



Strong ESG Credentials Paramount in Value Creation and M&A



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As part of IMAP's special focus on environmental, social and governance (ESG), Creating Value hears from Christopher Kiermayr, Partner at ERM GmbH, the largest global pure play sustainability consultancy and market leaders in ESG due diligence. A regular collaborator on deals with IMAP Germany, Christopher explains the role of ESG in value creation and provides practical advice for investors looking to capitalize on the biggest investment opportunity of the decade and beyond.

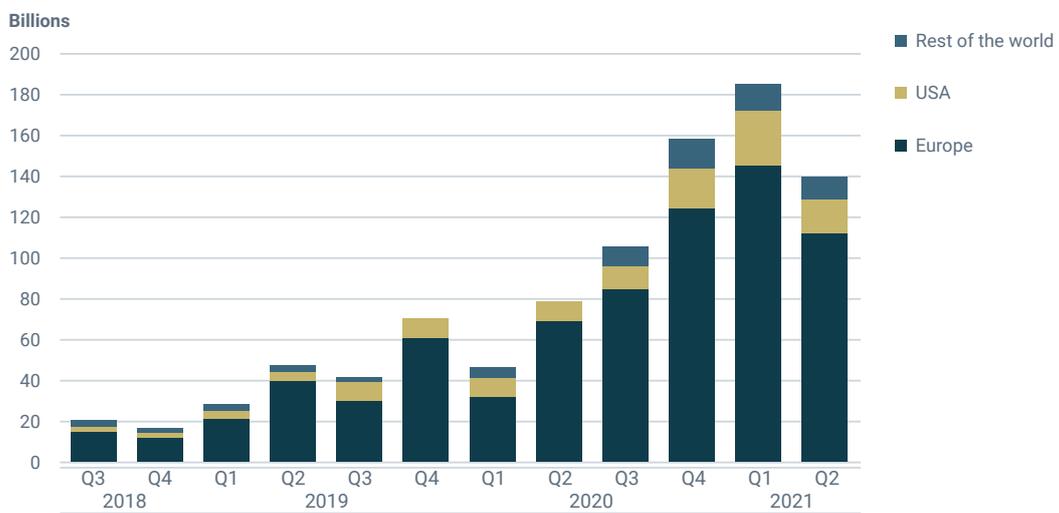
Investors and buyers are willing to pay a premium for companies that can demonstrate strong ESG credentials. Stakeholder activism on ESG aspects is adversely impacting the availability of capital.

The last year has shown how robust ESG management provides companies with resilience to external shocks.

Stocks of companies with strong ESG credentials and robust climate strategies have outperformed those of peers this year. Corporate goals around carbon neutrality

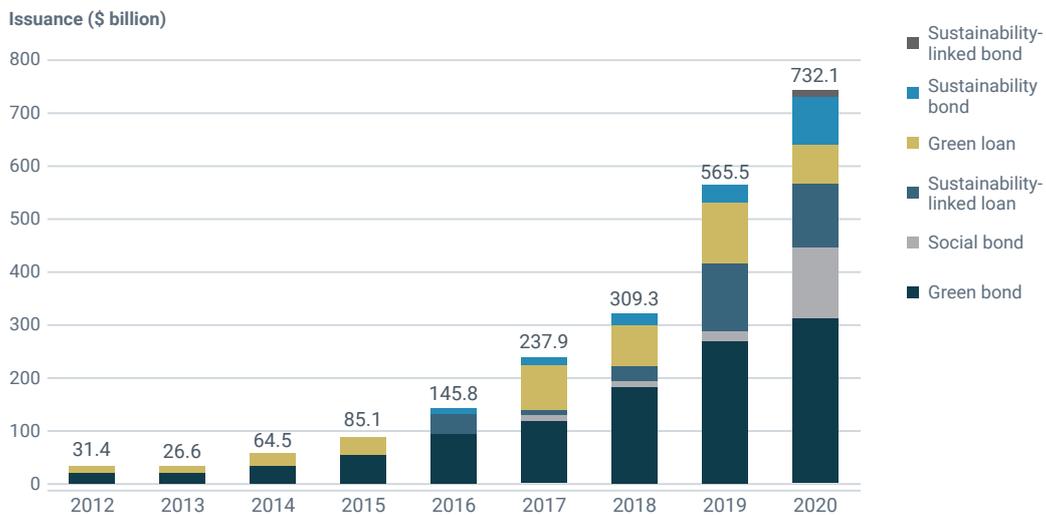
and energy transition strategies have accelerated activity to manage corporate portfolios by decarbonizing the asset base while increasing investment in and acquisition of sustainable products and technologies. ESG and sustainable investing has become the new standard to access finance. There has been a significant increase in the size of ESG funds, green bonds, capital flows to ESG funds and sustainability-linked financing, with ESG viewed as integral to strong corporate governance and business performance.

