.

### Micro Analysis

- **Environmental impact of product use:** In addition to the low-rolling resistance tyre technology, Michelin, anticipating the emerging issue of the environmental impact of tyre debris left on the road, has pioneered the industry in this respect.
- **Quality and safety:** Quality is a pillar of group strategy, a commitment backed by the excellent group performance in various customer satisfaction surveys. Michelin tyres rank first in every segment of the J.D. Power Satisfaction Survey in the USA – the industry benchmark – and the group's products have received various awards around the world from, inter alia, the US National Highway Traffic Safety Administration (NHTSA).
- **Product disposal and recycling:** Michelin is the most active tyre manufacturer in the area of tyre disposal and recycling. The group initiated the setting-up of a recovery network in Europe and works with public authorities to promote the 'producer responsibility system' which sees tyre manufacturers effectively taking charge of old-tyre recycling and reuse. Furthermore, the group leadership in tyre recycling contributes to Michelin's operational performance in that it helps optimise group consumption of raw materials.

## ASIA PACIFIC: TOYOTA

Toyota Motor Corporation (Toyota Motor) is the world's largest car manufacturer, with 8.91 million vehicles sold in 2008 and a total revenue of ¥26,289 billion (ca. €221bn). The group manufactures its products in 53 locations in 27 countries and sells them in 170 countries under the Toyota, Lexus, Hino and Daihatsu brands. In addition to passenger cars and trucks (including light trucks) – which, together, generated 95% of the group revenues in 2008 – Toyota Motor is particularly involved in the motorboat and marine engine business. Toyota Motor employed 316,121 employees as at March 2008.

Toyota's sustainability challenges and opportunities are outlined below:

### Macro Analysis

- **Climate change/Resource depletion:** Toyota Motor is world leader in the area of full-hybrid-electric vehicles, with 440,000 Prius II sold in 2007 (ca. 5% of volumes) and four additional hybrid models marketed.
- **Growing and developing populations:** Toyota Motor benefits from excellent geographic diversification, with a very strong presence in North America (35% of its revenue in 2008), and solid performances in Europe (15% of revenues in 2008) and in Asia (excl. Japan, ca. 11%).

### Micro Analysis

- **Environmental impact of product use:** Toyota Motor's fleet is one of the most fuel-efficient, with an average of 149gCO<sub>2</sub>/km in the EU in 2007 (where it came fourth out of 13) and an

average fuel efficiency of more than 36 mpg in the US, making it the most fuel-efficient fleet on this market (i.e., the Number One!). Concerning internal combustion engines, Toyota is up there with the industry's best as regards advanced direct-injection gasoline and second-generation common-rail diesels. The group is also present in the area of Flexible Fuel Vehicles and Compressed Natural Gas vehicles.

- **Quality and safety:** Toyota is well-known for its attention to the product quality on which the group's reputation – not forgetting a core element of its commercial success – is based. Toyota is, in fact, an acknowledged industry leader in product quality. The group notably ranked first in the J.D.Power 2007 North American Customer Satisfaction Survey and in its Vehicle Dependability Study, and second in the J.D.Power Initial Quality Study. The group's vehicles are among the sector's best performers in crash tests, most models achieving 5 Euro NCAP stars.
- **Product disposal and recycling:** Toyota effectively integrates recyclability constraints in the design of its products, thus being one of the first car manufacturers to meet both Japanese and European recyclability standards: in 2007, Toyota achieved a recyclability rate of 96% of the total mass of newly produced vehicles, and 76% of the non-metallic waste contained in the vehicle. The group is currently building a network of 560 recovery centres for end-of-life vehicles in Europe.

## Three Questions to **Jean-Pierre Klumpp,** CEO of BlueOrchard



### 1. WHAT ARE MICROCREDIT FUNDS? WHAT TYPES EXIST? WHAT TYPES OF CLIENTS DO THEY TARGET?

Microcredit funds (MCFs) primarily invest in microfinance institutions (MFIs), which, in turn, provide financial services (micro-loans, etc.) to micro-entrepreneurs to develop countries in Africa, Asia, Eastern and Central Europe and Latin America. Most MCFs invest in the senior debt (i.e., loans) provided to MFIs for their refinancing. In addition, in recent years, since many MFIs have continued to experience an explosive growth rate, microfinance private equity funds have been launched to respond to the need for equity.

