

# INTEGRATING ESG IN PRIVATE EQUITY

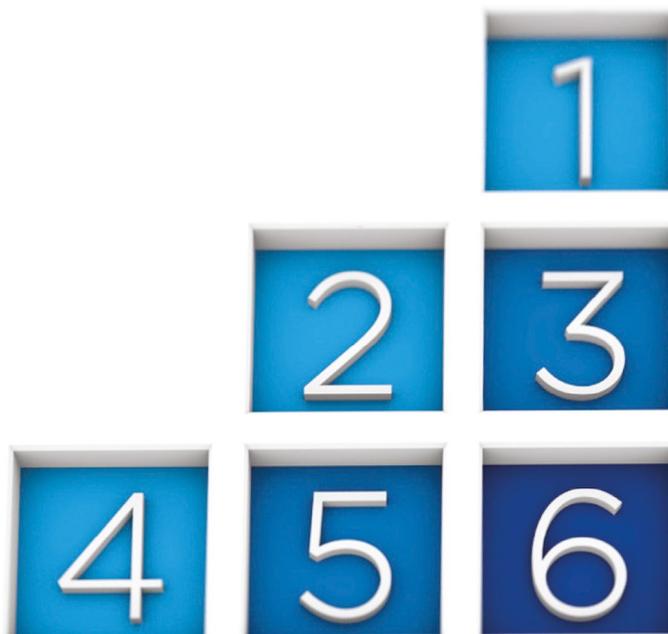
A GUIDE FOR GENERAL PARTNERS

CASE STUDIES



# THE SIX PRINCIPLES

- 1 We will incorporate ESG issues into investment analysis and decision-making processes.
- 2 We will be active owners and incorporate ESG issues into our ownership policies and practices.
- 3 We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- 4 We will promote acceptance and implementation of the Principles within the investment industry.
- 5 We will work together to enhance our effectiveness in implementing the Principles.
- 6 We will each report on our activities and progress towards implementing the Principles.



This publication is intended to promote the application of the Principles for Responsible Investment (PRI). The PRI Initiative was launched by the United Nations in 2006 after former UN Secretary-General Kofi Annan brought together a group of the world's largest institutional investors, academics and other advisors to draft a set of sustainable investment principles. At the heart of the six Principles for Responsible Investment is the premise that investors have a duty to act in the best long-term interests of their beneficiaries and this means taking into account environmental, social and governance factors.

The PRI engaged Spring Associates to conduct the research and develop the content for this supplement. The supplement was co-written by Spring Associates and the PRI Secretariat.

## spring associates

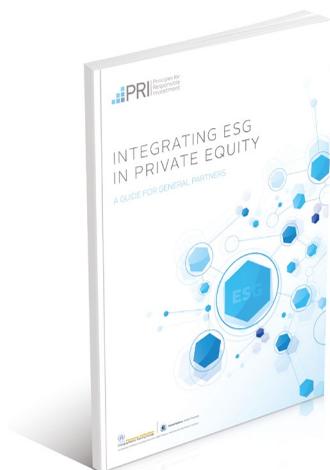
Spring Associates is a strategy consulting firm with a focus on adding sustainable value. Founded in 2005, Spring Associates is active in a range of sectors and particularly in regulated markets, such as Energy and Financial Services. The company has a clear vision on what it means to operate and invest responsibly and how to marry this theme with value creation. Spring Associates combines a deep understanding of ESG issues and developments with core due diligence skills and business expertise and is specifically experienced in developing and implementing comprehensive ESG methodologies for PE firms.

Copyright 2014

## PRI DISCLAIMER

The information contained in this report is meant for the purposes of information only and is not intended to be investment, legal, tax or other advice, nor is it intended to be relied upon in making an investment or other decision. This report is provided with the understanding that the authors and publishers are not providing advice on legal, economic, investment or other professional issues and services. PRI Association and the PRI Initiative are not responsible for the content of websites and information resources that may be referenced in the report. The access provided to these sites or the provision of such information resources does not constitute an endorsement by PRI Association or the PRI Initiative of the information contained therein. Unless expressly stated otherwise, the opinions, recommendations, findings, interpretations and conclusions expressed in this report are those of the various contributors to the report and do not necessarily represent the views of PRI Association, the PRI Initiative or the signatories to the Principles for Responsible Investment. The inclusion of company examples does not in any way constitute an endorsement of these organisations by PRI Association, the PRI Initiative or the signatories to the Principles for Responsible Investment. While we have endeavoured to ensure that the information contained in this report has been obtained from reliable and up-to-date sources, the changing nature of statistics, laws, rules and regulations may result in delays, omissions or inaccuracies in information contained in this report. Neither PRI Association nor the PRI Initiative is responsible for any errors or omissions, or for any decision made or action taken based on information contained in this report or for any loss or damage arising from or caused by such decision or action. All information in this report is provided "as-is", with no guarantee of completeness, accuracy, timeliness or of the results obtained from the use of this information, and without warranty of any kind, expressed or implied.

# INTRODUCTION



These case studies supplement the PRI's Guide for general partners.<sup>1</sup> The twelve case studies were selected from the 50+ interviews conducted as research for this guide. They are referenced throughout the guide as examples linked to ESG integration within both the GP's organisation and investment process.

These case studies were selected because they contain relevant and practical information for GPs that are at the beginning stages of ESG integration and may also be facing issues of resource constraint. They highlight examples of good practice for developing and implementing an ESG strategy that GPs can use as guidance or as a starting point for discussion. GPs that have already advanced in ESG integration can review these examples as a thought provoking exercise to reflect and improve upon their own practices.

The twelve case studies aim to cover a range of geographies, investment strategies and GP size. They also highlight GP practices from firms that are at different stages of the ESG integration process – you will therefore find case studies that detail initial processes for integrating ESG within the GP organisation as well as examples of well-established and sophisticated due diligence and ownership practices.

This case studies supplement is not, of course, an exhaustive catalogue of good practice. For more case studies and guidance, look to the private equity page on the PRI signatory extranet.

	INVESTMENT STRATEGY	OPERATING REGIONS	HQ	AUM (APPROX IN US\$BN)	STAFF SIZE
Apax Partners MidMarket	Growth capital and buyout	France/French-speaking countries	France	3.5	27
Ardian	Buyout	Europe	France	6.5	25
Blue Wolf Capital Partners	Buyout	North America and Europe	USA	0.5	15
CapMan Russia	Growth capital	Russia	Finland	0.16	12
CVC Capital Partners	Buyout	Europe, North America and Asia	Luxembourg	41	~300
Direct Capital	Growth capital and buyout	Oceania	New Zealand	~0.5	8
Doughty Hanson	Buyout	Europe	UK	4.7	104
Egeria	Buyout	Netherlands	Netherlands	2.3	23
Global Environment Fund	Growth capital	Emerging markets and North America	USA	1	45
Idinvest Partners	Growth capital	Europe	France	5.5	40
Kendall Court	Growth capital	Southeast Asia	Singapore	0.285	15
Permira	Buyout	Europe, North America and Asia	UK	30	200

<sup>1</sup> Integrating ESG in private equity – a guide for general partners, PRI, March 2014

## APAX PARTNERS MIDMARKET

Investment strategy	Growth capital and buyout
Operating regions	France/French speaking countries
HQ	France
AUM (approx. in US\$bn)	3.5
Staff size	27

### KEY TAKEAWAYS

- The implementation of an ESG strategy requires careful planning and dedicated resources.
- A GP can survey their LPs to understand expectations and obtain support for an ESG strategy.
- A GP can assign responsibility to a point person within each portfolio company whose activities are monitored by the GP's ESG team.

