SUSTAINABILITY : Driving Investing and M&A Landscape

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Sustainability – Necessity And Not Luxury: For You, Us & All

In today's scenario where everybody is talking about climate change, eco-friendly consumption, going green and everything organic, sustainability has become of utmost urgency. If measures towards sustainability are not taken, it will impact the availability of basic necessities like freshwater, food security, and energy. Poor and developing countries, particularly lesser developed countries, will be among those most adversely affected and least able to cope up with the anticipated shocks to social, economic and natural systems. It's important for everyone to understand the role they can play in achieving sustainability.

Even Government is taking initiatives towards adopting sustainability. India has enhanced its climate change targets for 2030. India has said it is now committing itself to at least 45 per cent reduction in emissions intensity of GDP (emissions per unit of GDP) from 2005 levels. The existing target was 33 to 35 per cent reduction.

At the same time, India is also promising to ensure that at least 50 per cent of installed electricity generation capacity in 2030 would be based on non-fossil fuel-based sources. This is an increase from the existing 40 per cent target.

Carbon Trading is a central pillar of the EU's efforts to slow climate change. It is the process of buying and selling permits and credits that allow the permit holder to emit carbon dioxide. Government or Intergovernmental body sets an overall legal limit on emissions (the cap) over a specific period of time, and grants a fixed number of permits to those releasing the emissions. A polluter must hold enough permits to cover the emissions it releases. Each permit in the existing carbon trading schemes is considered equivalent to one tonne of carbon dioxide equivalent (CO_2e).

'**Sustainability**' is taking centre stage in society and the business world, amid shifting demand from conscious customers, growing investor awareness and stricter regulations. For business owners, leaders, and administrators, sustainable business practices are becoming imperatives.

Why All Businesses Should Adapt Sustainability?

Sustainability is a business approach to creating long-term value by taking into consideration how a given organization operates in the ecological, social, and economic environments. It is built on the assumption that developing such strategies fosters company longevity. Reducing exposure to carbon, for instance, could allow chemical companies to get a wallet-share of customers who have pledged to cut their carbon footprint. This translates into increased market share, improved ESG ratings and a potential boost to return to shareholders.

There are three core pillars of sustainability: economic development, social development, and environmental protection. **Economic development** refers to giving people what they wish for without negotiating the quality of life and reducing the financial weight of doing what is right. **Social development** is about the mindfulness and legal protection of human health from pollution and toxic activities of businesses and organizations, as well as upholding access to basic natural resources without compromising the quality of life. **Environmental protection** focuses on how ecosystems should be both studied and protected, and how technology can help ensure a greener future.

Paying attention to environmental, social, and governance (ESG) issues is becoming increasingly critical for companies across industries. **In the latest McKinsey Global Survey, 83% of C-suite executives and investment professionals believe that ESG programs will generate more shareholder value in five years' time than they do today. And in Accenture's research on responsible leadership, companies with high ratings for ESG performance enjoyed average operating margins 3.7 times higher than those of lower ESG performers. Shareholders also received higher annual total returns to shareholders, outpacing poorer ESG performers by 2.6 times.**

- **Select Key Benefits of Sustainability in Business**

Sustainability in business isn't just good for the environment or society at large — it's rather essential wfor the business itself. Here are just a few of the many benefits of operating a more sustainable business:

- **Reduce Business Costs**

A 2011 McKinsey survey on the business of sustainability found that 33% of businesses were integrating sustainable practices to improve operational efficiency and cut costs — resulting in a 19% increase from the previous year. Over the course of 10 years, clients of the managed service provider Elytus saved over $11 million through sustainable waste management and transparency. “Greening” a business takes an initial investment, but, over time, we save money by prioritizing sustainability.

- **Provides Competitive Advantage**

S&P 500 companies with sustainability baked into their strategy perform better than those that don’t: they see an 18% higher ROI because they’re managing and planning for climate change. According to Jeffrey Hollender, professor of sustainability at NYU Stern, “You will perform better financially by doing things like having a great sustainability program.” Researchers from Harvard Business Review agree: “We’ve been studying the sustainability initiatives of 30 large corporations for some time. Our research shows that sustainability is a mother lode of organizational and technological innovations that yield both bottom-line and top-line returns.”

