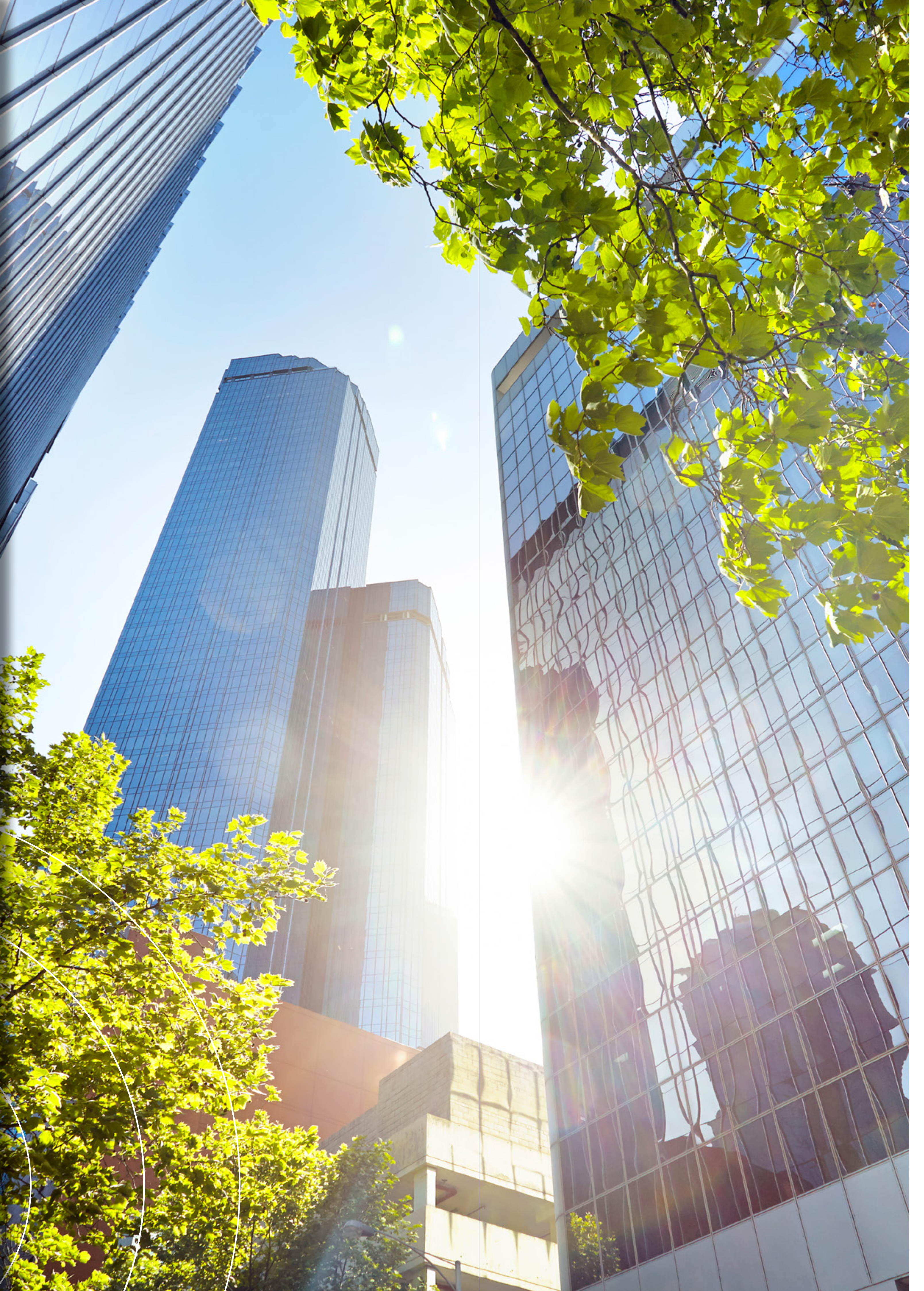
4.
ESG is a critical driver of deal value