Capital Flows into Sustainable Funds 2018-2020 (US\$)



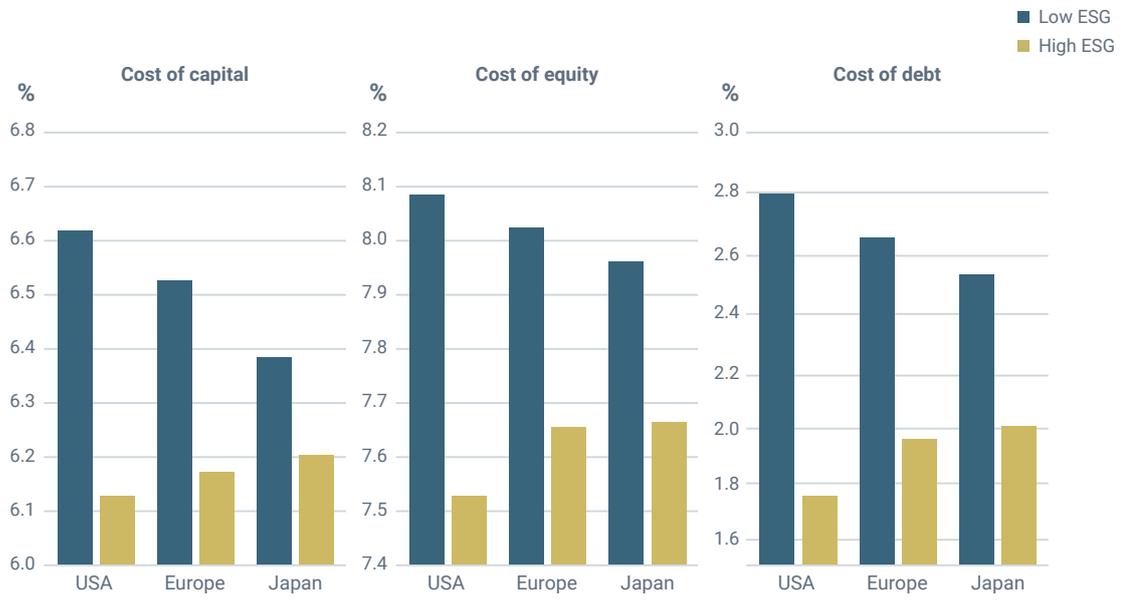
Capital directed to ESG-themed funds has seen a rapid acceleration since 2020, with European funds attracting most of the new capital. Source: Morningstar.

Growth in Sustainable Debt Issuance 2012-2020 (US\$)



Annual sustainable debt issuance grew from \$31.4 billion to \$732.1 billion over the period 2012-2020. Source: BloombergNEF, Bloomberg LP.

Costs of Capital, Equity, and Debt Compared to ESG Performance



The cost of capital, equity, and debt compared to MSCI ESG Ratings performance ranging from low ESG performance to high ESG performance for companies in the US, Europe, and Japan. Source MSCI.

Integrating ESG is no longer a “nice to have”; it is integral to strong corporate governance and business performance. Stocks, multiples, and valuations in general of companies with strong ESG credentials and robust climate strategies have outperformed those of peers this year. Investors and buyers are willing to pay a premium for companies that can demonstrate strong ESG credentials.

The amount of assets under management among ESG funds as of March 2020 was more than \$1 trillion, having grown by more than 35% over 3 years. The world’s largest asset owners are committed to mobilizing significant sums of private capital towards the 17 Strategic Development Goals (SDGs) and an increasing number of the world’s most influential LPs are focusing on ESG.



Significant Investment and Value Creation Opportunities for Astute Investors

According to ERM’s 2020 survey of over 50 Private Equity (PE) investment professionals, *‘Eyes on the Prize: Unlocking the Value of ESG Premium in Private Markets’*, 86% of those polled now have access to dedicated ESG teams when making investment decisions.

Furthermore, the results reveal that ESG issues offer significant value creation and investment opportunities in the coming 3-5 years and that there are specific actions that PE firms can take to help them make their way to the top of the ESG summit.

