Private Equity Club 2009

Facing today, tomorrow and the day after*

*connectedthinking

PricewaterhouseCoopers

Sustainability: Reconciling responsibility with revenue

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Sustainability: Reconciling responsibility with revenue

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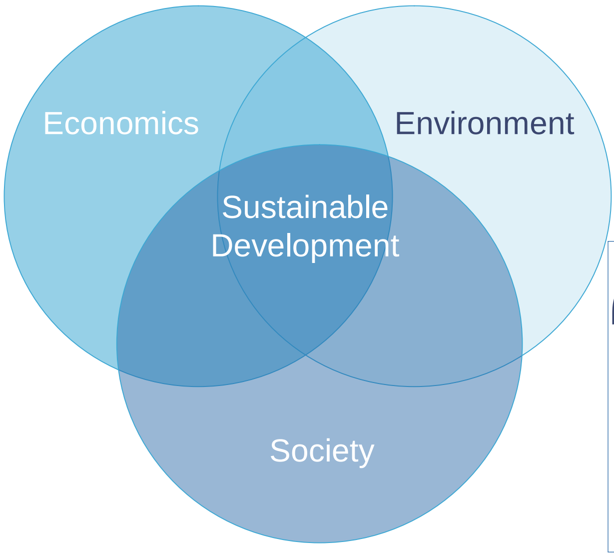
Sustainability: Reconciling responsibility with revenue

Phil Case

Assistant Director, PricewaterhouseCoopers LLP

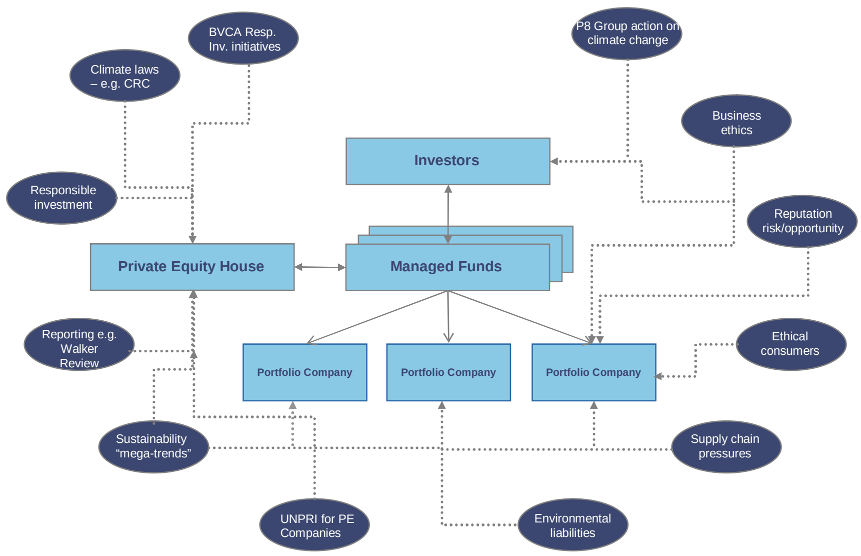
Three Pillars of Sustainable Development



"Meeting the needs of the present without compromising the ability of future generations to meet their own needs"

Brundtland Report, WCED 1987

Sustainability : Drivers for Action in the Private Equity Value Chain

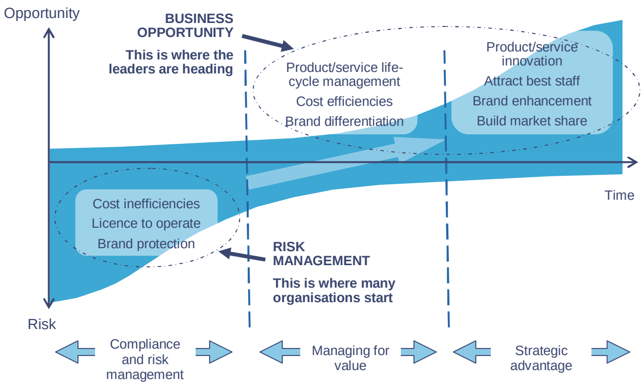


Sustainability: The Business Case

Business Benefits	
• Improved operational efficiency	• Preserve licence to operate
• Enhanced brand and reputation	• Promoting and increasing innovation
• Customer attraction and retention	• Improved access to capital
• Enhance human and intellectual capital	• Building and sustaining shareholder value
• Attracting and retaining talented staff	• Identification of new opportunities
• Improving risk management	• Generating increased revenues

Source: Sustainability: "Uncovering the business case for sustainability"

Sustainability – positioning a response



"We believe that [managing sustainability issues] will in the long run be an element in maintaining or increasing the value of the business…"

Mark Grizzelle, CFO at CVC, August 2009

Source: PwC

What are leading Private Equity Houses doing to manage sustainability issues?