Not long ago, companies regarded ESG (environmental, social and governance factors) as a 'nice-to-have' component of their wider strategic narrative – something that reassured investors and stakeholders but wasn't considered essential. Now, investors and stakeholders increasingly focus on the credibility of a company's ESG story to understand its risk and return profile in a changing world. Companies that demonstrate a mix of ESG-related growth opportunities and a sustainable business model may attract higher valuations from an expanded potential buyers.[10]

Across the entire spectrum of the economy, companies are considering the transition to a sustainable, low-carbon economy in all aspects of their portfolio and value chains. This was initially driven by regulatory and investor pressures focused on addressing climate-related risks, such as the need to decarbonise emissions-intensive sectors and the risks posed by the changing physical climate. However, the focus is now equally on the growth opportunities that the energy transition, circular economy, and shifting customer preferences for sustainable solutions are creating. This is evidenced by the level of capital being deployed in sectors that seek to harness strengthening ESG tailwinds, with US$30.3 trillion invested globally in sustainable investing assets (2022).[11] In Q1 2024 alone, US$900 million of net new money flowed into sustainable funds.[12]

These shifts are occurring across the globe, even in jurisdictions such as the USA, where there has been some pushback in recent years regarding the term 'ESG'. In fact, some US-based asset managers are increasingly focusing on building a credible narrative around ESG and demonstrating quantifiable commercial and sustainable impact.[13] For example, CalPERS, the largest US public pension fund, has acknowledged that a fundamental shift in the economy is underway and is looking at ESG to generate alpha, aiming to expand its low-carbon assets portfolio to US$100 billion by 2030.[14] This may signal further ESG investments from funds with a member-first philosophy.

The role of government policy and subsidies to incentivise private capital investment in nascent industries and technologies, such as green hydrogen and ammonia, sustainable aviation fuels, and low-carbon transport options for heavy industries has also increased significantly in recent years. The US Inflation Reduction Act (US$370 billion clean energy investments, the EU Green Deal (US$1.1 trillion), the Future Made in Australia (US$15 billion), Singapore Green Plan 2030 (US$26 billion green bonds) and Singapore Future Energy Fund (US$3.8 billion) are prime examples of this.[15,16,17,18,19]

Individual ESG-related topics, such as carbon footprints, resource consumption, and human rights in operations and supply chains, are increasingly considered as measures of performance and risk by investors and stakeholders.

The combination of all these factors means that ESG has now become intertwined with commercial considerations. It is therefore important for companies, particularly those looking to review their portfolio and divest non-core assets, to align their approach to ESG with their corporate strategy to provide a compelling story around risk and return.

Decision makers need to explore the implications of a sustainable low-carbon future on their current business (core and non-core) and understand how factors such as revenue, cost base, customer and market preferences, and regulation can be strategically leveraged and changed to demonstrate their companies' existing and future ESG credentials and maturity.

Positioning by ESG personas

How companies and financial investors are choosing to respond to this changing environment is being shaped by their differing motivations, sector experience, investor mandates and risk-return requirements. These factors inform their understanding of their underlying assets, business model and strategies, ultimately driving decisions about what is core and non-core in their portfolios. They also highlight where new sources of growth can be found and where growth may be constrained in the future.

In analysing how companies are responding to the growing significance of ESG factors in their portfolio assessment, we can see three distinct personas emerging:

Persona 1:
Drivers and pioneers

Understand the game-changing nature of the transition to sustainable low-carbon future and are looking to grow their market share, technological and capability advantage, and brand in existing and emerging ESG-aligned industries. This might include companies focused on renewable energy generation and all the supporting infrastructure to enable this; companies focused on the decarbonisation of the transport sector (rail, road, aviation, etc.); or companies focused on decarbonising and reducing waste in the food and agricultural sectors.

Persona 2:
Transformers and pivoters

Recognise the shifts taking place and the need to transform existing business models, revenue streams, R&D and brand/competitive positioning and are looking to uplift, expand or pivot these assets to align more closely with broader market and industry trends, and improve the sustainability of the business model to deliver longevity. Examples might include a technology company expanding its software offering to support carbon-reporting requirements; an auto manufacturer purchasing a critical-minerals company to provide the raw materials needed for EV production; or an energy company divesting its fossil-fuel assets and pivoting its business model to focus on renewable energy.