### COMPANY INTRODUCTION

Funds managed by Apax Partners MidMarket (Apax) invest in fast-growing companies across six sectors of specialisation: Technology, Telecom, Media, Retail & Consumer, Healthcare, and Business & Financial Services.

### APPROACH TO RESPONSIBLE INVESTMENT

Apax decided to implement a comprehensive ESG strategy for three reasons: intrinsic motivation within management, growing demand from LPs and the belief that Apax can really make a difference as a majority shareholder in most of its 17 portfolio companies. Apax believes the demand for ESG accountability in all business activities will continue to grow, not least because it is in the process of becoming a compulsory part of public and private company reporting in France.

### DEFINING AND COMMUNICATING AN ESG STRATEGY

Apax offers this advice to peers developing an ESG programme: create a step by step plan to get initial momentum through simple actions, and be ready to dedicate resources to this significant effort. The first step was to assign a senior partner responsibility for setting up the ESG programme. Apax then hired a consulting firm to carry out a survey of their LPs and to define an ESG strategy, based on both risk management and value creation. The ESG programme was presented during a strategic off-site meeting to obtain firm-wide buy-in.

### ESTABLISHING THE RATIONALE: LP SURVEY

The survey focused on three main topics:

1. Whether a GP should address ESG because of risk management issues or value creation potential
2. What the LP was currently doing to assess a GP's ESG practices
3. How the LP was currently following up after due diligence

The survey revealed that the majority of respondents see ESG issues as increasingly important, beneficial from a risk management perspective, and a means to create value. Half of the respondents used ESG specialists to assess ESG practices within GP firms and a quarter gathered statistics on their GPs' ESG practices. These responses reinforced Apax's commitment to their ESG strategy.

### INTEGRATING ESG AT APAX

After organisational buy-in had been achieved and an ESG strategy had been defined, Apax became a PRI signatory in November 2011. Signing the Principles is one action within Apax's ESG programme, rather than the programme driver. Other initiatives undertaken during the initial phase included a

carbon emission assessment at Apax, participation in ESG-related conferences and surveys, and inclusion of an ESG section in their annual report.

Next steps were to organise staff training and to develop a dedicated ESG team with top-level involvement. The team, which is led by a senior Partner and includes a member of the investment support staff, reports directly to the firm's President. Key decisions are made at the Strategic Committee level, comprising of the firm's partners. An annual presentation on objectives and progress is made to the Executive Committee. This is also communicated to LPs and other interested stakeholders via Apax's annual report.

The ESG team was then tasked with overseeing the total integration of ESG into investment processes. ESG due diligence is only conducted on recent and new acquisitions in the Apax France VIII fund, since ESG initiatives require significant time to implement before exit.

### INTEGRATING ESG WITHIN THE PORTFOLIO

#### Due diligence

Apax's ESG team is responsible for conducting ESG due diligence on portfolio companies, identifying company specific issues and defining (and ideally quantifying) objectives. Information gathered from the portfolio company is analysed to assess what improvements need to be made before exit. Apax works with company management to define ESG specific goals and to draw up a roadmap.

#### Ownership

Apax's ESG team monitors progress throughout the lifetime of the investment by appointing a person from the portfolio company to monitor and report on the company's progress against the roadmap.

This process is resulting in tangible improvements that Apax believes will create value upon exit. Maisons du Monde, a home decoration retailer, is a good example of this, having been recently acquired from Apax (in partnership with LBO France and Nixen) by Bain Capital in September 2013. During ownership, Maisons du Monde focused on their purchasing policy for wood products as the avenue for greatest social and environmental impact. They require complete transparency from their suppliers on sourcing and encourage opting for wood certification in accordance with international standards. Through partnerships with NGOs in Indonesia, India and China, Maisons du Monde is improving working conditions at its suppliers' premises and supporting sustainably managed forests. Their responsible purchasing policy placed them third in WWF's 2012 wood barometer. The example of Maisons du Monde demonstrates the value creation potential of improving ESG issues – a 20% increase in sales was generated by redesigning a sofa with social and environmental impact in mind, while reducing the cost and maintaining the same end user price. Prior to exit, Apax employed an external consultant to complete an ESG vendor due diligence – the first of its kind in France. The consultant interviewed management and reviewed internal documents to identify the relevant indicators before preparing a non-financial report for exit that presented the relevant ESG risks and suggestions on how to address them. Apax has since decided to systemise the inclusion of ESG in every vendor due diligence going forward.

# ARDIAN

## ARDIAN – MID CAP FUND

Investment strategy	Buyout
Operating regions	Europe
HQ	France
AUM (approx. in US\$bn)	6.5
Staff size	25

Please note the data is applicable solely to Ardian Mid Cap buyout activity; as a whole, Ardian manages / advises US\$ 44 bn and employs more than 320 professionals.

### KEY LEARNINGS

- A GP can establish an internal committee to develop and monitor their ESG strategy, and to provide support to the investment team.
- An annual ESG survey of the portfolio is a strong lever for continuous improvement on ESG performance.
- A GP can ensure long term alignment of stakeholder interests through a profit sharing scheme at exit.

### COMPANY INTRODUCTION

Since 1997, Ardian has established itself as a European leader in the LBO mid-market, with 55 investments, 40 exits and by supporting more than 60 build-up acquisitions. Ardian's Mid Cap team seeks to acquire and develop companies valued at between €150 million and €1.5 billion over the long term alongside management.

### DEVELOPING AN ESG STRATEGY

Ardian's ESG strategy has the full support of the CEO, which has ensured that ESG has been on the agenda for quite some time. Since 2008, Ardian has been formalising a "mainstream" ESG strategy aiming at integrating ESG at every stage of the investment process and in all its investment activities. This approach is publicly disclosed through an ESG Charter. Ardian is also an active signatory of the PRI since 2009.

The ESG strategy is supported by an internal CSR Committee made up of representatives from the different investment teams (including Small Cap, Infra and Funds of Funds alongside the Mid Cap) and from support functions such as Compliance, Legal, HR, Procurement and Corporate Development. The Committee is chaired by the ESG Director and holds quarterly meetings aimed at sharing knowledge and best practices on ESG, defining the annual action plan on ESG strategy to be submitted to the CEO and monitoring the progress of this action plan.

### INTEGRATING THE ESG STRATEGY INTO THE INVESTMENT PROCESS

Ardian's ESG strategy is embedded within the investment process of every fund to enhance value creation. Instead of having a dedicated ESG team, each investment professional is responsible for including the consideration of ESG factors at every stage of the investment process, with the option to use external resources as appropriate. Pre-acquisition ESG analysis is summarised in a mandatory section within the investment memo submitted to the Investment Committee. The company's level of ESG performance is factored into the final investment decision. Depending on the materiality of ESG risks identified in the due diligence phase, corrective actions may be embedded into a post-acquisition 100 day plan. At exit, Ardian has started to consider the ESG-related value created within a portfolio company by commissioning an external consultancy to conduct a vendor due diligence prior to sale.

### TRANSLATING THE ESG STRATEGY INTO OWNERSHIP PRACTICES

Performance on ESG factors is included within the monitoring of portfolio companies through both continuous interaction with portfolio company management and the portfolio company's Supervisory Board. Some common ESG topics, i.e. safety, will be consistently monitored. More specific ESG risks that arise will be addressed through a tailored action plan with associated KPIs that are instituted at the Supervisory Board level. Although Ardian invests mostly in low risk countries, the portfolio companies usually have supply chains which must be taken into account during the monitoring phase.

For example, a portfolio company in the food business built an internal tool to assess the sustainability of its suppliers' farming practices. The methodology relies on a questionnaire with key indicators such as water consumption, greenhouse gas emissions, percentage of renewable energy used, working hours and crop diversity. The tool was built in very close partnership with the farmers and has enabled assessment of almost 20,000 tons of raw materials by the end of 2013.