Considering ESG at the heart of investment theses will generate strong returns

overwhelmingly agree that focusing on ESG themes will generate good investment opportunities.



believe that Europe is likely to be the hot bed of ESG investment activity.

Areas and sectors that offer the most significant investment opportunity in the next 3-5 years.

Areas	Sectors
Climate Change	Energy
Societal well-being	Consumer Goods
Water/wastewater	Healthcare
Circular Economy	TMT

Mainstreaming of ESG in investment processes is well underway

of investment teams are part of their firm’s ESG committee.



believe that ESG credentials are a factor in winning deals.



believe ESG “sell-side” due diligence will be undertaken more in the next 3-5 years.

Strategic outlook and systematic approach needed to realize ESG premium at exit

have a thematic ESG fund or strategy and actively seek out ESG-focused investment.



said that to maximize value, there needs to be regular and in-depth board engagement with companies.



increase in the perception of ESG as a positive contribution to the exit multiple in sale processes.

Based on this survey, firms should feel galvanized to take bold steps toward the significant opportunities presented by the transition to a sustainable, low carbon and equitable economy. While value protection is important, future-facing firms will generate higher returns by incorporating an ESG approach that systematically targets ESG based value creation and proactively invests behind the sustainability megatrends.

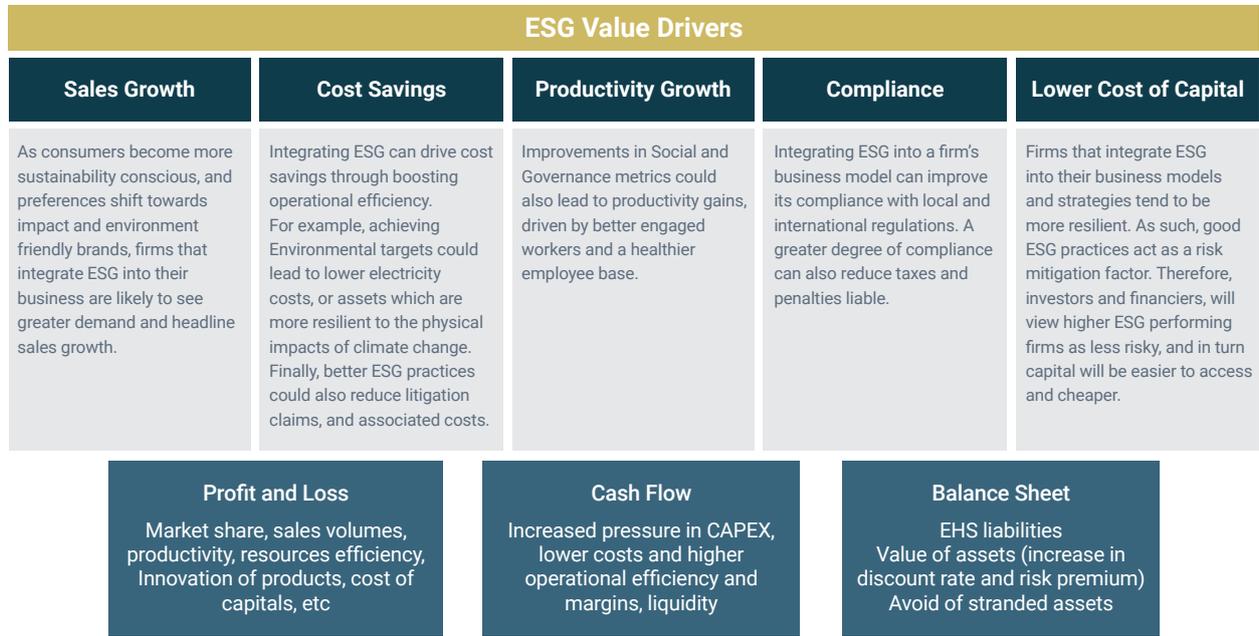
To truly realize the full potential of ESG we believe that PE firms should consider the following:

- Setting a strategic vision, and fostering a culture that sees ESG as a significant value creation opportunity
- Establishing the firm’s ESG investment strategy and process for identifying ESG market trends
- Moving due diligence from compliance to ESG best practice, to generate superior returns
- Ensuring companies become “ESG strong” during ownership to benefit from a higher exit multiple