- **Enhances Bottom-line**

One can earn more money and boost bottom-line by making business more sustainable. Reduced business costs, more innovative strategies, an improved reputation, and more new customers who value sustainability all work to increase the amount of money sustainable businesses earn.

- **Productivity Uplift**

Adapting green practices ensures better health of the employees, which in turn boosts employee motivation and productivity at work. It also helps attract talent through greater social creditability.

- **Initiatives Undertaken by Leading Corporates**

Several companies in the industry are already taking significant strides towards improvement by employing innovative technologies to cut down emissions, kicking off decarbonization efforts, and enabling other sectors to become more sustainable. Many of today’s leading companies in sustainability have stepped up largely as a consequence of a crisis. Examples below :

- **Tata Chemicals** commissioned a solar photo-voltaic plant to save energy. With an aim to control greenhouse gas emissions, it proposed to establish a 150 kWp grid connected solar photovoltaic power plant on the rooftop terrace of the electrical sub-station
- Through its HYBRIT (Hydrogen Breakthrough Ironmaking Technology) initiative, **Swedish Steel India** has taken up green chemistry/manufacturing initiative, which intends to replace coking coke with hydrogen in the steel manufacturing process by replacing coal with hydrogen.
- **Tata Consultancy Services (TCS) and Reliance Industries** recently announced roadmaps towards reduction in greenhouse gas emissions towards zero.
- **JSW Hydro Energy Limited has raised USD 707 million** overseas through the issuance of USD denominated green bonds which are currently listed on the Singaporean Stock Exchange
- **Godrej Locks & Architectural Fittings and Systems** at its eco-friendly manufacturing unit in Goa has adopted green chemistry for manufacturing locks.

Recommendations For Early Adapters

Industry leaders embarking on their ESG journeys could look at three priorities as a starting point:

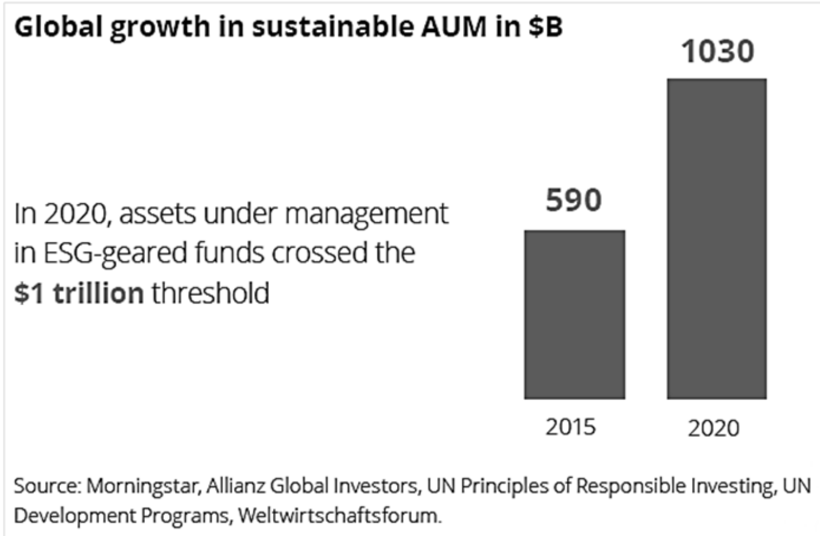
- **Formulating an ESG vision and strategy:** Companies could review current business practices to understand where they stand and what could be changed. They could then prioritize sustainability drivers that matter most, use this information to formulate a clear ESG vision and communicate it to all stakeholders.
- **Improving decarbonization efforts:** Since emissions are a major consideration in the environmental impact of the chemical industry, companies could focus on decarbonization efforts across different levels of emission.
- **Exploring green growth opportunities:** They could develop products with a focus on sustainability to meet the needs of today’s environmentally conscious customers.