The successful translation of ESG strategy into ownership practices can be further propelled by increasing stakeholder motivation and incentivisation.

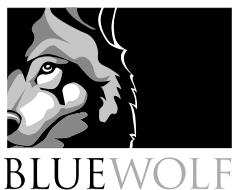
#### Incentivising investment teams

Ardian employs an external consultant to conduct an annual ESG survey on the portfolio, applying an internal ESG appraisal system by which all portfolio companies are compared on their ESG performance. Companies are ranked based on an analysis of selected key ESG themes for each company, a qualitative assessment of the company's policies and performances with regards to these ESG themes, and an assessment of the company's overall progress in the field of ESG development. The primary objective of asking these questions is to increase awareness and improve ESG practices within both the portfolio companies and the investment teams.

The survey has proven to be a good inroad for training the investment teams to embed ESG into their monitoring processes. Investment managers have the opportunity to review and learn from good ESG practices across the portfolio. This collaborative exercise is complemented by a naturally competitive element among the investment teams when comparing portfolio companies on their ESG performance – this and the practical approach of focusing on the business of portfolio companies means that the survey process has gained traction with the investment teams as an effective way to engage with them on ESG integration.

#### Incentivising portfolio companies

One concrete way that Ardian is able to translate their ESG strategy into ownership practices is through the introduction of a profit sharing scheme; sharing value created at exit with company employees as an effective and positive way to align the interests of all stakeholders in the long term. Ardian has implemented profit sharing schemes with six portfolio companies already and considers it to be a pillar of their ESG strategy. Further gains for Ardian are increased traction with portfolio company employees and their increased attractiveness as a shareholder when discussing new acquisitions.



## BLUE WOLF CAPITAL PARTNERS

Investment strategy	Buyout
Operating regions	North America and Europe
HQ	USA
AUM (approx. in US\$bn)	0.5
Staff size	15

### KEY TAKEAWAYS

- Through ESG due diligence, a GP can identify efficiency and economic gains.
- By improving working conditions, a GP can reduce employee turnover and improve worker safety.
- A GP can work constructively together with a company's unions and workers to improve the bottom line, while providing workers with increased compensation, benefits and other non-monetary opportunities.

### COMPANY INTRODUCTION

Blue Wolf Capital is a private equity firm that takes control stakes in mid-market companies and works with those companies to resolve complexities and achieve sustainable growth. Blue Wolf invests in strong businesses whose value can be increased by constructive resolution of complex challenges, particularly those involving financial or operational distress, troubled labour relations, or governmental or regulatory issues.

### APPROACH TO RESPONSIBLE INVESTMENT

Blue Wolf's investment strategy incorporates ESG issues throughout the investment lifecycle. Blue Wolf staff have the government, labour relations, and operations management experience to understand how ESG issues impact multiple stakeholders in all businesses. Blue Wolf also has expertise in resolving issues borne from organisational and operational mismanagement and/or corporate governance failures.

### CASE STUDY: ACQUIRING HEALTHCARE LAUNDRY SYSTEMS ("HLS")

HLS's predecessor company was established by a consortium of not-for-profit healthcare systems in 1973 to provide dedicated laundry processing for its owners, who represented some of the largest healthcare institutions in the Chicago market. In 2002, HLS's former owners commissioned a new facility which operated at a low capacity, creating operational and financial distress. HLS represented an attractive investment opportunity because it was a regional leader with ~30% market share (almost twice that of the next largest player), had strong customer relationships, long-term customer contracts and significant excess capacity. As part of due diligence and active work with HLS post-investment, Blue Wolf identified numerous opportunities for improvement across the company.

#### Economic sustainability and governance

HLS was previously governed by a Board of Directors composed of representatives from its constituent owners. Management was fully outsourced to a third-party. The Board was not active at the company and moreover viewed HLS as an affiliated service. Consequently, HLS consistently undercharged their institutions for services and did not pursue profitable growth. Through active governance, the acquisition of a complementary business located 90 miles away, and the alignment of interests between Blue Wolf and management, Blue Wolf altered the business focus from providing not-for-profit services to a profit-oriented mentality, resulting in increased revenues of over 40% and profitability of over 220% over 27 months.

#### Social sustainability

During due diligence, Blue Wolf recognised that there were certain constraints between HLS and two of their three union

relationships which needed resolution in order for the business to thrive. The first involved a severely underfunded multi-employer pension plan which numerous employers had exited, leaving a massive liability that was being borne by the handful of remaining companies. The second concerned the labour agreement with the union representing the majority of hourly workers. The work rules in the labour agreement needed to be revised to allow for additional shifts and other changes to accommodate the anticipated growth in the company's business.

During the acquisition process, Blue Wolf negotiated for HLS to cease being a participant in the underfunded pension plan by paying a significant withdrawal liability and creating a new defined contribution pension plan for the affected employees with identical levels of employer contributions. This shift was overwhelmingly ratified by union members.

In negotiations with the second and larger union representing hourly workers, a new collective bargaining agreement was negotiated prior to closing, and certain work rule changes were agreed upon to allow HLS to more efficiently manage the expected growth in laundry volume. The new work rules and procedures also included a renewed labour-management effort to improve worker safety that was embraced by the hourly workforce.

During ownership, Blue Wolf recognised that HLS's labour policies and practices could be improved and therefore engaged a law firm to evaluate all employment documentation, resulting in a workforce turnover of about 60%. Blue Wolf worked collaboratively with HLS's unions to ensure a fair document evaluation program and, despite not being obliged to do so, negotiated severance benefits with HLS's unions for the affected employees. The law firm also provided all HLS managers and Human Resources professionals with training on best practices in documentation review and hiring processes and ensured that HLS was in compliance with all employment laws. HLS's employment practices were subsequently audited by the federal government, which concluded that HLS was in compliance with the law. Blue Wolf also placed increased emphasis on safe production practices, and through initiatives to reward safe behaviour and spotlight poor production practices, the incident rate was reduced by 9%.

#### Environmental sustainability

Blue Wolf evaluated HLS's environmental impact and consequently authorised capital spending to reduce water and energy usage, e.g. investing in a water recycling system to reduce the amount of water used per pound of laundry by 20%, and increasing the amount of laundry processed per unit of energy by 9%.

#### Outcomes

The investment in HLS is an example of Blue Wolf's approach to investing in highly complex situations with opportunities for improvement in various ESG factors. By resolving the ESG fundamentals of a market leader with a stable customer base, Blue Wolf was able to sell HLS within 27 months of investment for a robust profit. Blue Wolf's commitment to concrete ESG actions throughout the lifecycle of an investment was also demonstrated by the donation of a vacant HLS property to The Nature Conservancy upon exiting HLS; this both helped Blue Wolf to sell HLS and allowed The Nature Conservancy to meet its goals for a very prominent fundraising campaign.



**CAPMAN RUSSIA**

Investment strategy	Growth capital
Operating regions	Russia
HQ	Finland
AUM (approx. in US\$bn)	0.16
Staff size	12

**KEY TAKEAWAYS**

- Regional operating units of international PE firms may vary the intensity of ESG integration according to the characteristics of the region.
- DFI LPs have high ESG performance requirements and this will drive ESG integration in regions where DFIs are active.
- GPs can use LPs' reporting templates as a basis for their own system for monitoring and reporting on ESG.

**COMPANY INTRODUCTION**

CapMan Group is a listed PE fund manager with €3.3 billion under management. The firm has five partnerships: Buyout, Russia, Credit, Public Market and Real Estate. At the end of Q1 2013, CapMan's portfolio consisted of 39 companies and 57 real estate assets.

