

KEYNOTE INTERVIEW

A new investment climate



Partners Group head of ESG and sustainability

Adam Heltzer talks us through the firm's approach to dealing with the impact of climate change on its portfolio – the risks and the opportunities

Q Within your environmental, social and governance agenda, where does climate change sit?

At Partners Group, climate change stands out as one of our high priorities due to the scale of the risk, the impact and the urgency, and that's escalated over the past six months. It's very important to us, as well as our stakeholders, which are not just our clients and shareholders, but also our colleagues and our portfolio companies. Our task is to translate this huge and complex topic to the portfolio companies we invest in on behalf of our clients.

Q What climate impacts are you most concerned about?

From a risk perspective there are many different concerns, but extreme weather events

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have proven to be a key climate risk, which is evident from the devastation that has happened with wildfires in Australia and flooding in Indonesia. Clearly, this raises major social concerns for our investors, which we continue to monitor from all angles.

From a portfolio perspective, these events can have a direct financial impact, too. For example, in our current portfolio we have a restaurant chain with branches in California, which lost revenue due to the wildfires last year. We've also had investments shut down due to flooding. Over the past year, we considered an investment in the rail space, but the documentation

for the asset highlighted river flooding as a risk. We've also looked at a possible investment in the agriculture space, where climate change has many impacts, including global shifts in areas of production, which is a threat to our core markets. The flip side is the creation of new markets, for instance as the US breadbasket moves north to Canada – that is part risk, part opportunity – but you can see how the issues are prolific.

Q How do you identify and deal with climate risk in your investments?

Our annual ESG Key Performance Indicator survey collects carbon footprint data and fuel and energy consumption numbers to pinpoint areas for action, as well as information on climate risk. For instance, has

the business suffered any adverse financial impacts from climate-related incidents? In the example of the restaurant chain, we also asked how many of their other restaurants were in locations vulnerable to similar physical and financial impacts.

However, it's not always easy to get information. Only a minority of companies will have a robust carbon dioxide emissions number ready to give to us. Gathering that data for assets in European jurisdictions where there is greater regulatory pressure is an easier conversation than in the US, but we do this for our entire portfolio.

Active ownership is critical. We could hire an outside firm to triangulate a footprint number based on very crude industry averages that generate a working estimate. That is not as reliable as sitting down with a portfolio company and explaining how to measure necessary factors and helping them to understand the definitions and validating the data. That takes a lot of time and education to get right.

We also conduct what we call a "sweep" to assess a number of ESG topics that cut across our portfolio, for example health and safety, cybersecurity, fraud risk and climate change. It's a way to capture data on a single topic across several companies at once and prioritise risks and opportunities, including in energy and fuel management for which we have developed a standardised toolkit.

Q What do you do with all this information?

We use this information to improve our portfolio companies' climate-related efforts, our investment process, and of course share it with our investors. The emissions data is published in our annual corporate sustainability report and included in our ESG dashboard. This also addresses those companies where we have not been able to gather enough data.

There has to be transparency and forthrightness around what's not good enough and how we're working to improve it. This is critically important and lacking in the broader ESG world. As owners, our role is to continuously professionalise the way the data is collected so we can have an ever-more reliable emissions figure that we can defend. This is a multi-year effort, but we are on that journey.

Q Before you invest, how do you assess risks and opportunities?



Q Does your approach to climate-related risks and opportunities differ across asset classes?

It does. We have the most impact on our private equity portfolio because we have more control and climate change is well integrated into our investment process. Our due diligence includes climate change topics and we are engaging with our portfolio companies directly. Our established system for scoping and implementing ESG initiatives, tracking and reporting on them has been running very well for several years.

Real estate is a bit different as the topics are much narrower. Globally, buildings contribute to a huge base load of emissions. Here, we are focused on energy management. During due diligence on an asset, we ask the operator about its current energy efficiency efforts, what initiatives they have undertaken to reduce consumption and its sustainability certifications, which will include climate-related topics. We can also benchmark buildings against their peers: similarly sized buildings in similar locations. Then we act during ownership to reduce emissions over time.