ESG Investing

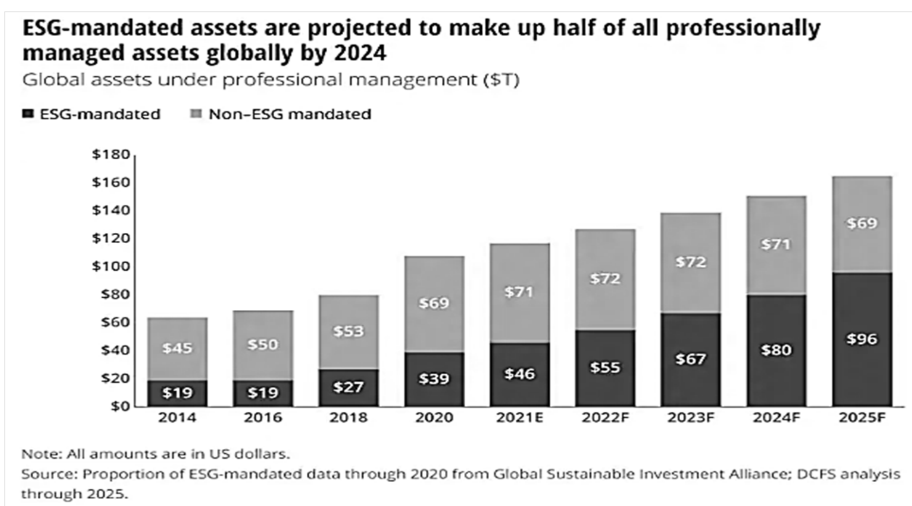
Sustainable finance is generally referred to as the process of considering environmental, social and governance factors when making investment decisions, leading to increased longer-term investments into sustainable economic activities and projects. Its growth has been driven by the desire of investors to have an environmental and social impact, along with the economic performance of investing. This growth is a response to a larger trend which saw many countries around the world to mobilise efforts to contribute to a global improvement. Now finance is taking its active position in trying to implement these concepts in the investing practice. The instrument that was born from this will is the Environmental, social, and governance (ESG) rating, from which ESG Investing is developed.

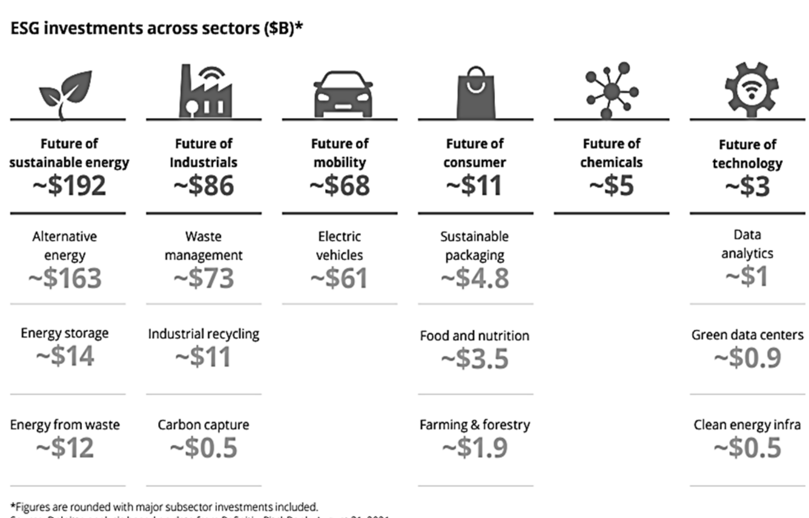
Investors acknowledge that resolving environmental issues is one of the decade’s most difficult challenges. Hence, flows into ESG funds more than doubled between 2020 and 2021. **According to BlackRock, the world’s largest asset management firm, during the peak of the COVID-19 pandemic in 2020, more than eight out of ten sustainable investment funds outperformed non-ESG-based share portfolios.** This trend is expected to continue in the following years.