CapMan's equity and mezzanine funds invest in Nordic and Russian companies and its real estate funds invest in commercial and hotel properties and property development projects in the Nordic countries. CapMan's two other investment partnerships, Technology and Life Science, focus on developing and exiting their current portfolio companies. This case study focuses on CapMan Russia specifically.

**APPROACH TO RESPONSIBLE INVESTMENT**

CapMan Russia is committed to promoting responsible business practices in its portfolio companies and leads by example by integrating ESG into its own business activities. It has appointed an internal manager contact to be responsible for coordinating ESG issues within CapMan Russia and liaising with the CapMan Group ESG manager. CapMan Russia is responsible for the practical implementation of the CapMan-wide ESG policy in Russia. CapMan Russia's ESG guidelines and practices may sometimes be stricter due to demands by its DFI investors.

In Russia attention to ESG issues has increased significantly, especially in the last 5-7 years. The LPs are the most important driver for this development, with high performance requirements set by the IFC and EBRD. Adherence to these requirements is monitored by the investment managers and portfolio company management. To support their investment managers in this, CapMan Russia has arranged training by external consultants on ESG issues.

**DUE DILIGENCE**

ESG has been integrated into CapMan Russia's due diligence process and involves the ESG manager's participation from the start.

CapMan excludes several sectors, so the first step in initial due diligence is to check against this exclusion list. The next step is to screen the nature of the potential investment to determine the scope of the ESG due diligence that will be required. If a potential investment is categorised as 'low risk,' CapMan Russia will conduct the ESG analysis using its own resources. If a company is classified as 'medium risk' or 'high risk,' CapMan Russia will hire external ESG consultants to perform a detailed due diligence. These consultants are asked to map out the relevant ESG issues and draft a post-investment ESG action plan in alignment with IFC and EBRD standards. Apart from checks based on CapMan Russia's own ESG policy and

assessment of the inherent sector/geography related ESG risks, the external consultant's ESG assessment can also include site visits and the evaluation of the portfolio company's quality of management of ESG issues (i.e. their commitment, capacity and track record in this area).

CapMan Russia may decide not to invest in businesses that contain high ESG risks. However, a poor ESG score does not automatically prevent an investment if the target has potential for value creation through improvements in ESG performance. To support the investment committee's decision-making process, the post-investment action plan drafted by external consultants will be attached to the investment documentation in the form of an ESG roadmap.

**OWNERSHIP**

CapMan Russia expects its portfolio companies to commit to ESG improvement plans. The boards of the portfolio companies are expected to address ESG risks and opportunities that were identified during due diligence. In addition, each portfolio company is required to draw up a programme for good corporate governance. The ESG performance of portfolio companies is monitored by regular site visits, management and board meetings, and annual reporting.

After the deal CapMan Russia provides reporting templates to the portfolio company, which can be used for providing information for CapMan's annual ESG report. These templates are based on those of the IFC and the EBRD, but Capman Russia has made a single template that fulfils all the different demands of the different LPs.

CapMan Russia is increasingly integrating ESG issues into its financial monitoring process. ESG issues are included in the reporting for all companies with each portfolio company required to provide an annual ES Performance Report to CapMan Russia.

CapMan Russia compiles an annual ESG report for its LPs. The report is compiled in conjunction with the portfolio companies and includes ESG improvement opportunities.



## CVC CAPITAL PARTNERS

Investment strategy	Buyout
Operating regions	Europe, North America and Asia
HQ	Luxembourg
AUM (approx. in US\$bn)	41
Staff size	~300

### KEY TAKEAWAYS

- A GP can develop a screening tool for investment deal team members to use during due diligence.
- A GP can survey their portfolio companies to determine the levels of ESG integration and understanding, and what is needed in terms of support.
- A GP's operations team can use findings from ESG due diligence to develop value creation opportunities.

### COMPANY INTRODUCTION

CVC Capital Partners (CVC) focuses on large buy-outs in Europe, North America and Asia. Over the past five years, CVC has been formalising its approach to responsible investment. CVC recognises the impact that the PE industry can have on the environment and society and as such believes the consideration of ESG issues should be integral to its investment process. It is also widely acknowledged across the firm that ESG best practice by companies overlaps in many areas with sound business management and value creation within a business.

### DEVELOPING AN ESG STRATEGY

Through its ESG strategy, CVC aims to:

1. Ensure that a consistent approach is taken to ESG due diligence on potential investments
2. Monitor and understand the progress that portfolio companies have made with their own ESG programmes and develop a method of reporting this progress to investors, and
3. Encourage portfolio companies to take a proactive approach to ESG matters, including sharing best practice on ESG.

### INTEGRATING ESG STRATEGY INTO OPERATIONS

In order to meet the goals of its ESG strategy, in the past few years CVC has focused on the following projects:

#### Sustainability screening tool

CVC has made an ESG review a requirement in the potential investment review process. To identify ESG related issues during the due diligence process, investment deal team members are given access to an online sustainability screening tool developed by an external consultant. The screening tool is divided by industry sector in order to highlight the specific ESG risks and opportunities of a particular sector. The issues covered include environmental, climate change and energy use, labour issues, business ethics and corruption, human rights and water availability. If appropriate, ESG actions are then built into the post-acquisition investment plan, often with the assistance of CVC's operations team. A portfolio company review, including an ESG review where appropriate, is undertaken six months after initial investment.

#### Commissioning a survey across the portfolio

The formalisation of CVC's ESG integration strategy began in July 2009. A sustainability consultant, involved with the firm's ESG programme, helped commission a comprehensive survey of 49 of the firm's then 50 portfolio companies.

The aim of the survey was to better understand the perceptions and management activity of ESG in the investment portfolio.

The feedback from the survey was extremely positive with about two thirds of the portfolio companies expressing an interest in obtaining further assistance in relation to sustainability and best practice. Results from the survey also indicated a divergence of ESG understanding across the portfolio.

Last year CVC commissioned a new survey, which was more in depth, reflecting the fact that the ESG agenda at most portfolio companies has matured since the last survey. Its primary objective is to assess the general attitudes of the portfolio companies towards ESG in their businesses, and to assess perceptions on risk and opportunities. It also sought to understand what portfolio companies would find helpful from CVC in terms of support.

Following completion of the survey, each company was given a four page summary of their approach to ESG and a high level benchmark of their approach compared with the rest of the portfolio. The aim is to enable CVC to highlight anomalies between risk, management of that risk, attitudes and action.

#### Value creation within the operations team

The operations team is now an integrated part of CVC's ESG strategy. Where relevant they use both information accumulated from investment due diligence and the results of their own investigations to determine where they can add value to a portfolio company.

One such example of where ESG meets value creation is a programme at a portfolio company operating in the distribution sector. By virtue of its operations, fuel use is a significant sustainability issue and expense for this company. The operations team, working with the investment team, have put together a programme to target the reduction of 20-30% in fuel consumption. This will be achieved through the introduction of more efficient vehicles, route and load optimisation mechanisms and a programme to encourage more fuel efficient driving.

In order to encourage other portfolio companies to consider similar schemes, the firm is considering ways to share experiences and best practices within the rest of the portfolio.



# DIRECT CAPITAL

## DIRECT CAPITAL

Investment strategy	Growth capital and buyout
Operating regions	Oceania
HQ	New Zealand
AUM (approx. in US\$bn)	~0.5
Staff size	8

### KEY TAKEAWAYS

- A GP can ensure that ESG issues flagged during due diligence are properly addressed through active ownership in conjunction with the portfolio company's management.
- A GP can work with the portfolio company management to establish metrics to monitor ESG issues during ownership.
- A GP provides quarterly updates to their LPs on any ESG issues identified during due diligence and ownership.

