

# ESG and Value Creation in Private Equity

11 December 2017



*The business of sustainability*

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# Introduction to ERM



## History

40 years of working with leading organisations including 50% of Fortune 500 companies in the last 5 years



## People

Unique blend of staff i.e. technical, strategy, GP, LP and banking experience



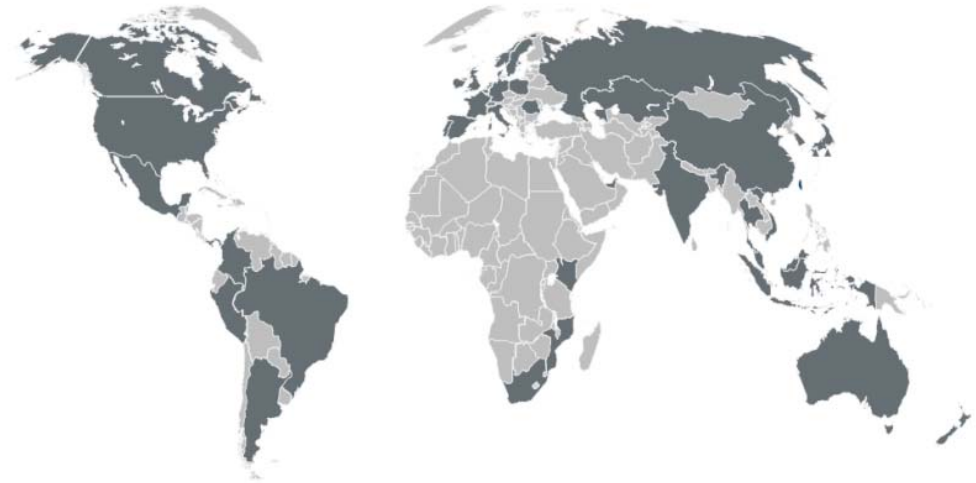
## Private Equity and Financial Sector

Delivers ESG support to over 100 GPs, LPs and lenders across the globe



## Experience

500+ ESG assessments annually for PE and their portfolio companies.



160

Offices in 40  
countries

4,500+

Professional  
staff

150+

Countries with  
projects completed

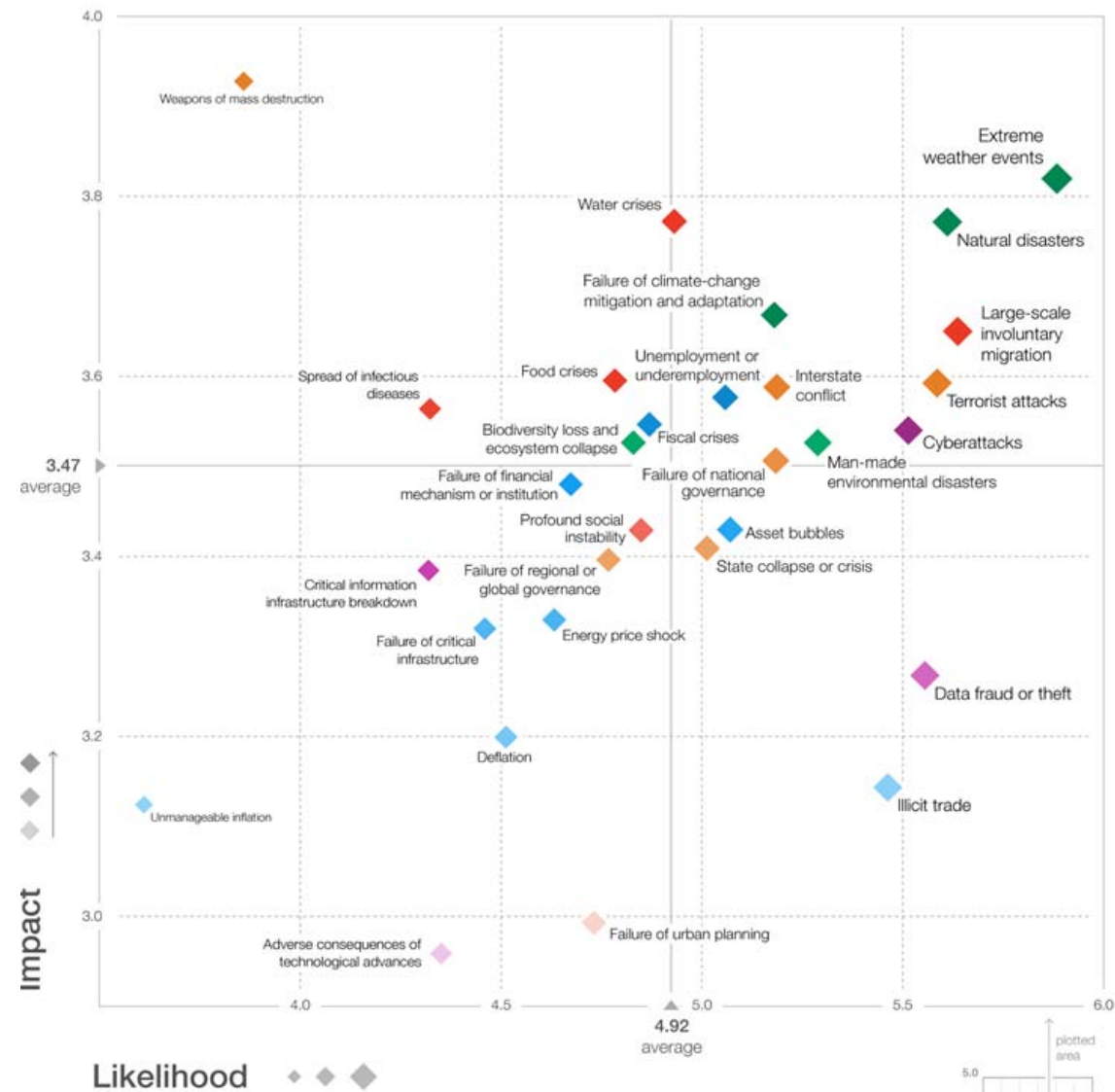
# ESG continues to headline across the macro risk landscape