MCFs such as Dexia Microcredit Fund (DMCF – a specific type of Sustainable and Responsible Investment), jointly managed by BlueOrchard and Dexia Asset Management, provide investors with both a financial and a social return (double bottom line). The first wave of clients/investors was initially high-net-worth individuals attracted both by the socio-economic developmental impact of the investment and by the financial trumps provided by its low volatility and low correlation to traditional financial assets. As social added value is very important to us, we are investing time and resources in measuring and reporting social impact where possible. Thanks to the capital provided by the loans, micro-entrepreneurs lacking access to traditional banking services are able to develop and grow productive businesses and improve their families' and communities' standard of living. In recent years, many institutional investors, in particular pension funds, considering microfinance a new 'alternative' asset class with a long-term investment horizon, have progressively integrated mature microfinance products/funds into their asset allocation.

### 2. WHAT ARE THE SPECIFICITIES OF MCF MANAGEMENT? HOW HAS DMCF BEEN ABLE TO POST SUCH GOOD PERFORMANCE OVER THE PAST TEN YEARS?

Microfinance as an industry has grown at a stellar pace over the past 25 years. Nevertheless, it is only in the past ten years that international commercial funding has entered this new investment field. The investment universe suitable for microfinance investment vehicles (MIVs) comprises well-performing MFIs that meet the fund manager's qualifying criteria. It is, therefore, key for good managers to have a thorough understanding of microfinance, of the MFIs themselves as investment targets/borrowers and, last but not least, of the environment (the overall country situation, especially as regards microfinance) in which MFIs operate.

DMCF has performed well in the past ten years thanks to the winning combination of the microfinance expertise that BlueOrchard has developed over many years, a very disciplined approach to credit and risk management (credit scoring, due diligence on site repeated annually, monthly monitoring, etc.), and good portfolio management and monitoring. To date, and since the fund's inception in 1998, there have been no repayment defaults but rather an overall positive performance year after year. The targeted annual return of the fund is the 6-month Libor (London Interbank Offered Rate) plus 1 to 2%. This target has been achieved nearly every year since inception, with extremely low volatility. Moreover, we remain very vigilant to risk and, although we believe the returns will continue to be largely uncorrelated to the mainstream financial assets, we keep a well-diversified portfolio at, for instance, country level, to secure our assets.

### 3. WHAT ARE THE LONGER-TERM PERSPECTIVES AND OPPORTUNITIES?

MIVs performed well in 2008 despite the turmoil on the financial markets. This is particularly true of DMCF, which shows a very solid performance for the year, although the performance of the EUR and CHF classes was somewhat affected by the volatility in the currency markets, which, although making hedging costs higher than usual in the last quarter of the year, still generated solid returns here. In the context of the overall 'inclusion' objective of microfinance, it is obvious that MFIs progressively develop relationships with banking institutions in their own country as the latter represent an additional source of funding next to savings, financing from development banks and international investors like MIVs. The global credit crunch is therefore having an impact, primarily on liquidity and refinancing. Rising food prices in some of the countries targeted by DMCF, lower remittances and instances of over-indebtedness at sub-borrower level also need to be factored in. Nevertheless, this primarily impacts the pace of growth rather than the actual credit quality. We are pleased to see that the MFIs in which we have invested are holding their own, taking all the right measures (e.g., more moderate growth projections, concentration on portfolio quality and provision of other banking services). We believe this challenging period will contribute to the further strengthening of the microfinance industry. The lower volatility, de-coupling arguments and socio-economic impact will continue to be interesting attributes for investors. We can observe keen interest from various new investor groups for microfinance. We expect MFI growth to continue, albeit at a slightly more moderate pace of 20 to 40% as the markets become more mature. Microfinance is a key to economic and social development and the needs of the developing economies are so great that the growth potential for microfinance investments is immense. DMCF is proud to be one of the contributors.