### COMPANY INTRODUCTION

Direct Capital (active since 1994) invests into private companies in Australia and New Zealand. The firm provides capital to fund growth and business expansion, to complete acquisitions, to fund the business through to a public listing and to help business owners facilitate a change of ownership to their management team.

### INTEGRATING ESG IN THE ORGANISATION

Direct Capital has a dedicated resource who supervises the integration of ESG, however it's the investment director that is ultimately responsible for ensuring ESG issues are identified, monitored and addressed throughout the investment cycle. The investment directors are also key in providing the necessary information and feedback needed for the reporting cycles that underpin Direct Capital's ESG efforts.

### INTEGRATING ESG INTO THE INVESTMENT CYCLE

Direct Capital's ESG investment framework includes both a top-down scan of ESG issues relevant to the company's industry, and a bottom-up review of the target company's internal ESG strengths and exposures. The framework requires investment directors to complete comprehensive ESG check lists while reviewing potential investments. Where necessary, Direct Capital engages external consultants to conduct assessments and to evaluate potential courses of action and their associated costs.

#### Due diligence

Direct Capital looks for both ESG risks and opportunities during the pre-investment stage in alignment with their belief that integrating ESG considerations has a potential impact on investment value. Broadly speaking, risks are more easily identified than opportunities but in some cases it is the resolution of a risk that can present the opportunity.

Direct Capital follows the route of active ownership by assuming a position on the portfolio company board. Within the portfolio companies, ESG issues that have been identified during due diligence are mainly addressed at board level rather than at the ESG/ CSR officer level. The board is able to give prominence to these issues and to allocate additional resources to tackle them.

#### Monitoring

In certain cases the issues identified during the due diligence phase are grounds to increase the monitoring of certain ESG issues. In one case the due diligence unearthed that a company had had some health and safety issues in the past. Based on this finding, Direct Capital decided to actively benchmark the company's performance in this area against the entire industry

in order to better monitor the situation. In short, when material ESG issues have been identified, Direct Capital will work directly with the board of the portfolio company to establish specific metrics to monitor these issues. In these cases Direct Capital will also exert influence on the portfolio company to report on ESG issues through board reporting and to regularly monitor alignment with industry standards or external regulations.

### REPORTING TO LPS

Direct Capital publishes an annual ESG compliance document which is distributed to all LPs alongside the annual report. This ESG statement includes a detailed description of Direct Capital's risk identification process and elaborates on specific ESG due diligences undertaken during that year. The report also gives an update on how previously reported risks have been managed. Direct Capital also reports to LPs on a quarterly basis and includes an ESG section on each portfolio company's ESG plan and performance.

The ESG sections in the quarterly reports will provide information on any ESG issues identified during the pre-investment phase and on any new issues that might have arisen during ownership. Extra information is provided on occasions when LPs have expressed concerns regarding a specific investment. Most of the ESG issues that Direct Capital reports on have to do with employee safety and environmental concerns. The basis for the reporting to LPs is to provide investors with relevant and material ESG developments that have occurred within each company.

# DOUGHTY HANSON

## DOUGHTY HANSON

Investment strategy	Buyout
Operating regions	Europe
HQ	UK
AUM (approx. in US\$bn)	4.7
Staff size	104

### KEY TAKEAWAYS

- Early consideration of ESG coupled with on-site due diligence visits can enable a GP to more effectively tailor engagement activities and target material issues.
- A GP can collaborate with the portfolio company to incorporate ESG risks and opportunities into a tailored and flexible action plan.
- A GP can establish in-house ESG resource with the experience and qualifications necessary to understand both the operations of the portfolio and needs of the deal team.

### COMPANY INTRODUCTION

Doughty Hanson has been active in European private equity for over 27 years, acquiring majority stakes in market leading businesses with enterprise values at the time of acquisition typically in the range of €250 million to €1 billion. The firm has long recognised the importance of undertaking business in a responsible manner; believing that ESG matters can have a significant impact on private equity investment, both in terms of raising funds, making investments and managing portfolios.

### APPROACH TO RESPONSIBLE INVESTMENT

Doughty Hanson's approach is to treat ESG as integral to the business, both at a firm level and within the portfolio. Doughty Hanson addresses a wide range of ESG issues throughout the investment lifecycle through a culture of active ownership and access to in-house ESG expertise that is supported by a wide network of external specialists. ESG efforts are coordinated by a dedicated Head of Sustainability, qualified by over 22 years' practical ESG expertise, who is a Partner within the private equity team.

### COLLABORATING WITH PORTFOLIO COMPANIES

Doughty Hanson works with the portfolio to identify, manage and act upon ESG risks and opportunities through a targeted action plan. This is achieved by identifying and validating what works well, and identifying gaps for value enhancement and risk management. The action plan is specifically designed to be flexible to capture information on an on-going basis and to take into account change management. If issues arise or are identified that were not in the original action plan, they are simply added to it. The approach is to not simply rely on reporting what a company is already doing but to seek to validate and enhance existing initiatives and instigate new ones where necessary. Additionally, Doughty Hanson seeks to play an active supporting role in the event of an ESG incident or crisis.

Rather than focus on any one aspect, Doughty Hanson seeks to understand how all applicable ESG issues might impact an investment during its lifecycle. ESG initiatives at portfolio companies tend to focus on issues that are most material to the investment and a successful exit. All initiatives come with CEO approval and backing. Examples of the types of initiatives that Doughty Hanson will validate or instigate include:

- **Managing risk** (identifying and mitigating ESG risk e.g. supply chain assessment, product life-cycle assessment, provision of training, behavioural safety)
- **Professionalising** a firm from the perspective of ESG management (recruiting senior executives and/or plant

level specialists; developing policies, processes and procedures in collaboration with these executives and specialists; formalising management systems and reporting processes)

- **Growing the top line** (identifying opportunities to develop new products and services and validating existing ones)
- **Saving money** (reducing cost through environmental efficiency, e.g. energy, water, waste, and/or improved health and safety, e.g. fewer accidents and reduced insurance costs)

### MONITORING AND DISCLOSURE

Doughty Hanson engages with the entire portfolio on ESG with a varying focus according to need, materiality and exit strategy. Each portfolio company has a tailored action plan that incorporates the ESG factors identified during both due diligence and ownership. Progress against this action plan is monitored and reported on in exactly the same manner as for any other aspect of value creation and risk management; namely discussions at weekly team meetings, during periodic steering committee meetings, and within reports from quarterly investment committee meetings attended by all investment professionals and Partners.

There is also a formal annual ESG reporting obligation across the Funds. This captures data relating to health and safety performance (e.g. accident statistics), environmental performance (e.g. water conservation or energy management), community engagement (e.g. charitable activities) and governance (e.g. ABC risk) as well as any bespoke ESG initiatives or issues the company has been involved in. The data received each year helps inform the bespoke value creation work within individual portfolio companies. Doughty Hanson has also undertaken fund-wide ESG assessments on issues of material impact to the fund as a whole.

### RESULTS

A typical engagement will ultimately seek to address all the relevant material ESG aspects of a business. For example, at floor coverings manufacturer Balta, Doughty Hanson and portfolio management worked to grow the top line through the development of "green" product ranges. Doughty Hanson provided in-house expertise to challenge and also validate the "green" credentials of the range. Since 2011 the range has generated additional revenues of over €4 million. This work compliments initiatives aimed at addressing energy efficiency and installing on site renewable energy, and which have resulted in cost savings of €1.7 m a year and saving 4,750 tonnes carbon annually. Similarly, providing training and improving the organisational safety culture resulted in improved safety performance and savings of €1.9 m since 2009 arising from a reduced number of incidents.