Example market responses
• Determining strategy, policies and procedures;
• Allocating resources;
• Reviewing risks & opportunities from sustainability across the current portfolio;
• Working with portfolio companies that have the most value at risk and value to gain from sustainability;
• Investigating sustainability risks throughout the value chain;
• Developing and implementing sustainability screening for new deals (guidelines and toolkit);
• Becoming a signatory of the UNPRI for PE Houses.

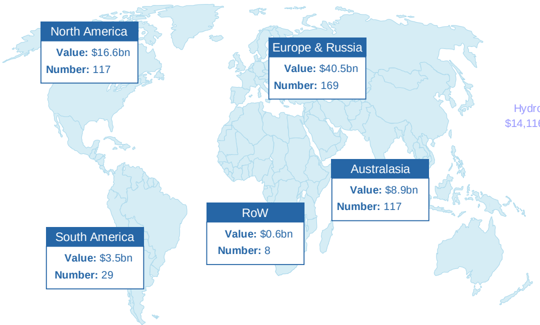
Sustainability: Reconciling responsibility with revenue

David Armfield

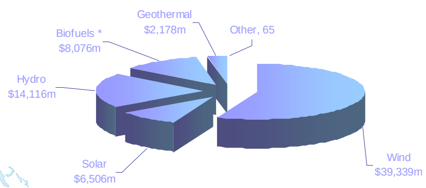
Partner, PricewaterhouseCoopers LLP

The climate for investment in renewables

During 2007 and 2008, 440 renewables deals were announced with reported value totalling US$70.1bn…

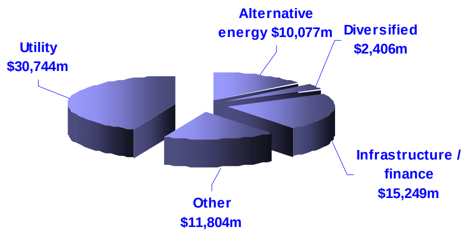


…with the majority focussed on the wind and hydro sectors



Infrastructure continues to capture the vast bulk of investment

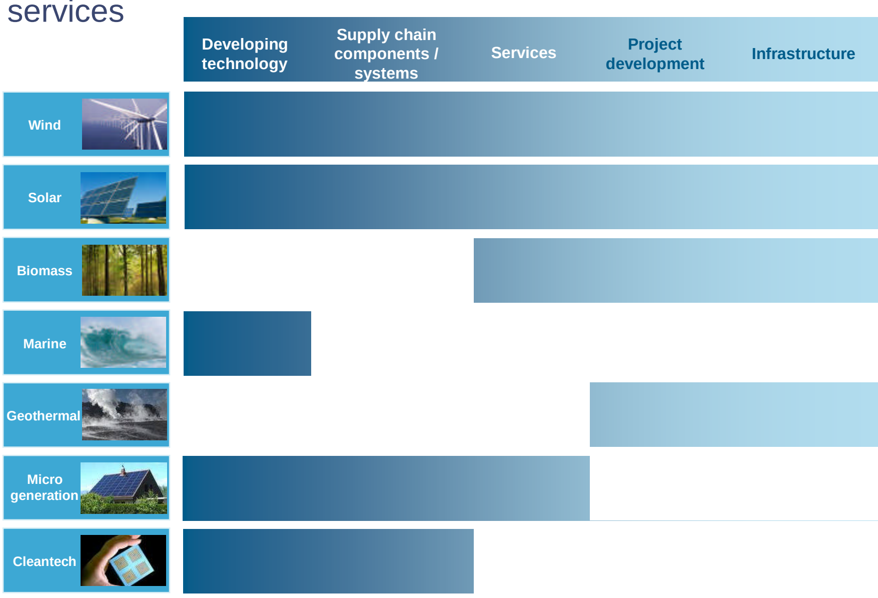
Financial investors accounted for 22% of the total deals in 2007 and 2008. The majority of these deals were either operational assets or infrastructure plays.