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ESG CREDENTIALS

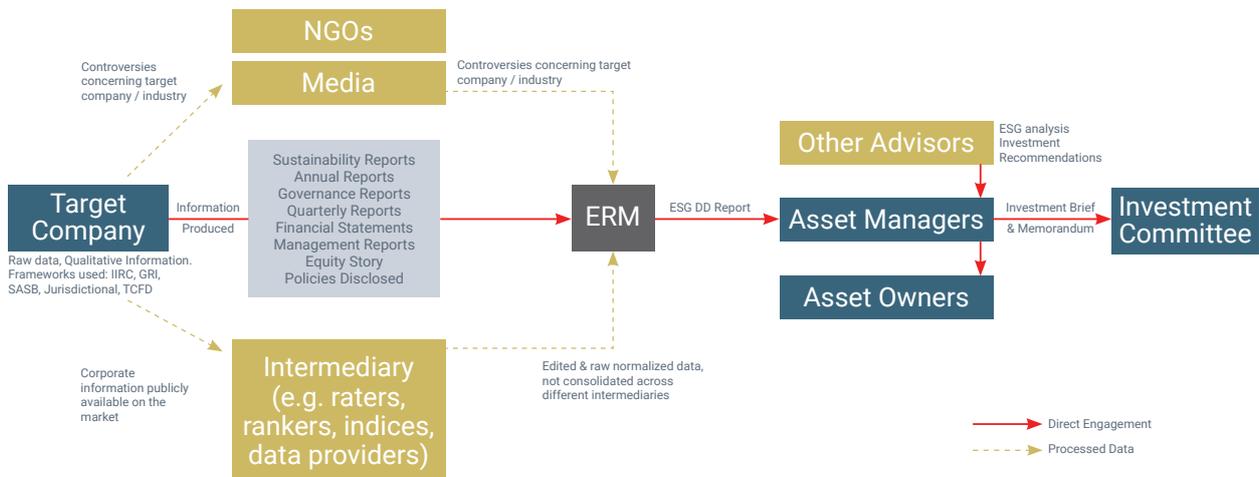
Furthermore, there are five concrete areas that we suggest PE firms should focus on which will significantly contribute to increasing ESG value:



The world is changing. Forces from all directions are pushing governments, regulators, businesses, NGOs, and investors to build a more sustainable future - and fast. This sustainability shift and resulting disruption is creating significant investment and value creation opportunities for the astute investor.

Integrating ESG into Investment Decisions

ESG factors and aspects play a pivotal role in the valuation of an asset in terms of both ascertaining its current value and protecting the initial investment, as well as gauging the potential for value creation and defining an asset's ESG trajectory and shaping the exit strategy.



Capitalizing on the Biggest Investment Opportunity of the Decade

The megatrends underpinning the transition to sustainable economies create genuine opportunities to outperform while also creating a positive legacy for society and the environment. Addressing this opportunity does not need to be resource intensive; in fact, there is evidence that structured approaches are more, not less, efficient than reactive ones. The scale and pace of change means that ESG can no longer be considered a small corner of the specialist investment world, a tickbox exercise or simply a risk management framework.

ESG and sustainability themes need to be at the core of investment strategies, decisions, and processes if PE firms are to continue raising capital from increasingly ESG- focused LPs and to capitalize on the biggest investment opportunity of the decade and beyond. There is a need for significant investment to address pressing sustainability challenges and a clear role for investors to play in the transition to a sustainable, low carbon and equitable economy.

Based on our experience, the key factors resulting in sustainability and ESG issues that should be on everyone's radar are:

Environmental Factors	Social Factors	Governance Factors	Sustainable Development Goals
<ul style="list-style-type: none"> • Climate change • Integration of facilities into the environment • Emissions • Waste/ Wastewater • Decarbonisation of the energy mix • Innovation in technology • Biodiversity and natural capital • Environmental compliance and management • Supplier assessment 	<ul style="list-style-type: none"> • People management, development and motivation • Occupational health and safety and well being • Partnerships with stakeholder groups • Social identity • Diversity, inclusion and equality/ equity of opportunity • Human rights / Modern Slavery • Community investment • Product stewardship • Just Transition 	<ul style="list-style-type: none"> • Code of Conduct • Board oversight of risks • Compliance with laws, regulations and international agreements • Stance on bribery and corruption • Data privacy / cyber security • CEO pay • Political advocacy 	 <p>Which ones are priorities for your business?</p>



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The growing ecosystem of ESG regulations, voluntary disclosure frameworks, incentives and targets are driving corporate leaders and financial players to make sustainability commitments and disclosures. Financial organizations - and their clients - must respond to quickly changing sustainability policies and increasing stakeholder scrutiny.