Doughty Hanson believes that these initiatives better position their businesses for exit. For example, at packaging business Impress, sold in 2010, initiatives contributed to a 50% reduction in accident frequency rate, 500 tonnes of waste recycled a year, 1,800 tonnes of carbon emissions saved a year, and equating to €2 million a year in savings or €12 million (6x Exit Multiple). This represented 3% of the €380m of equity value or 5% of the overall €40m in annual cost savings generated at the time of exit, and the firm had only just started to really engage at that company.

# EGERIA

## EGERIA

Investment strategy	Buyout
Operating regions	Netherlands
HQ	Netherlands
AUM (approx. in US\$bn)	2.3
Staff size	23

### KEY TAKEAWAYS

- A GP can ask its portfolio companies to draw up their own ESG policies and goals.
- A GP can analyse the materiality of ESG issues across the portfolio to identify areas of greatest impact where they should focus their efforts.
- A GP can ask their portfolio companies to develop progress reports on their priorities, plans and status on an annual basis.

### COMPANY INTRODUCTION

Egeria was founded in 1997 and is a fully independent Dutch private equity firm, targeting controlling stakes in mid-market companies (with a value between €50 and €250 million) in The Netherlands or in companies that have a clear Dutch link.

### RESPONSIBLE INVESTMENT

Egeria recognises the impact that private equity investments may have on the environment and society – and vice versa. Egeria also believes that ESG factors can have a material impact on the financial performance and value of its portfolio companies and therefore feel they are responsible for mitigating any ESG risks as well as seizing ESG opportunities. In the autumn of 2010, Egeria's partners decided to make their ESG values and corresponding conduct more explicit. The partnership felt it was of key importance to align the management of ESG factors with their core business of creating long term value for their LPs, and also to be able to demonstrate this. They also decided to go after some “quick wins” first, i.e. initiatives that would yield concrete and measurable results relatively fast, that would get the more sceptical team members on board.

### ESG FRAMEWORK

Egeria has developed an ESG framework that is consistently applied across the portfolio, integrating ESG into fund management, due diligence and reporting. The methodology allows Egeria to identify opportunities in areas of greatest impact, and to marry risk mitigation to tangible value creation.

Egeria asks its portfolio companies to develop policies and goals for the ESG issues that are most important to them and most relevant to their operations. Egeria is able to analyse the materiality of these issues and get a comparative perspective on the ESG issues within a single company, across the full portfolio or within an impact category. This has the potential to expose unexpected opportunities and risks that might have been missed if not for the ESG lens.

As Egeria focuses on the different aspects of sustainability to help create value, this topic is increasingly addressed in the meetings with local management. Ultimate responsibility for acting upon ESG risks and opportunities lies with the company management.

During the second half of 2011, all portfolio companies prepared reports on their priorities, status and plans for the first time, with the assistance of external expertise. As follow up, progress reports are now prepared on an annual basis. Consistent portfolio wide reporting creates discipline and drives progress on the most pressing issues in the portfolio. Additionally,

reporting ‘creates its own reality’ – once all members of the investment team and all company management teams realise that ESG performance is an essential output, then they will act accordingly.

### OWNERSHIP

Egeria's approach is to focus their efforts only on those opportunities and risks that are material and aligned with the strategy of the company. The portfolio is separated into quartiles, from ‘most relevant’ to ‘less relevant’. Companies that are labelled ‘most relevant’ have higher risks and/or opportunities than others, and are expected to manage them accordingly.

After the third year of active monitoring, managing and reporting, Egeria has created many examples of how ESG management and value creation coincide. Health and safety records have improved across the board, energy and water consumption are more actively and successfully managed, and many companies have embarked upon innovation programmes to create new products and services that both improve ESG performance and are in line with market appetite.

For some companies, ESG is a decisive part of their positioning. The market recognises (and pays for) the fact that their products are more sustainable and recyclable - this positioning also has a positive spin-off on the employee and local government perceptions. In such cases, investing in a ‘sustainable turnaround’ pays off in many respects. An example of this is the tile manufacturing company Royal Mosa. During Egeria's ownership, the company obtained a silver Cradle to Cradle certification for virtually its entire production line. Cradle to Cradle design is an innovative approach to sustainability that seeks to create systems that are not only efficient but also essentially waste free. In addition, a selection of Mosa's tiles positively contribute to the possible LEED status of a building. In short, sustainability has become an intrinsic part of the value creation proposition of the company.

For some portfolio companies, ESG issues are less relevant as the company's environmental and social impact is limited. Nevertheless, these portfolio companies will also be encouraged to investigate their potential to create sustainable value.



**GLOBAL ENVIRONMENT FUND**

**GLOBAL ENVIRONMENT FUND**

Investment strategy	Growth capital
Operating regions	Emerging markets and North America
HQ	USA
AUM (approx. in US\$bn)	1
Staff size	45

**KEY TAKEAWAYS**

- A GP can identify the rationale for a prospective investment through an ESG lens.
- A GP can use local consultants to review the prospective company's compliance with local and national laws, as well as IFC Performance Standards and Guidelines.
- During due diligence, a GP can work with the prospective company to identify an ESG action plan which the company is then bound to in the investment documentation.

**COMPANY INTRODUCTION**

Global Environment Fund (GEF) is a global PE investment management firm with approximately US\$1 billion under management with a focus on clean energy, energy efficiency, environmental services and natural resources. Established in 1990, GEF invests growth capital in established companies answering the global demand for increased efficiency and decreased consumption of energy and natural resources. GEF is organised into three distinct teams covering North America, emerging markets and sustainably managed timberlands. The firm was recognised as the Sustainable Investor of the Year in 2009 and 2010 by the Financial Times.

**APPROACH TO RESPONSIBLE INVESTMENT**

For GEF, ESG processes are embedded in the portfolio through strategic, management and operational activities. GEF believes that companies with proper environmental and social practices are more likely to be exited with higher valuations than non-compliant competitors. This is especially relevant if the company is acquired by multinational strategic players unwilling to take on the significant potential liabilities of companies exhibiting substandard practices. In addition, international buyers often require clean and efficient transaction processes, where a company can be a more attractive target when demonstrating higher quality documentation, management practices, and sustainable operations at international standards.

GEF has integrated ESG principles through its investment decision-making and portfolio management processes, collectively known as the GEF Sustainable Investment Approach, which is overseen by the firm's leadership. GEF investment teams are supported by dedicated ESG and portfolio management resources.

**EXAMPLE OF THE GEF SUSTAINABLE INVESTMENT APPROACH: RED AMBIENTAL**

To illustrate some of the elements of the Sustainable Investment Approach, GEF's investment in Red Ambiental provides a practical example. Red Ambiental is a Mexican integrated waste management company providing waste collection and disposal services.

**Energy or environmental rationale**

As a first step GEF identifies the energy or environmental rationale for an investment, in addition to the commercial and finance opportunity. Through its engagement in the global waste sector, GEF recognised that Red Ambiental addressed Mexico's need for modernisation in the waste management sector by already meeting, and in some cases exceeding, local environmental standards. Access to GEF's capital would enable

Red Ambiental to scale nationally while improving operations to meet international waste management standards.

**Due diligence**

GEF follows a due diligence process that integrates analysis of the company's environmental and community footprint, resource efficiency, safety processes, labour management, along with business integrity and corporate governance, into financial, market and operational diligence. For each potential investment, these considerations are mapped and prioritised, with the key issues and risks driving the team's detailed analysis and the engagement of experts to assist with specific environmental or community issues. For many of its portfolio companies, GEF follows the IFC Performance Standards and Guidelines.