# News

## EU climate bill paves way for hard year of talks

The world's most stringent climate-change package was re-approved by the European Parliament on 17 December, 2008. The clearing of the European Union's final hurdle means the bloc is now legally committed (a) to cutting its greenhouse gas emissions to 80% of 1990 levels by 2020, (b) to generating at least 20% of its energy from renewable sources by 2020 and (c) to committing billions of euros in funding to the development of carbon capture and storage technology. Dexia Asset Management's Macro Sustainability Analysis is performed on a number of Key Sustainability Challenges (KSC), the long-term sustainability trends of which climate change is one of the most important. Dexia Asset Management will gradually include this legal framework in its Sustainability Analysis on an industry-by-industry basis for all companies in the developed markets.

<http://www.ft.com/cms/s/0/5987d5e0-cca3-11dd-acbd-000077b07658.html>

## The third Club Washington tackles green energy

On 13 November, 2008, Dexia Asset Management's third Club Washington (a meeting on sustainable development and sustainability challenges) took place. The topic of the third meeting – whose keynote speaker, Madame Corinne Lepage, formerly Minister for the Environment in France and current president of ecological think tank CAP21 – was "Green Energy: Myth versus Reality". Gaëtan Herinckx, Head of Sustainable and Responsible Investment, rebutted some popular myths about green energy, including the myth that green energy is expensive, by stating that many forms of green energy are already comparable to fossil fuels. He also argued that we need a mix of alternative energy forms in order to address climate change and energy security challenges and shed some light on the future trends in wind, solar and geothermal energy. Energy and climate change – major themes in Dexia Asset Management's sustainability analysis – is reflected in Dexia Equities L Sustainable Green Planet, our green sustainable thematic SRI fund, that tackles the environmental domains of water, energy and waste management.

## Mandatory CSR reporting for Denmark's largest companies

At the end of 2008, a law was adopted in Denmark requiring the 1,100 largest companies in the country to report on their corporate responsibility efforts. The new bill, which was passed by a vast majority in the Danish parliament, makes it mandatory for publicly listed companies, state-owned companies and institutional investors to include information on CSR in their annual financial reports, which must include information on the company's policies for CSR or Sustainable and Responsible Investment (SRI), on how such policies are implemented in practice, and the results obtained, as well as management expectations for the future with regard to CSR/SRI. The latter is still voluntary and it is up to the companies themselves to decide how to engage, but if a company has no CSR policy, it is obliged to officially say as much. The new reporting requirement takes effect from 2010. Dexia Asset Management applauds this initiative. In its sustainability analysis, much attention is paid to the ways in which companies report on their corporate responsibility efforts. The setting of quantitative and concrete goals is also poised to gain in importance.

[http://www.unglobalcompact.org/newsandevents/news\\_archives/2008\\_12\\_17.html](http://www.unglobalcompact.org/newsandevents/news_archives/2008_12_17.html)

## "Dramatic" rise in number of companies measuring staff well-being

81% of UK employers now publicly report their commitment to health and well-being compared with 68% in 2007. According to Business in the Community's "Business Action on Health" campaign, there has been a "dramatic" increase in the number of FTSE 100 companies reporting their progress on health and well-being using quantitative measures, up from 7% in 2007 to 23% in 2008. For many sectors, Health & Safety is one of the most important themes evaluated by Dexia Asset Management's sustainability analysis. The increasing amount of performance-reporting is a welcome development, as it consequently increases the ability to make quantitative performance comparisons.