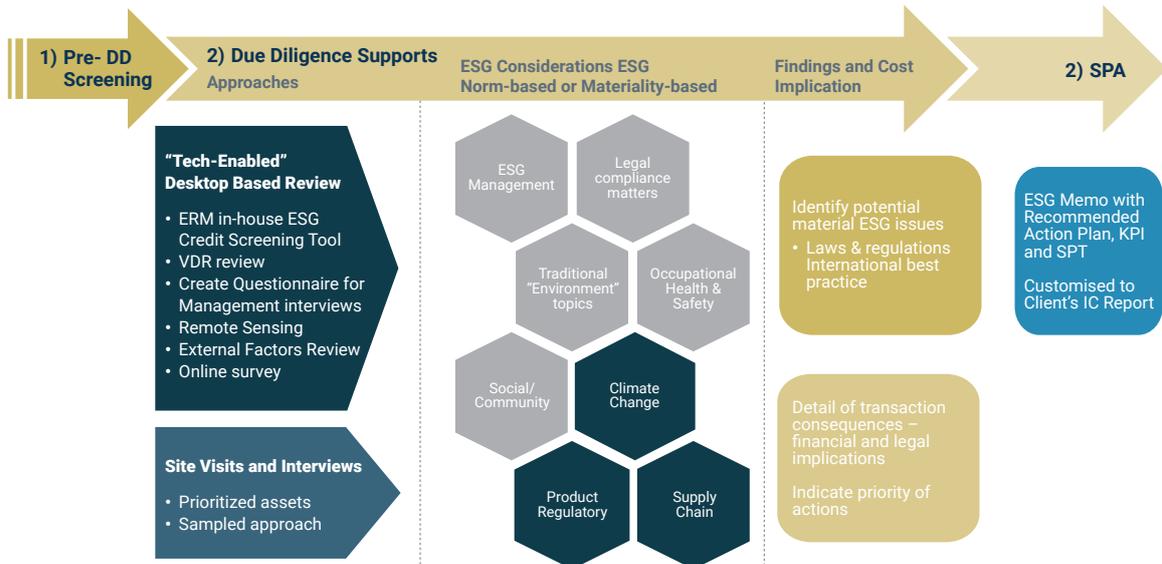
ERM is an advisor to more than 500 corporate and financial sector organizations, building on our technical, strategy, legal and in-house private market, and banking experience. We partner with clients across every stage of their investment lifecycle:

Transaction Advisory

Buyer's Key ESG Concerns in a Transaction



ESG Due Diligence Methodology



Strategic Direction & Driving Improvement

ERM Approach on ESG Integration Over The Fund Lifecycle

ESG STRATEGY AND FRAMEWORK OF THE MANAGEMENT COMPANY

Strategy, governance, internal awareness

- ESG strategies, action plans and roadmaps
- Policies & procedures
- Climate change strategies
- Benchmarking & positioning
- ESG awareness trainings
- Materiality assessments
- SDGs alignment

Reporting & assurance

- Internal and external reporting aligned with international frameworks and standards
- Support and assurance on UN PRI questionnaire
- Support for ESG ratings improvement (Gresb, UN PRI, etc.)
- Support in preparing ESG documents for fundraising preparedness

INTEGRATION OF ESG FACTORS INTO INVESTMENTS



ESG risks and opportunities have entered the mainstream and become inextricably linked to corporate strategy and business outcomes. Faced with this, companies have an opportunity to position themselves to act on the challenges and opportunities presented and to turn them into a competitive advantage.

A proactive business response to ESG risks and opportunities has the potential to protect and maximize the top-line by being more aligned with customer expectations, increasing innovation, reducing operating costs, and lowering cost of capital via participation in sustainable finance products. Facing up to these challenges will also better position companies to tell their ESG stories more authentically - creating narratives which can be directly increase enterprise value (EV). ■



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Having regularly met Chris and his team on the other side of the table during due diligence procedures, we realized it would be of great benefit to our sell-side clients to engage ERM for an ESG fact book early in the project. That way, if they find some critical aspects, we still have the time to resolve them prior to addressing potential buyers. Additionally, with assistance from ERM, we often include a slide on ESG factors in our info memorandums, which is important to investors looking to assess these aspects of a project at an early stage - and is greatly appreciated.