## Categories

- ◆ Economic
- ◆ Environmental
- ◆ Geopolitical
- ◆ Societal
- ◆ Technological



COMMITTED TO  
IMPROVING THE STATE  
OF THE WORLD



# Low carbon transition posing fundamental questions



*"The vast majority of reserves are un-burnable if global temperature rises are to be limited to below 2°C. ..The tragedy of the horizons could cause market failure."*

*"We [Bank of England] will be deepening and widening our inquiry into stranded assets."*



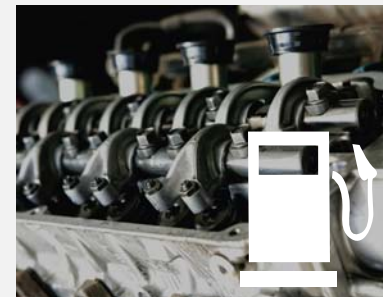
Wants to pull investments out of the Oil & Gas sector, citing a desire to minimise "the Norwegian economy's vulnerability to a permanent drop in oil prices".



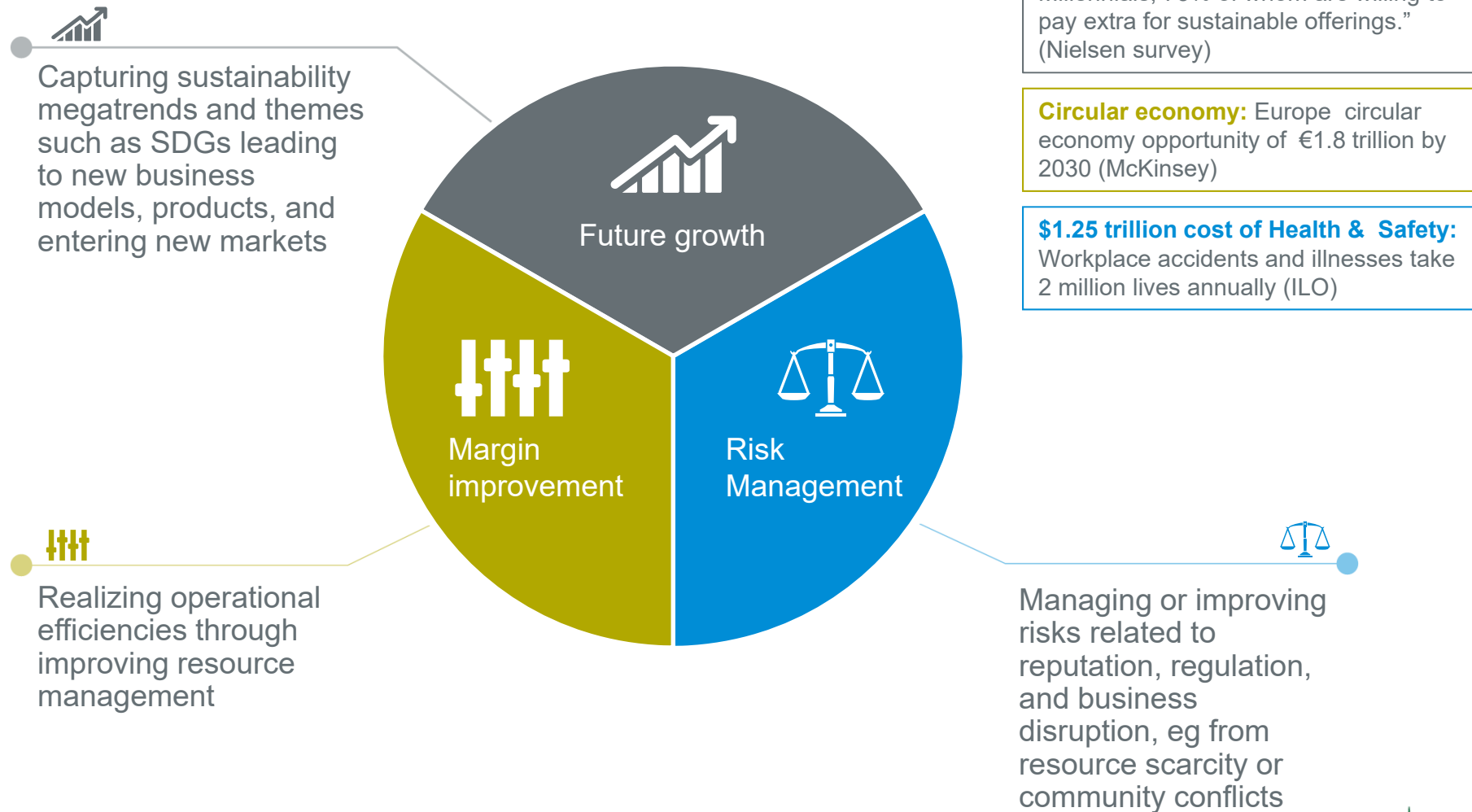
The Task Force engaged ERM to inform its work by developing a technical paper on the use scenario analysis in disclosure of climate related risks and opportunities