Persona 3:
Residual value players

Understand the world is changing and are looking to capture the residual value of assets that are facing strong headwinds, are undervalued and have limited life. They are continuing to support these sectors as the economy transitions and are considering opportunities for an asset's next stage of life following the assets terminal value becoming zero. Examples of this might include coal and gas assets.

Optimising portfolio rebalancing outcomes through ESG

Historically, ESG has either been overlooked or considered implicitly during portfolio rebalancing. However, organisations are now increasingly considering the opportunities inherent to ESG and are looking to extract value from both the buy- and the sell-side.

ESG value creation

There is growing awareness of how ESG can be a source of competitive advantage when harnessed as an engine for innovation and growth. It challenges companies to rethink their internal and external approaches to their products, services, and processes, and to consider how they are facing into ESG trends.

ESG value creation focuses on identifying revenue-accretive opportunities that can deliver positive environmental and social impact while enhancing reputation and brand, including solutions that meet customer goals such as their sustainability agendas. Ultimately, ESG value creation can support revenue growth for both the buy- and the sell-side, with the following key drivers:

Revenue per customer

- Green premium, with higher prices driven by a compelling customer proposition, for example positive branding, meeting public decarbonisation commitments, and protection against reputational, financial and competitive positioning risks from not being sustainable.
- Expansion of existing revenue streams and creation of new revenue streams, with green and/or sustainable solutions providing greater cross-sell and up-sell opportunities among the existing customer base and serving to attract new customers.

Number of customers

- Attract ESG-conscious customers, particularly those who have started on their sustainability journey and are considering solutions that enable their decarbonisation for example. They will have some knowledge and understanding of their ESG procurement criteria.
- Customers who have not yet started to consider sustainability. Customers who have not yet started to consider sustainability may be looking to uplift their capability rapidly, and may decide who they procure from based on their understanding of the ESG positioning and the supplier's brand.'

Rebalancing your portfolio to fuel growth

Other ESG-linked synergies

There are additional benefits that strong ESG practices can provide to the buy-side or sell-side beyond cost savings:

Reputation and branding	• Improved reputation and branding in market. Having a strong ESG proposition is important to both the buy- and sell-side to foster trust, build goodwill and communicate the company's ethos such that it resonates with stakeholders including customers, employees and regulators. ESG can be a lever for companies who are looking to shift their brand identity, particularly from a neutral or 'dirty' sector. • Opportunity for buyers to take on the green branding of the target. While this can appear attractive, it is fraught with danger given uncertainty of investor and customer response. For example, the initial announcement following Shell's acquisition of Powershop Australia resulted in customer uproar.[20] If a buyer wishes to pursue this, extensive change and stakeholder management will be key to navigate and rationalise the benefits of the deal.
Operational efficiency, improvement and resilience	• Buyers can achieve rapid ESG capability uplift from acquiring the initiatives, learnings, and knowledge of the target, including their sustainability team if they have one. This can accelerate understanding of how the buyer can generate value from ESG and embed it within the organisation, but also highlight areas of risk. Proactively addressing and mitigating these risks allows for strong operational resilience, for example through the strategic placement of assets to minimise impacts of physical climate risk. • Improved operational efficiency can provide time and material savings and improve output. For example, improving the operational efficiency across the value chain can minimise raw material usage, save time in production and distribution, and increase productivity. This may be supported by the tracking of qualitative and quantitative metrics such as raw-material usage, energy consumption and carbon emissions attributed to transport.
Talent attraction, engagement and retention	• Drive competitive advantage through best-in-class talent proposition by meeting the needs and values of employees. This resonance can drive employee advocacy of the business, for example on public rating sites such as Glassdoor and LinkedIn, and higher rates of engagement and retention. This is crucial in industries where there is a shortage of talent, the technology industry is an example of this.
Lower cost of capital	• Building ESG credentials can provide access to green financing. It represents an opportunity to lower the cost of capital, particularly since green and sustainable loans lower the lending rate based off progress against ESG measures. • Having strong ESG credentials can support business longevity due to lower perceived risk and higher resilience.[21,22] A lower risk profile makes a company more attractive, particularly for financial investors who are concerned about how the changing external environment might impact the long-term viability of their investment.
Regulatory compliance	• Companies that can develop a fit-for-purpose approach to dealing with emerging and existing regulatory concerns will be attractive to potential investors, and their ability to future-proof their operations by leveraging their information advantage to inform better decision making.