2008 saw a steady increase in investment in technology but significant reduction in infrastructure investments as the credit markets contracted.

This has tracked through to 2009 with significantly lower levels of M&A activity across the renewables sector

PE investment is likely to be focussed on supply chain and services



Wind remains the most developed market but its value chain remains dynamic

Turbine manufacture

Wind farm development and operation

Technology development → 2nd tier suppliers → 1st tier suppliers → Manufacturers → Developments → Servicing → Owners/ Operators

Technology development	2nd tier suppliers	1st tier suppliers	Manufacturers	Developments	Servicing	Owners/ Operators
New turbine technology Generation 2 and 3 foundations	machined parts, fasteners, electrical components etc	rotor blades, towers, gearboxes, generators, control systems	Turbines, towers, foundations, installation equipment & transmission / distribution equipment		Day to day repairs and maintenance, engineering, consulting and man power	

Conclusions

- Wind represents the biggest supply chain investment opportunity today with solar closest behind
- Microgeneration and energy efficiency in the built environment remains a fledgling market significantly dependent on feed in tariffs and funding economics
- Developing technologies likely to remain the preserve of Venture Capitalists and venturing arms of large corporates
- Largest investment pools will remain directed at infrastructure investment

An approach to protecting and creating value through sustainability

Mark Thompson

Director, PricewaterhouseCoopers LLP

Agenda

Project genesis and key drivers

- Companies who address this agenda will be more valuable on exit
- Desire to lead PE field
- Previously limited action in this area
- Investor interest

Risk mitigation
- Regulatory compliance
- Raw material supply security (availability, quality, cost)
- Emerging market challenges
- Ethical supply chain
- Community impacts
- Biodiversity and land use impacts

Cost reduction
- Resource use efficiency
- Energy use reduction
- Lean and green supply chain
- Packaging efficiency

Revenue enhancement
- Stronger relationships with key customers based on sustainability credentials
- ‘Sustainable’ products and services
- Price premium for sustainable solutions
- Growing new markets
- Carbon credits

Key objectives – what were we asked to do for CVC?

Design a sustainability survey to explore both:

management perceptions related to the sustainability agenda

management responses in relation to sustainability issues

Needed to focus on both sustainability-related risk and opportunity

Easy to use survey to be completed by the company CEO

- Key consideration was to design questions that would provide the right data

The tool – sustainability issues

- Building on the four pillars of sustainability, respondents were asked what level of concern they had for the following issues:

Workplace	**Community**
Labour	Community impact
Workplace	Human rights
Environment	**Marketplace**
Climate change and energy use	Supply chain risks
Water availability	Human rights
Environmental impact	

The tool – sustainability perceptions

- Respondents were asked the degree to which they perceived sustainability:
- to pose a risk to their business?
- present a commercial opportunities for their business?

- Also asked how sustainability compared to other macro risks such as:
- - economic downturn
- - terrorism
- - pandemics


The tool – sustainability management

Where respondents were ‘highly’ or ‘slightly’ concerned about sustainability risks, the survey asked what management response they had in place. This included for example:

- Do they carry out formal risk identification?
- Have they implemented a policy?
- Do they report internally?
- Are staff trained to manage this risk?
- External reporting?

What did the survey tool look like in reality?

Users can see the level of completion

Radio buttons

More detailed description when you 'hover' over key phrases

Easy navigation: back / next

What do the results tell CVC?

- Its portfolio is concerned about sustainability
- This concern is despite downturn
- Management response to sustainability issues is highly varied between companies
- Labour-related risks including workplace safety and talent retention pose the highest level of concern to nearly half of the portfolio.
- Potential exposure to climate change and energy use risks
- Companies perceive there to be significant business opportunities related to the sustainable development agenda
- Companies could do more to realise opportunities

What the results findings mean for CVC

- CVC now has a strong understanding of those companies who may be exposed to risk, or may be under-realising opportunity.
- 75% requested further help with this agenda:

"We are happy CVC is embracing sustainability. This really helps us. We would like to meet reps from other CVC portfolio companies to exchange ideas and best practices and maybe create a front runner community."

"Best practice knowledge transfer can prevent mis-effort and reduce learning curve."