Vs



# Value model for PE companies through an ESG lens





# PE ESG Survey: Material impacts and significant untapped value

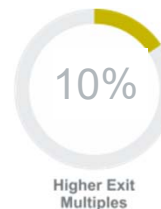
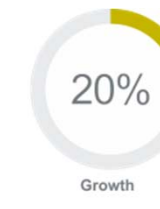
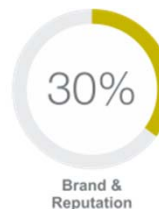
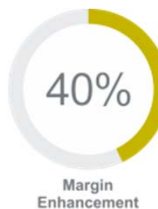
## 70%

of survey respondents have seen ESG issues materially impact their investments

### Value Protection (60%)



### Value Enhancement (40%)



*“The gap is getting bigger between best in class and followers”*

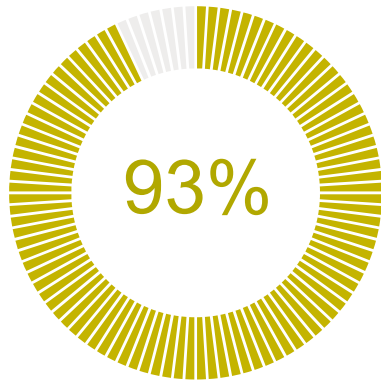
*European LP*

## 95%

of survey respondents believe there is significant untapped value from ESG in their portfolio companies

Source: \* ERM 2016 Survey ‘ESG: The Multiplier Effect’, covering 60 GPs and LPs with \$1.3trillion AUM

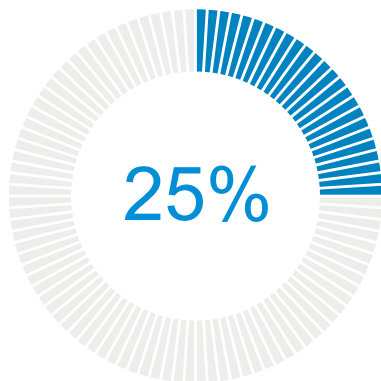
# Limited Partners' ESG engagement on the rise



