



# Responsible Investment

*Delivering Value from ESG for Private Equity Firms*



ERM has identified some strong Environmental, Social and associated Governance (ESG) market trends through the completion of over 250 annual assignments across the globe for Private Equity (PE) firms.

## Market Trends

- 1 There is **heightened scrutiny and pressure** from investors and Limited Partners (LPs) to address ESG
- 2 An increasing number of **PE firms are developing priority actions** to implement and embed their ESG policy into their investment processes
- 3 Many **PE-backed companies do not have board approved policies** and initiatives in place to address material ESG issues
- 4 However, leading portfolio companies are realising **value from a proactive and systematic ESG approach** and appreciate support from PE owners
- 5 ESG initiatives are being **tailored to address both material risks and opportunities** facing the company and prepare them for eventual exit

## What has ERM learned?

- Given the sustainability megatrends facing companies, ESG issues have the potential to present material risks and opportunities
- Corporate leaders have generated multi-billion \$ value from ESG opportunities, and some PE firms are starting to realise their own multi-million \$ gains
- Shaping an effective ESG framework, including processes and reporting, to align interests of stakeholders is critical
- Applying a holistic ESG mind-set early in the investment process can help maximise business value
- Focused engagement is needed with portfolio companies to obtain buy-in to improve performance and realise value at exit

## Applying a Total Portfolio Stewardship approach to enhancing value



### Integrated DD Approach...

- 1) Liabilities
- 2) Risk Management
- 3) Opportunities

### ...in the context of the eventual exit of the asset:

- Improve the rate of return
- Identify and quantify liabilities, risks, and opportunities for value creation onto the opening balance sheet – increase EBITDA
- Improve net present value

### Eyes Wide Open:

#### EBITDA Enhancement

- Environmental Reserves and Accruals:**
- For over-reserved companies, reduce and move "savings" directly to the balance sheet

#### Revenue Enhancement

- Insurance Recovery:**
- Find the "lost money" associated with past and current policies

#### Operational Cost Savings

- Contaminated Site Management:**
- Risk-based management approaches to reduce remediation CapEx expenditures

### Improve and Sustain Performance:

#### Revenue Enhancement

- Growth in Products and Services:**
- Product / service innovation (eg ethical/efficient)
  - Supply chain eco-efficiency
  - Competitive advantage from lower lifecycle impact

#### Operational Cost Savings

- Resource Efficiency:**
- Design and implementation of cost savings from reduction in energy, waste, water, and other materials
  - Portfolio performance improvement programmes

#### ESG Value Protection Programmes:

- Material ESG risk reduction programmes:
  - ✓ License to operate and growth constraints
  - ✓ Product stewardship
  - ✓ Personnel-related health & safety
  - ✓ Reputational and customer sensitivity
- Effective ESG communication and reporting

#### Insurance Premiums:

- Reduce insurance premiums with improved ESG performance and reduced risks and liabilities

### Realise the Value:

- Quick and clean exit – take ESG off the negotiating table
- Articulate business value created from transferability of new ESG management systems now in place
- ESG performance improvement claims are backed by actual facts and data
- Boost credibility of both the company and the GP
- Realise enhanced value for stakeholders

## A selection of our experience



### Case Study 1 Developing Framework and Supporting Fundraising

A client wanted to develop an effective ESG policy and framework that would help them meet sector good practice and satisfy the fund's investors.

#### ERM supported the client by:

- Strengthening existing policy and investment processes to include systematic consideration of material ESG issues from early stage screening to realising value at exit
- Supporting portfolio companies through direct engagement to address key ESG risks and identify opportunities for value enhancement
- Communicating progress to stakeholders through reporting on material issues

#### Outcomes:

- The client was better positioned for fundraising through demonstrating ability to enhance value from better ESG credentials
- Securing leadership position in peer group through sustained performance improvements



### Case Study 2 Acquisition Due Diligence

ERM performed sustainability due diligence for a confidential PE client looking to acquire a global food and beverages manufacturer.

#### ERM supported the client by identifying potentially material issues relating to the following:

- Continuity of supply concerns over the availability of key raw materials (eg from over-fishing), which could either drive up costs (in the order of \$10m+) or require substitution (which would take time to arrange)
- Constraints to growing operations in water stressed regions (\$3m+ to source alternative supplies)
- Potential child labour issues at a farmer-owned brand farm, which was not directly managed by the target company

#### Outcomes:

- The client could obtain price adjustments for some of the unallocated Capex issues
- Material ESG issues were fed into the 100-day planning process to help support the business growth strategy and protect value by minimising risk exposure
- Plans were put in place to enhance brand and reputation management through engagement with stakeholders, eg Marine Stewardship Council (MSC)



### Case Study 3 Value Enhancement

Portfolio company projects to improve and sustain business performance.

Throughout the hold period, a number of projects were implemented, over time, to improve business performance and create ESG success stories.

#### ERM supported the companies by undertaking the following projects:

- Energy and resource efficiency programme
- Corporate health & safety programme
- Supply chain and lifecycle analysis project

#### Outcomes:

- Over \$9m in cumulative energy cost savings over a 3-year implementation phase
- Over \$8m in avoided costs annually, due to a 68% reduction in loss-time accidents
- Approximately \$1.65m in annual cost savings due to reduced product packaging
- Better competitive positioning with ESG-sensitive customer base



### Case Study 4 Divestiture Due Diligence

Working on behalf of a PE owned company, ERM prepared an ESG divestiture due diligence report of a global manufacturing business as part of its exit strategy.

#### ERM supported the company by:

- Collating relevant ESG information across the portfolio through management interviews, site visits and focused questionnaires
- Identifying quick-fixes that could be addressed to avoid unnecessary price-chips or contractual protection

#### Outcomes:

- The client was able to demonstrate robust management of ESG issues in a balanced way, to satisfy potential bidders and ensure a smoother sales process
- Identification and successful close out of quick fix EHS items prior to going to market on the deal, which reduced potential exposure by \$750k
- In addition, timely specialist inputs by our wastewater treatment plant expert helped the company reduce its capital outlay by \$2m to meet future regulatory requirements

## About ERM

ERM is a leading global provider of ESG consulting services and has developed a Total Portfolio Stewardship approach to supporting PE firms.

Our Private Equity clients include Actis, Arle, Blackstone, Bridgepoint, Bain, Carlyle, DBAG, Doughty Hanson, EQT, Graphite, Inflexion, KKR, and TPG.

Our LP clients include Axa, Caisse des Dépôts et Consignation, CPPIB, Colonial First State, Norfund, OMERS, OTPP and PGGM.

ERM has co-developed and presented EVCA training on Responsible Investment.

**We have over 150 offices across 40 countries and territories, employing over 5,000 people.**



## ERM Expertise

In developing our ESG offerings, we have harnessed our global experts in order to help our clients effectively address social (human rights, health & safety, labour, community/customers, ethics), environmental (compliance, resource efficiency, legacy resolution, financial and economic impacts) and associated governance issues.

We have been privileged to work with some of the world's leading corporations who have embedded sustainability into their global business culture. We are able to staff assignments at short notice from our 5,000-strong sustainability professionals across 40 countries. Our employees have backgrounds in strategy, science, business management, social science, environmental management, engineering, finance and numerous other professional disciplines

To discuss further please contact:

**Jaideep Das, Partner**

E: [jaideep.das@erm.com](mailto:jaideep.das@erm.com)

T: +44 (0) 20 3206 5364

**Jeff Gibbons, Partner**

E: [jeffrey.gibbons@erm.com](mailto:jeffrey.gibbons@erm.com)

T: +1 (0) 484 913 0370