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The Sustainability Imperative for M&A

Why sustainability is now a cornerstone of the M&A Agenda to protect and create value

Determining the impact of environmental, social, and governance (ESG) considerations across a company's value chain is becoming central to how many companies craft their overall business strategy.

Companies are under pressure from increasing regulation (including the EU Taxonomy, Art. 964 Swiss CO and related ordinance of the Swiss Federal Council), stronger investor and NGO activism and shifting consumer demands. The bar has been raised: executing on an ambitious ESG strategy is now core to protecting a company's "licence to operate".

Companies that make rapid ESG progress are seeing increases in their valuation and their business opportunities:

- A simple correlation analysis from 2022 showed over 2x higher EV/EBITDA multiples for Consumer companies with best ESG scores compared to those with the lowest scores;
- More sustainable, inclusive and less carbon-intensive economic models also open up new business opportunities. This drives growth and helps attract high calibre talent, motivated by purpose-led work.

In today's business environment, attracting external investment, whether from banks, private equity or via an IPO, requires not only myriad non-financial disclosures but also an ambitious ESG strategy and clear evidence of implementation and delivery. Institutional investors are prioritising companies that are transitioning to more sustainable business models, products, and services – not only because they feel they must but also because they see long-term value-creation potential.

M&A should be a central part of the corporate arsenal as a means to manage a company's sustainable corporate strategy. It can help execute on the value ambition by:

- Securing innovative business models to accelerate the decarbonisation of value chains, in particular of companies operating in hard-to-abate sectors;
- Accessing technological solutions to tackle social challenges, in particular for companies sourcing from conflict-affected and high-risk areas (CAHRAs).

We observe **three main trends** for **Sustainability M&A**

Protect your "Licence to Operate"

ESG is seen as a strategic imperative as companies are increasingly concerned that risks arising from the value chains of acquired companies will threaten their "**licence to operate**."

The general pressure to combat climate change requires companies not just to commit but act on their environmental impact. However, material acquisitions can significantly dilute the progress an acquiring company has made. The **resulting failure to meet publicly made environmental commitments** (such as achieving 100% recyclable or reusable packaging by 2025), **can lead to reputational damage with customers and investors, harming the brand, company and management team.**

Besides the environmental dimension, companies are also protecting their "**social licence**". **Child labour, precarious working conditions or the use of bribery** in the supply chain of an acquired company can trigger material **reputational damage and financial risk.** This is particularly relevant for sectors sourcing from CAHRAs. Examples include rare earths and minerals used in EV batteries, and precious metals and stones used in jewellery.

Case study: ESG controversy screening

As part of ESG Due Diligence we conducted a rapid ESG controversy and adverse event screening, using a proven tool capturing publicly available information globally. We identified recent lethal accidents at one of the contract manufacturing organisations of the target, which affected our client's investment decision.

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Increase transparency on the financial impact

What distinguishes ESG risks significantly from most other risk categories that companies have managed in the past is the unclear financial impact of ESG initiatives and risks. Serial acquirers are asking us:

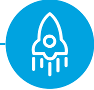
- How can future profitability levels be grown or at least maintained in a new, less carbon-intensive and more socially sustainable business model?
- What is the impact of climate risks on the value of acquired assets? Is there a potential risk for material impairments or even stranded assets in the future?

Creating transparency as part of ESG due diligence will identify material financial exposure. Relevant diligence questions include:

- What is the **EBITDA impact** from a more sustainable sourcing or packaging strategy, e.g. switching to “green” steel or to fully recyclable containers?
- What **one-off cost or Capex** will be required to align the target to less carbon-intensive operations of the buyer (e.g. by replacing inefficient equipment)?
- What **financial exposure** will there be for the target related to climate change risks (e.g. the impact of flooded manufacturing facilities)?
- What are **sustainability synergies**, e.g. proven solutions for waste reduction?
- How ready is the target to meet mandatory **non-financial disclosure requirements** (e.g. EU Taxonomy)**?** What one-off and run cost has to be added?

Case study: Waste reduction programme

In the context of a post-merger integration project, we supported a Swiss-based international food company in identifying and launching a manufacturing waste reduction programme across the factories of a recently acquired company, increasing recurring EBITDA by USD 5m.



Shift to more innovative business models

The shift to more sustainable economic models opens up new business opportunities. This drives growth and gives companies an edge hiring high calibre talent attracted by the appeal of work aligned to their values. It gives companies the opportunity to reposition their offering and helps to futureproof revenues by:

- **Strive in existing markets:** A focus on sustainability can spur innovation through sustainable and therefore differentiated products that enable price premiums, capture market share, and drive operational efficiencies;
- **Unlocking new markets:** Sustainability provides an opportunity to increase the total addressable markets and capture above average growth for the industry by moving into new markets.

In addition, **private equity investment continues to flow into businesses that are focusing on sustainability,** either directly or via private-equity-backed corporates consolidating a sector and expanding their skillset or service offering. This trend is expected to continue, with innovation leading to an increasing number of emerging ESG-focused sub-sectors that offer strong growth opportunities. Examples include innovations related to the future of food, pharmaceutical cold chain solutions, waste reuse for electricity generation and electric vehicle infrastructure.

Case study: Equity funding to fuel growth

We helped the shareholders of one of the leading environmental and civil engineering companies in Switzerland find an equity partner to continue their strong growth, fuelled by public and private investment in sustainable construction.

Connect with us

Roberto Micelli leads the Sustainability M&A team at Deloitte Switzerland, supporting corporates and private equity firms in realising ambitious environmental and societal objectives through M&A transactions. To connect with Roberto and his team, email rmicelli@deloitte.ch

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