GEF also conducts targeted ESG due diligence according to the investment sector. In the case of Red Ambiental, due diligence was focused on specific issues involved in non-hazardous waste collection, transportation and disposal. GEF's investment team worked closely with environmental consultants to assess the company's operations and accompanied them on site visits to Red Ambiental landfills, truck depots and offices. GEF engaged specialised local counsel to review and analyse the company's compliance with local and national Mexican environmental laws and regulations, as well as IFC best practices for the industry. Opportunities for improvement and areas of potential liability were identified, assessed and prioritised in discussion with management. For example, a process was sought to enhance the safety of local families who make their livelihood as landfill waste scavengers (known locally as pepenadores).

GEF then developed an Environmental and Social Action Plan (ESAP) in conjunction with management prior to closing the transaction. The Red Ambiental ESAP contained company-wide and site-specific items, such as drainage pumps, landfill permits, and obtaining additional environmental and civil society permits.

**Investment agreement**

The ESAP is incorporated into the investment documentation. Management is bound by the Shareholder Agreement to follow GEF's ESG policy and implement the ESAP.

**Monitoring**

During the ownership phase, management of the portfolio company will work with the GEF investment team to implement the ESAP. Red Ambiental's management has incorporated the ESAP into their core management systems under the direction of the COO, while demonstrating its ongoing commitment to best practices through the pursuit of ISO 9001 and 14001 certifications. In some cases, an annual third-party environmental and social audit is also performed to confirm progress and identify future issues.

GEF uses an annual ESG monitoring report to measure the company's progress on a variety of ESG factors, comprising of both quantitative and qualitative KPIs. GEF presents an Annual ESG Report to its investors.



## IDINVEST PARTNERS

Investment strategy	Growth capital
Operating regions	Europe
HQ	France
AUM (approx. in US\$bn)	5.5
Staff size	40

### KEY TAKEAWAYS

- A GP can develop an ESG Profile Review and an accompanying risk rating for potential investments which can then be factored into the investment committee's decision-making process.
- A GP can set up a system to consistently incorporate findings from ESG due diligence into the investment documentation, creating a traceability for ESG issues identified in the pre-investment review.
- A GP can make use of external assistance in setting up a separate ESG steering group.

### COMPANY INTRODUCTION

Idinvest Partners (Idinvest) is a European PE firm that invests primarily in small medium enterprises. Idinvest has invested in more than 80 high-tech companies offering strong growth potential and has developed environmental expertise having almost €130 million worth of environmentally themed companies (wind, solar, biomass/biogas and hydro power plants) in its portfolio.

### BUILDING A RI POLICY

Idinvest strongly believes in the need to incorporate extra-financial factors in the business lines while at the same time maintaining a high level of performance. ESG criteria deserves careful consideration, from both strategic and operational perspectives, as a means of creating value and managing risks more effectively with the potential to add value at exit. Since 2002 Idinvest has been engaged with initiatives like Socially Responsible Private Equity (SR-PE) and in 2007 it began to actively translate ESG considerations into its operations. As of 2012, Idinvest entered into a new phase of ESG implementation and consolidation when it formalised its Responsible Private Equity Policy (RPEP) and set up processes to incorporate ESG into its direct and fund of fund investments.

ESG considerations are incorporated into Idinvest's internal documents, including: the Investment Executive Summary (which incorporates the ESG Profile Review and the ESG risk/rating), the Investment Committee Report (which includes a summary of the ESG Profile Review results, any specific or detailed ESG due diligence that was conducted and the investment decision) and in the Final Investment / Acquisition Recommendation (which includes the summary of the ESG Profile Review results in the form of an investment memorandum).

Idinvest has formed an ESG steering group to steer and monitor Idinvest's RPEP. It is composed of members of the executive board, the Partner in charge of the project coordination, the compliance officer, and the business development manager. Idinvest works closely with a specialised external consultant to implement, regularly review and report on its RPEP. The Idinvest RPEP is presented at an annual seminar to which all employees are invited to maintain awareness.

### FACTORING ESG INTO THE INVESTMENT DECISION

Typical ESG due diligence for direct investments will involve interviews with senior management and on-site inspections. In some cases external expertise will be consulted. The first

step is to integrate due diligence findings into the ESG Profile Review for the investment. This review is based on three criteria: external shareholders (e.g. other PE firms that may be involved), senior management (including criteria such as what is their link with the overall performance of the firm, what is their ESG knowledge, and whether management has the capacity to take action on ESG issues if needed) and business activities (regulatory exposure i.e. Articles 225 and 75 of the Loi Grenelle II, and overall ESG risk exposure in the company industry). This review results in an ESG rating of 'high', 'moderate' or 'low'.

Idinvest's investment committee is charged with examining all ESG Profile Reviews for its prospective investments, and will take the ESG risk rating into account when making the investment decision. Investments with a 'high' ESG risk rating are excluded.

If an investment is given a 'moderate' risk rating during due diligence, or if a current investment is involved in an ESG incident, then Idinvest will conduct an enhanced ESG analysis. This means working with a specialised consulting firm to prepare a company-specific questionnaire to understand and address the ESG concerns. This questionnaire is completed by the auditing firm that performs the accounting, technical and legal audits for Idinvest prior to investment (or post-investment in the event of an ESG incident). The findings of this questionnaire will inform the investment decision and the ensuing monitoring process.

### MONITORING ESG FACTORS WITHIN PORTFOLIO COMPANIES

Idinvest has periodical discussions with its portfolio companies on ESG. The ESG Profile of each portfolio company is reviewed every 24 months, and in the case of an ESG related incident there will be an additional immediate review. Idinvest expects portfolio company management to be in control of managing any environmental risks commonly associated with the company's industry. In regards to monitoring social risks, Idinvest works to make sure that its portfolio companies maintain good relations with employees, comply with labour regulations and promote employee engagement and growth-sharing. On the governance side, Idinvest monitors the composition of the boards of directors and supervisory boards, the distribution of power among supervisory bodies, handling of conflicts of interest and internal control systems and audit trails.

This year, Idinvest plans to start sending out an annual ESG questionnaire to all of its direct investments (including Debt/Mezzanine) in order to collect more systematic information on targeted ESG performance indicators. The plan is to develop the detail of these indicators over time to link with the ESG Profile Review of the company.

# KENDALL COURT

## KENDALL COURT

Investment strategy	Growth capital
Operating regions	Southeast Asia
HQ	Singapore
AUM (approx. in US\$bn)	0.285 (as of 31 <sup>st</sup> March 2013)
Staff size	15

### KEY TAKEAWAYS

- A GP can review international standards recommended by DFIs and adapt them to the local rules applicable to the region of operation.
- During the investment agreement stage, a GP can stipulate that the portfolio company forms an ESG committee.
- A GP can quantitatively measure ESG improvements where possible and provide companies with the tools that will allow them to do this.

### COMPANY INTRODUCTION

Through growth, Kendall Court intends to achieve societal development and improvement within its operating markets. It uses structured instruments as a tool to invest directly into mid-market companies in Southeast Asia. Presently the company holds eight portfolio companies across different industries.

### APPROACH TO RESPONSIBLE INVESTMENT

Kendall Court believes that by considering the spectrum of ESG issues relevant to an investment, it is possible to identify business problems that are created through a lack of long-term care, convenience, or a wasteful mentality based on false assumptions of resource abundance.

Opportunities in Kendall Court's target markets are often in high ESG risk industries such as natural resources and plantations. Kendall Court's approach is not to avoid these high ESG risk sectors; rather, it seeks to promote sound ESG practices for the long-term sustainability of these resource-rich economies.

Kendall Court's ESG objectives are to mitigate risk and aim to achieve operational excellence, since better-managed companies, including management of ESG aspects, are generally more profitable.

Kendall Court has appointed a dedicated Business Process Specialist that is steeped in ESG practices. The role is responsible for (i) ensuring full compliance with best practice ESG guidelines, (ii) ESG pre-screening and auditing on proposed investments, and (iii) development and implementation of ESG procedures within Kendall Court and its portfolio companies.