- *"We are very resource constrained and do not have a view into what is being proposed for the future. Any support in identifying what will be required and ways to meet standards will be helpful."*

What CVC can now do

- Provide support to certain companies in order to protect value by reducing risk exposure, or help realise upside sustainability benefits.
- Focus on a distinct set of companies requesting further help and assistance. This may involve:
  - Knowledge-sharing workshops (regional or issue specific)
  - Internal reference sources (e.g. Intranet portal site)
- Increase interaction with 'priority companies' to improve risk management and enhance realisation of sustainability-related opportunities

Impact of CRC Energy Efficiency Scheme (CRC) on Private Equity Funds

Henry le Fleming

Manager, PricewaterhouseCoopers LLP

Jonathan Nugent

Senior Solicitor, PricewaterhouseCoopers LLP

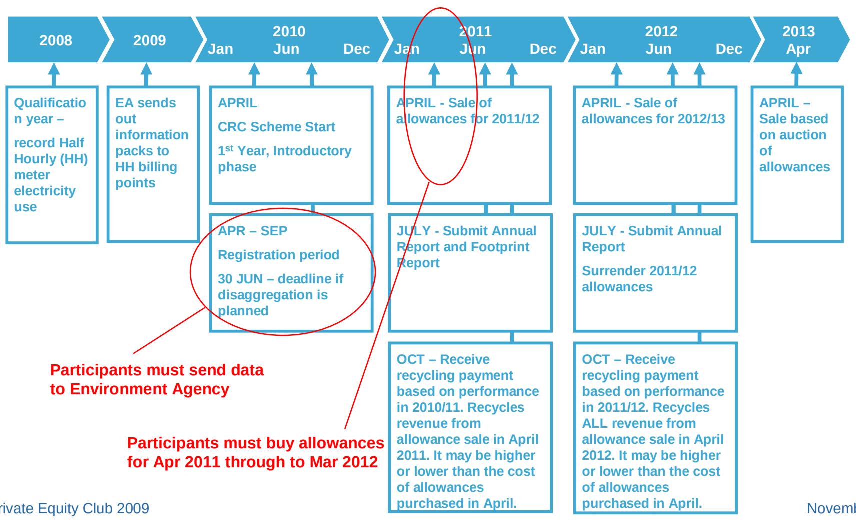
Agenda

1. Overview of the CRC regulations
2. Impact on Fund Structure
3. How to incentivise portfolio companies
4. The CRC impact in acquisitions and on exit strategies

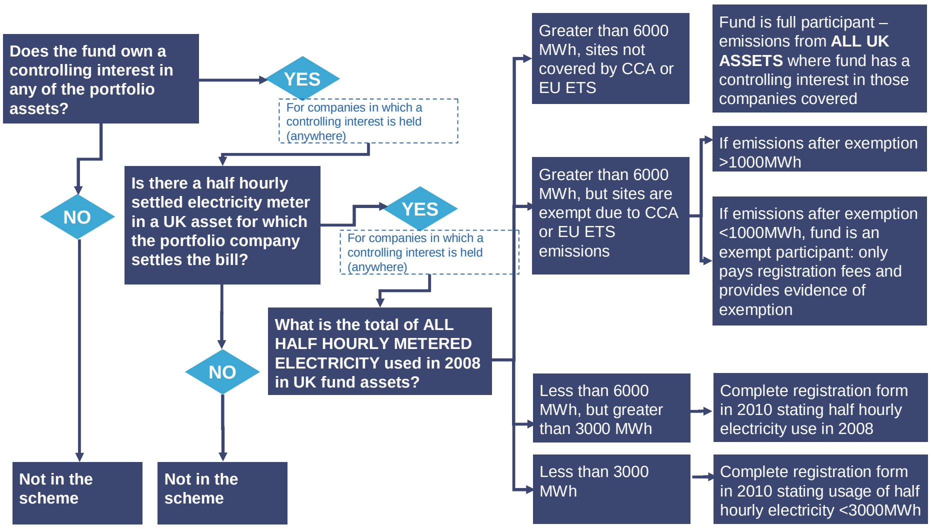
What is the CRC?

- The Government is introducing a new regulatory carbon trading scheme, based around the purchase of carbon credits, to improve energy efficiency in the UK.
- Around 5,000 of the UK's largest energy users will be in the scheme that starts April 2010.
- The CRC will impact a wide range of sectors such as manufacturing, retail, hospitality / leisure, financial services, IT / telecoms, hospitals, local government, and water utilities.
- These companies are unlikely to have been affected by other carbon trading schemes such as EU Emissions Trading Scheme or Climate Change Agreements.
- The CRC regulations apply to a legal entity or group of companies, not a specific site. This will have consequences for, amongst others, PE funds.