<http://www.hrmagazine.co.uk/channel/news/article/851919/Dramatic-rise-number-companies-measuring-staff-wellbeing/>

# Our sustainable funds and their returns as at January 2009

Retail fund reports available at [www.dexia-am.com](http://www.dexia-am.com)

Name of the SRI fund/subfund	ISIN code cap.	ISIN code distrib.	Description	Performance				
				YTD	1 year	3 year	5 year	
<b>EQUITY</b>								
Dexia Sustainable EMU	BE0174192774	BE0945307420	Equities listed in the euro zone	-7.04%	-44.29%	-42.88%	-23.49%	
Dexia Sustainable Europe	BE0173540072	BE0945310457	European equities	-3.91%	-42.36%	-44.14%	-22.35%	
Dexia Sustainable North America	BE0173901779	BE0945318534	Equities listed in the US and in Canada	-7.11%	-42.20%	-38.60%	-29.88%	
Dexia Sustainable Pacific	BE0174191768	BE0945054808	Equities listed primarily in Japan and in Australia	-8.68%	-49.58%	-53.56%	-33.95%	
Dexia Sustainable World	BE0946893766	BE0946892750	International Equities	0.66%	-34.89%	-42.24%	-27.06%	
Dexia Equities L Sustainable Green Planet	LU0304860991	LU0304861296	International Equities	-0.18%	-32.96%	-	-	
Dexia Equities L Sustainable World	LU0113400328	LU0113400591	International Equities	-1.47%	-34.61%	-43.61%	-27.87%	
Dexia Equities L Sustainable Emerging Markets	LU0344046742	LU0344046825	Emerging Markets Equities	0.46%	-	-	-	
<b>BONDS</b>								
Dexia Sustainable Euro Corporate bonds	BE0945493345	BE0945492339	Corporate euro-denominated bonds	-1.73%	-7.70%	-7.25%	-	
Dexia Sustainable Euro Bonds	BE0943336116	BE0943335100	Bonds issued by the public and the private sector	-1.93%	-1.53%	0.10%	-	
Dexia Bonds Sustainable Euro Government	LU0012089420	LU0012089693	Bonds issued by the public sector in euro	-0.76%	2.61%	5.38%	15.77%	
Dexia Sustainable Euro Long Term Bonds	BE0945484252	BE0945483247	Public and private sector bonds denominated in euro; portfolio with average long duration	-3.35%	-1.88%	-2.77%	-	
Dexia Sustainable Euro Short Term Bonds	BE0945490317	BE0945489301	Public and private sector bonds denominated in euro; portfolio with average short duration	0.51%	2.08%	7.55%	-	
Dexia Sustainable World Bonds	BE0945478197	BE0945477181	Public and private sector bonds denominated in different currencies	0.82%	2.15%	-0.11%	-	
Dexia Ethique Gestion Obligataire	FR0000934978	FR0000935025	Bonds in euro	-0.32%	3.18%	5.93%	15.07%	
<b>GLOBAL BALANCED</b>								
Dexia Sustainable European Balanced High	BE0169199313	BE0945312479	European equities and euro-denominated bonds (predominantly equities)	-3.28%	-29.88%	-30.34%	-8.88%	
Dexia Sustainable European Balanced Medium	BE0159411405	BE0945316512	European equities and euro-denominated bonds (equally weighted)	-3.13%	-21.14%	-20.85%	-1.59%	
Dexia Sustainable European Balanced Low	BE0159412411	BE0945314491	European equities and euro-denominated bonds (predominantly bonds)	-2.38%	-11.10%	-9.03%	7.97%	
<b>MICRO-CREDIT</b>								
Dexia Micro-Credit Fund	LU0091117944		Micro-credit	0.08%	5.31%	18.53%	29.73%	

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You will also find information on our internet site at [www.dexia-am.com](http://www.dexia-am.com).

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**IMPORTANT INFORMATION CONCERNING THE SUSTAINABILITY ANALYSIS**

Dexia AM's Sustainability Analysis is based upon different sources of information developed within Dexia AM's SRI team, among others: sector studies and company analyses by Dexia AM's sustainability analysts, "Dexia AM's Sustainability Analysis Research Methodology 2006", "Methodology Guidelines November 2005" by Franca Morroni, "Dexia AM SRI Business Case 2004" and Dexia AM leading SRI principles and multiple research conducted since 1996 as well as data from selected SRI data providers.