ESG and sustainable investing are projected to increase at a rapid pace in the future. **By 2025, it is expected that around 33% of all global assets under management (not just local) would have ESG mandates.**



Recent surveys indicate that client demand continues to be a catalyst for investment managers' consideration of sustainability investment metrics in their decision-making processes. At their current growth rate, ESG-mandated assets (defined here as professionally managed assets in which ESG issues are considered in selecting investments or shareholder resolutions are filed on ESG issues at publicly traded companies) are on track to represent half of all professionally managed assets globally by 2024



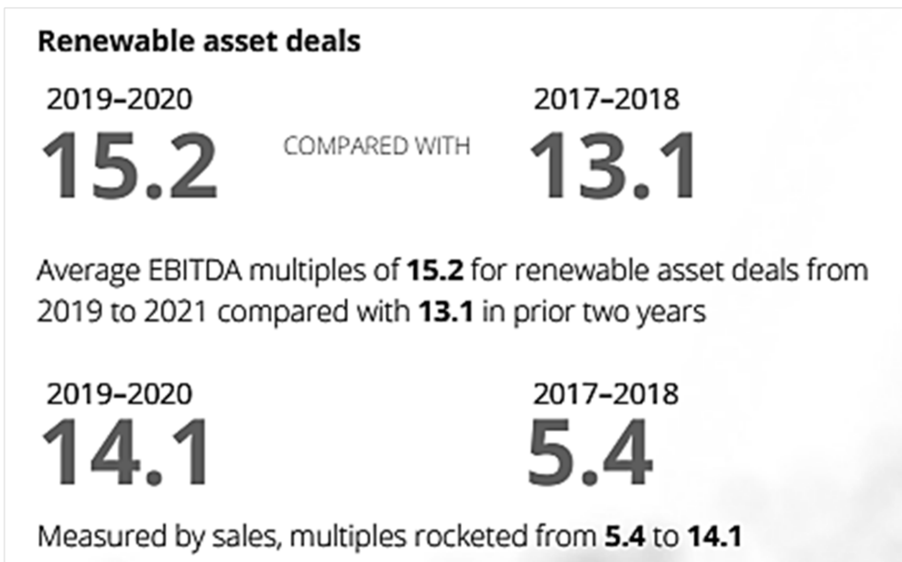


Environmental Social & Governance (ESG) Becoming Key Element for M&A

The increasing importance of ESG also has a tangible effect on M&A activities. More than 30% of businesses have witnessed operational consequences from climate change, and in 2019, natural disasters caused an estimated $137 billion worth of losses. M&A can help mitigate risks while capitalizing on opportunities from ESG disruption. Acquisitions and divestments allow businesses to establish the necessary set of assets, skills, and technology.

ESG deals skyrocketed from $92 billion in the whole of 2020 to $103 billion in only the first half of 2021, burgeoning in energy, industrials, and transport, with numerous significant acquisitions in the consumer, finance, technology, and chemicals sectors. The United States, Germany, and China represented the leading target markets, with important activity in Canada, France, Spain, India, and beyond compared with 2016, three times as many dealmakers are witnessing ESG-augmented exit multiples, with a quarter willing to pay up to 50% more for sustainable assets, presenting a risk of overpayment.

This sentiment is further reinforced by market data, which found that in the first nine months of 2021, there were **798 M&A deals considered "sustainable" by data provider Refinitiv, representing a 44% year-over-year increase.**



M&A opportunities include methodically capturing sustainable and ethical value across deals, such as transforming middling ESG performers into disruptors. Government energy tax credits and incentives may also render these difficult prospects viable. Due diligence can look to understand the dangers and opportunities around resources, work conditions, waste, energy, and market access, all of which can be managed through careful integration and value creation.

Concluding Thoughts

It is an absolute urgency that we make conscious efforts to make our business environment sustainable not only for the planet and for the future of humankind but also for the midterm survival of the companies and their cash flows. The management must assess which factors are most material for their companies and to determine how best to move forward. The next steps will likely be informed by their individual strengths and opportunities to create advantageous leadership positions that will drive sustainable growth and generate future cash flow.

Feedback is welcome at info@pantomathgroup.com