CRC Timeline

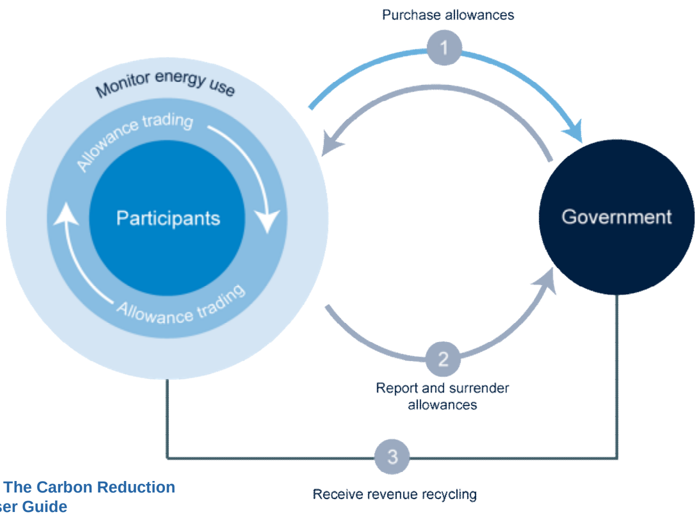


Qualification process for PE houses



Source: DEFRA The Carbon Reduction Commitment User Guide

There is an annual cycle to comply with the regulation



Source: DEFRA The Carbon Reduction Commitment User Guide

What are the costs in the CRC?

Capital costs

Regulatory costs and risks

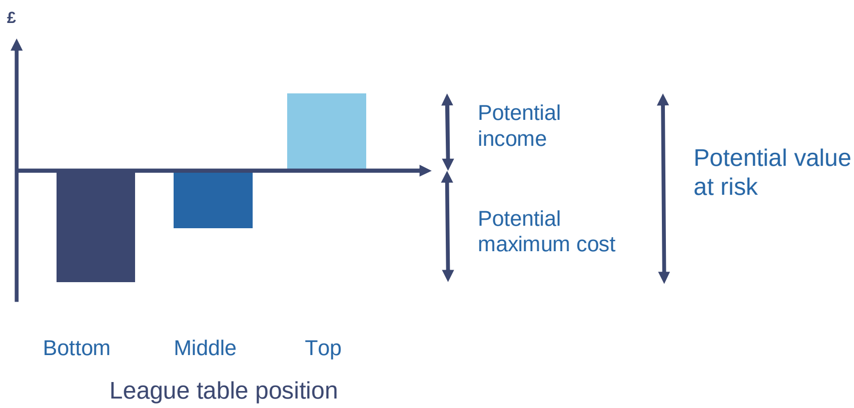
Operational costs

Impact of bonus or penalty payment

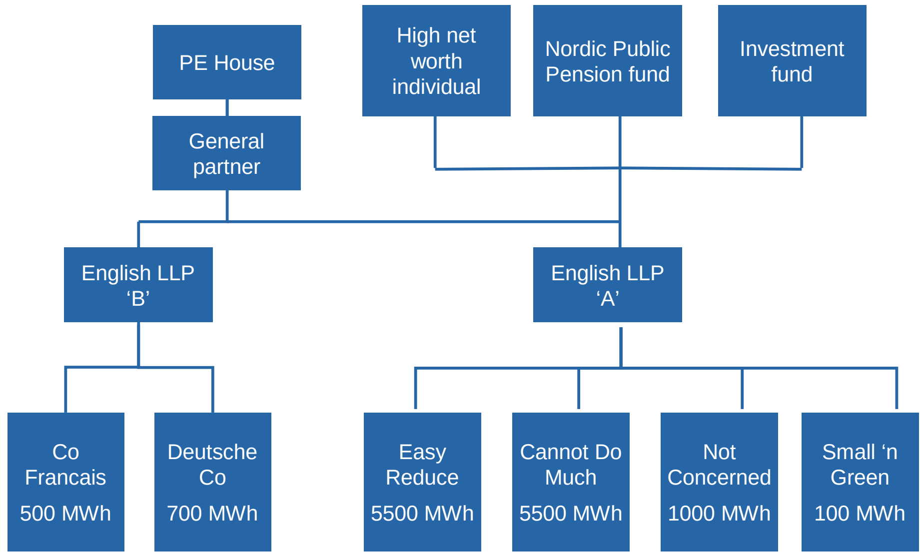
Reputation impact

Financial implications…
You could make money from the scheme

Financial costs of the CRC



Why is PE Fund structure important?