Private debt is the asset class that differs the most because we have less control. In this case our approach is somewhat more focused on risk mitigation. We take a similar overall approach to risk in private debt as we do to private equity, but in debt we work with the sponsor, which can have varying processes around ESG. However, we have had a number of sponsors say they want to take action on climate issues but don't know how. They have asked us for a steer on what to look for and how to tackle these risks given Partners Group's expertise in the area.

Our standard ESG due diligence questionnaire addresses climate change topics, including carbon emissions, but we build on that with input from an external expert who delves deeper into key areas.

For example, we now use a climate risk and opportunity matrix that ensures that when we approach the management team we have a fully baked climate change thesis about that company, what we can do to mitigate any risks and to capture upside opportunity.

Q Given the breadth of climate-related issues, how do you pinpoint what to focus on at the portfolio company level?

It's not so different from other ESG topics in that sense. The first question is, what's within our span of control, and then, where is our responsibility, where can we be most impactful and where are our returns most threatened? We are active owners and are extremely focused on strong board governance. Our initial emphasis is on emissions,

prioritising which assets are the biggest emitters, and introducing initiatives to reduce them, and then ensuring the key risks are fully integrated into our enterprise risk management process overseen by the board. Our ESG team is part of Partners Group's industry value creation team, our in-house operating team, that works hand-in-hand with our investment team. This means we are closer to our assets than many others.

Q How are climate-related risks and opportunities integrated into the value creation plan?

ESG footholds are embedded into every portfolio company's value creation plan. Within our ESG engagement, climate change as a topic is considered alongside other ESG priorities.

In due diligence, we select the topics that are the most critical and prioritise according to their materiality to the business or social and environmental impact, then start with the most urgent. We own assets for four, five, six years and take a long-term perspective so we are able to square away the most pressing issue then move to the next.

Q When you talk to management teams, how receptive are they to your climate change input?

We are invested in companies in multiple industries and geographies. As you would expect, we see the full spectrum of responses from people asking for help with thinking about the risks and opportunities to others for whom it's not the first thing on their minds. In both cases our approach is the same: we identify specific topics relevant to the business and see how they speak to risks and opportunities and, of course, the ethical imperative.

Q What are the main challenges?

The major one is translating the broader concept of climate change into an organisational set up. The Task Force on Climate-related Financial Disclosures provides a framework and has added some structure to this large and complex topic. But even then you have to tailor the framework to your specific strategy, platform and culture.

The second challenge is to galvanise senior management to take action to authorise and drive improvements. I'd argue that compared to other ESG topics, with climate change, you have to do more

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change management and education within the firm and at portfolio companies, and in some cases even with clients. As a team we have to work out how to translate our key climate-related messages to all our stakeholder groups.

The complexity is a challenge. So, we focus on the largest and clearest impacts. There isn't much argument against reducing energy consumption through low-cost/no-cost behaviour changes at our portfolio companies. We focus on areas where there is unlikely to be a net negative impact, for instance building renewable energy infrastructure in Australia, which has one of the largest coal-fired power generating bases in the world.

Q Where do you see the opportunities?

We actively target assets and companies that back the transition to a low carbon economy, such as wind and solar energy and supporting industries like battery storage. We are looking at an investment now that manufactures electric vehicle recharging stations.

We have also invested on behalf of our clients in a European energy efficiency business that, prompted by European energy directives, retrofits meters that charge apartment residents for their energy use rather than billing them based on the size of their apartment. This can reduce consumption by 10-20 percent.

There is no question that we will see the impact of climate change on our portfolio companies. Governments will have to take action, as spelled out in the UN Principles for Responsible Investment's 'Inevitable Policy Response'. We think about how that will impact companies and the opportunities that will flow from that. We adapt for the leading edge regulators to stay ahead of our peers.

Q What's the cost of doing nothing?

If we did not act, we would be overlooking risks with material impacts on the investments we make on behalf of our clients, and failing to capture the opportunities to cut fuel and energy costs, and to create value. If we didn't take climate change seriously, we would also lose the faith, confidence and trust of our clients, shareholders, employees and business partners, as well as government counterparts and regulators. ■