*of LPs are incorporating ESG in their manager selection processes\*\**

*“Some LPs are driving the agenda, but this is a relatively small percentage, especially in the US. If there is broader recognition [by LPs] it will certainly drive change in greater adoption of better ESG performance”.*

*European large cap GP\*\**



*believe that successful ESG programmes in their portfolio companies can enhance the reputation of the GP itself, and subsequently boost their own ability to fund raise. \*\**

*“...several hundred million more dollars during fundraising...”*

*North American large cap GP\*\**

# Transaction Due Diligence: Impact on value & growth



**Client:** Private Equity (Food & Beverages)

**Project:** Transaction Support

- **Continuity of raw material supply concerns** over the availability of certain key raw materials, which could either drive up costs (of the order of \$10m+) or require substitution
- **Constraints to plans** for expanding operations in water stressed regions (\$3m+ to source alternative supplies)
- ERM wastewater expert identified **additional Capex outlay of \$5m** across three sites to meet future regulations
- **Reputational concerns and additional OPEX** required to ensure appropriate labour conditions in operations and supply chain and compliance with regulations such as the UK Modern Slavery Act (MSA)





# Examples: Portfolio Company Opportunities



## Productivity and cost avoidance: Health & Safety Management

Improved health and safety and management resulted in a **68% reduction in Incidents with Days Lost** (i.e., loss time accidents) globally – future **cost avoidance estimated at \$8M+**.



## Eco products range: Driving revenue growth during hold-period

Product innovation developments offer eco-friendly models with natural refrigerants, improved energy efficiency, technology to prevent leaks, increased recyclability of products. **\$50m growth in 5 years**

# Value driven Compliance Programs: EED Compliance



- Undertaking 95 energy audits across the Portfolio Companies to identify low and no cost energy saving opportunities
- Able to efficiently demonstrate and report regulatory compliance to the regulators before the deadline
- The energy audits and procurement analysis identified **low and no cost energy saving opportunities** for Portfolio Companies in **excess of \$1.7m** with an average payback of less than 12 months

# Developing Fund ESG Framework to enhance value



## ESG Maturity Assessment

*Factors to Consider*

*Benchmark*



### ESG Maturity Rating

Limited

Medium

Leader

### GP Benchmarking

Starting Out Limited Moderate Leader

#### Governance

RI Roles & Responsibilities

RI Investment Policy

Publicly available policies/ docs

#### Pre-Investment Process

ESG/ Fund placement docs

ESG/ Screening

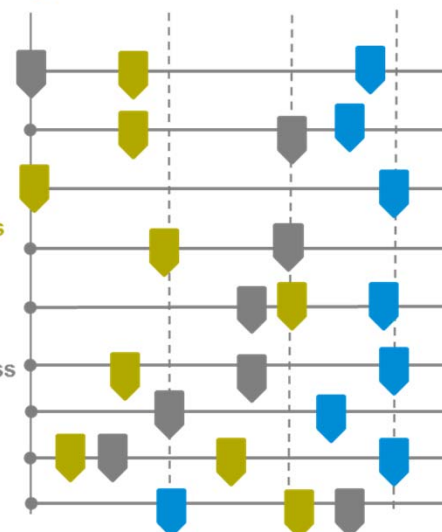
ESG/ Due diligence

#### Post Investment Process

% PCs with ESG policy

Proactive ESG disclosure

ESG considered at Exit

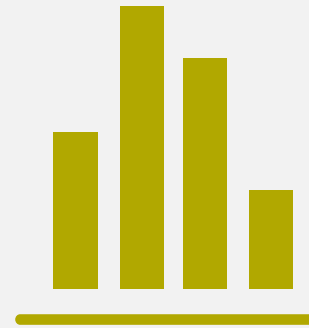


# Integrating material ESG issues can result in positive valuation impacts

Harvard  
Business  
Review  
SOCIAL RESPONSIBILITY

## The Type of Socially Responsible Investments That Make Firms More Profitable

by George Serafeim  
APRIL 14, 2015



*“The results are very consistent: firms making investments on material ESG issues outperform their peers in the future in terms of risk adjusted stock price performance, sales growth, and profitability”.*



*“Companies should stick to social and environmental issues that are strategically important for their business if they want such efforts to contribute to the valuation”.*