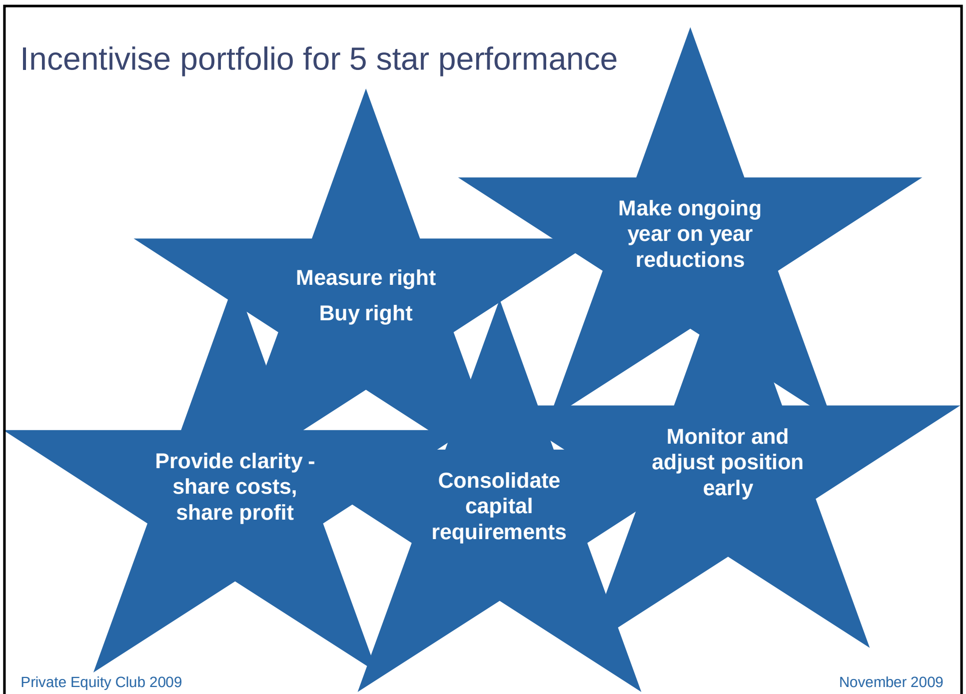
Disaggregation

PE Fund/organisation can nominate portfolio companies to participate separately if:

- Portfolio company would qualify to participate in its own right (known as a "Significant Group Undertaking" (SGU));
- Consumption by remainder of the organisation does not fall below 6,000MWh HH;
- PE Fund/main participant) must register (including SGUs) by 30 June 2010;
- Portfolio company / SGU must register as a participant by 30 September.

After disaggregation, PE fund and SGU are separately liable. SGU will be separately listed in league table and receive own recycling payment.

Incentivise portfolio for 5 star performance



Acquisitions and Exits - Rules

If new portfolio company is **not** a participant or SGU:

- Energy use emissions must be included in the PE Fund's CRC annual report from the **date of purchase**.
- There is no requirement to notify Administrators. Baseline is not updated
- On exit, emissions are excluded from the date of sale.

If the acquisition/sale involves an entire Participant or SGU, this is a ***Designated Change*** and:

- Responsibility for compliance transfers to the purchaser for the whole compliance year
- If purchaser is not a Participant it must become one
- If SGU becomes a stand alone entity it must register as a Participant.
- Requirement to notify the Environment Agency within three months
- Disaggregation is possible on acquisition of new SGU
- Baseline emissions against which performance is calculated will be updated.

Acquisitions and Exits - Implications

- CRC liabilities will become a key part of due diligence –
  - emissions usage of target entities
  - impact on acquirer portfolio
  - existing liabilities for non compliance
  - adverse publicity impact of poor performance
  - impact on participation/structure of PE fund
  - acquisition of allowances from the seller
- Purchasers and sellers must notify the Environment Agency of Designated Changes
- Cash flow implications after obtaining CRC obligation – revenue recycling payment is not paid until 6 months after purchase of allowances
- Acquisition activity that increases the groups size will increase the administrative burden of compliance

Questions

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