### INTEGRATING ESG INTO THE INVESTMENT CYCLE

Kendall Court has built its ESG system by reviewing the international standards recommended by DFI toolkits and adapting these to the local rules that are applicable to their regions of operation.

#### Due diligence

Kendall Court uses its own toolkit (based on the CDC toolkit with adjustments made for the Southeast Asia market) to screen for material ESG related risks and opportunities. Portfolio companies are required to adopt the CDC Investment Code or their own code that is of a similar or higher standard. Additionally, Kendall Court applies the IFC Performance Standards when reviewing and examining potential investments on ESG related matters. By using the IFC standards and industry specific standards where relevant (e.g. using LEED in the hotel

sector) Kendall Court is able to map out the ESG risks and opportunities and what the potential engagement plan should look like for each investment.

In terms of exclusion, Kendall Court does not invest in companies active in gaming, alcohol and tobacco, defense and projects causing irreversible environmental damage. During detailed due diligence the Business Process Specialist will lead the ESG audit programme and share relevant information with the investment team. Based on the outcomes of the due diligence process, Kendall Court will write a company-specific action plan. ESG related concerns and actions are included in the deal agreement between Kendall Court and the portfolio company.

#### Investment agreement

During the investment agreement stage, Kendall Court will stipulate that the portfolio company forms an ESG committee. This committee will typically consist of 3-6 people, including the portfolio company's CEO and CFO whenever possible and at least one Kendall Court employee, with Kendall Court's Business Process Specialist always directly involved. The rationale behind this ESG committee is that inter-departmental coordination on ESG matters is crucial to avoid a silo mentality when it comes to ESG implementation. Moreover, meaningful change requires human capital and resources and the CEO and CFO have decision-making power over these matters.

#### Monitoring

The ESG performance of portfolio companies is measured quantitatively where possible. Kendall Court's Business Process Specialist identifies clear targets and KPIs to identify costs savings. To help portfolio companies calculate costs and savings, Kendall Court provides them with self-constructed examples and spreadsheet templates. These examples concern amongst others case studies specific to their sector of operations to encourage positive actions, while the use of templates encourage consistency in comparative reporting from across the portfolio. Examples of the former include highlighting cost savings and actions taken by comparative companies within similar sectors. For the latter they include data capture forms for energy consumption to ensure common data sets across related companies is collected to enable efficient analysis, comparison and recording of impacts during implementation of energy efficiency measures. Thus this approach helps Kendall Court to have a central and streamlined system to monitor ESG improvements and costs savings against the company specific action plans. Additionally, ESG reporting is in itself a way to demonstrate a well-run company and may positively impact the price upon exit.



## PERMIRA

Investment strategy	Buyout
Operating regions	Europe, North America and Asia
HQ	UK
AUM (approx. in US\$bn)	30
Staff size	200

### KEY TAKEAWAYS

- A GP can commence organisation-wide integration of ESG factors by including specific reference within the GP's Business Principles.
- A GP's New Joiners Program can include a training session dedicated to the integration of ESG matters within the investment process and across the organisation.
- A GP can make the consideration and analysis of ESG factors a requirement for Investment Committee papers and discussion.

### COMPANY INTRODUCTION

Permira adopts a buyout strategy for funds managed and focuses on the Consumer, Financial Services, Healthcare, Industrials and TMT sectors. The firm has twelve offices across Europe, the US and Asia with investments made on a global basis.

### DEVELOPING AN ESG STRATEGY

Permira's operations are underpinned by their Business Principles, in accordance with which all employees are expected to conduct their activities. As part of formalising their ESG initiative, Permira specifically revisited these organisation-level guidelines. Two of the eleven principles make specific reference to ESG factors: "Follow best practice with regard to applicable environmental, social and governance standards" and "Add sustainable value to investee companies".

Permira employed the services of a third party specialist to assist in the formulation of its approach to responsible investment with the objective to build a structured system around the company's existing activities in this area.

As part of this process, Permira worked with the third party specialist to develop a toolkit, which provides the methodology for analysis and management of ESG issues through the investment process. Lessons learned during the implementation of the toolkit are used for ongoing refinement – for example, company offsites have a dedicated ESG session, which provides updates on and feedback into this process.

### INTEGRATING ESG WITHIN THE ORGANISATION

Permira has set up a working group dedicated to ESG matters. The group brings together investment professionals, the Chief Risk Officer and a member of the Investment Committee. Involving members on the working group that are able to challenge ESG considerations provides a basis for excellent discussions and can result in a clearer rationale for any actions taken (i.e. challenges such as "we are already doing this" and "it costs too many resources").

In addition, one person per industry sector is appointed to be the "ESG knowledge centre" for deeper sectoral expertise and training where required.

To communicate the message on organisation-wide integration of ESG practices to all new employees, the New Joiners Program includes a training session dedicated to the integration of ESG matters within the investment process and across the organisation.

During any fundraising process, Permira's experience is that their PRI signatory status and their approach to responsible investing pre-empts answering many questions from LPs on ESG factors and in some cases entirely satisfies this part of the LPs due diligence process. However, some LPs do request more details, which the team will provide where possible.

### INTEGRATING ESG INTO THE INVESTMENT PROCESS

#### Due diligence

All Permira employees involved with due diligence are aware of the need to incorporate ESG factors into the investment process from an early stage. This is a reflection of the specific consideration given to ESG issues by the Investment Committee, with the incorporation of a specific section on ESG considerations in the Investment Committee papers.

During initial due diligence, a particular focus is given to potential risks and a prospective investment could be rejected on ESG grounds at this stage. If a positive preliminary investment recommendation is made at this stage, a due diligence team will be built.

Further due diligence on new investment opportunities then seeks to assess the company's current track record on ESG matters, considers the risks but also aims to identify improvement opportunities. In some cases this can pose significant challenges, for example with companies operating in numerous geographies and served by complex supply chains. Third party advisors are used in the due diligence process as necessary.

During due diligence, a 100 day post-investment plan is drafted. This is a detailed document against which all early stage progress is measured. Permira has found that it can be difficult to set ESG focused KPIs on a portfolio wide basis; these KPIs often become too high level and are ultimately not helpful. Permira therefore aims to specify the method of analysis based on the individual company and its industry.

#### Monitoring

As part of ongoing portfolio company monitoring activities, detailed ESG reviews have been completed on almost all companies in the portfolio using external advisors, which includes a comparison to current industry-wide practices.

Post-acquisition, Permira collects material ESG information, both as part of its scheduled cross-portfolio risk assessments and its twice-yearly portfolio monitoring exercise. This enables measurement of progress against issues identified during the investment process. Permira reports on material ESG issues to their LPs through its annual portfolio review document and, where appropriate, on an ad-hoc basis. Some of their LPs will also send out annual ESG questionnaires. Overall, Permira believes that when reporting to LPs it is better to over-communicate ESG factors rather than the converse, particularly where an issue surfaces unexpectedly.

Permira believes that they can always learn from companies with existing good practices and these could then be applied to other portfolio companies as applicable.

The PRI is an investor initiative in partnership with  
**UNEP Finance Initiative** and the **UN Global Compact**.

#### United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: [www.unepfi.org](http://www.unepfi.org)



#### UN Global Compact

Launched in 2000, the United Nations Global Compact is both a policy platform and a practical framework for companies that are committed to sustainability and responsible business practices. As a multi-stakeholder leadership initiative, it seeks to align business operations and strategies with 10 universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to catalyse actions in support of broader UN goals. With 7,000 corporate signatories in 135 countries, it is the world's largest voluntary corporate sustainability initiative.

More information: [www.unglobalcompact.org](http://www.unglobalcompact.org)