Responsible divestment: an emerging concept

The intensifying focus on ESG as a driver of portfolio rebalancing activity is also now leading to consideration of the ESG profile of prospective buyers and what might happen to divested assets and the people employed within them. This is especially relevant in areas such as mineral extraction, where highly prized resources are often found in territories with historically weak environmental and employment regulation. Companies divesting mining assets, for example, may be forced to consider whether the prospective buyers are likely to be motivated to manage them responsibly, particularly if the buyer does not have the expertise, knowledge or focus on sustainable business practices.

Already we are seeing these kinds of issues being surfaced. If a luxury car manufacturer switches the sourcing of minerals essential to the electrification of its products to jurisdictions that have lower inherent ESG risk exposure, such as Australia and Canada, rather than locations which historically have been associated with labour exploitation, what happens to those abandoned resources? Is there a risk that a business with less concern for environmental or labour standards will acquire them? What responsibility does the divesting company have to ensure that divested assets go to 'good homes'?

ESG in portfolio rebalancing

The energy sector has a well-established approach to leaning into the energy transition to drive growth. However, the relevance of ESG goes across multiple, less-obvious sectors. Below, we have outlined how different ESG themes have driven portfolio rebalancing in different sectors and for different ESG personas (see page 31).

Climate

The physical impact of climate change is a risk to many companies, with the severity varying based on sector according to its impact on business operations, employee and customer safety, and the wider economy.

For example, extreme weather events can damage property and increase the number of claims, which may result in the unaffordability or unavailability of insurance in high-risk regions.[23] Similarly, climate change can impact the supply and quality of crops and livestock through reduced crop yield over time or loss of land to rising sea levels, which is an existential crisis for the agricultural sector.[24]

Solutions that aim to solve these challenges are emerging, with examples including:

Example	Persona	Description
Technology platform	Drivers and pioneers	CORE Markets, formed from the merger between Renewable Energy Hub and TFS Green APAC in 2022, provides climate software and services. The merger rationale was to bring together the carbon and energy commodity-market expertise of TFS with Renewable Energy Hub's existing carbon marketplace platform and net zero services.[25]
Agriculture	Drivers and pioneers	In 2023, Belgian sustainable crop-management provider Biobest Group acquired an 85% stake of Brazilian Biotrop, an Agtech that is similarly focused on sustainable solutions for agriculture. The acquisition rationale was to expand Biobest's footprint in the high-growth and favourable regulatory environment of the Brazilian markets and combine both firms' sustainability strengths.[26]
Climate insurance	Drivers and pioneers	In 2013, US agrochemical and agricultural biotechnology company Monsanto paid US$930 million for The Climate Corporation, which underwrites weather insurance for farmers. The deal rationale was to strategically expand Monsanto's revenue stream into the US$20 billion opportunity of services and data.[27]
Professional services	Drivers and pioneers	There have been many acquisitions to date in professional services, with a focus on building capability to expand into net zero-climate consulting. As a snapshot, in 2023, Schneider Electric acquired climate consultancy EcoAct, ERM acquired climate, energy and water advisor Coho, and Accenture acquired sustainability consultancy Green Domus. In 2022, Accenture also acquired carbon and climate-change-strategy consultancy Carbon Intelligence.

Changing consumer preferences and laws

Consumer preference for sustainable goods and services, alongside broader trends of health and wellness, has resulted in the emergence of new product categories, such as plant-based alternatives to meat and dairy, and natural paints. There is growing emphasis on sustainable practices including biodegradable and eco-friendly products and circular economy, which is supported by laws such as the Australian Recycling and Waste Reduction Act and Singapore's Resource Sustainability Act.[28,29]

Example	Persona	Description
Sustainable packaging	Transformers and pivoters	In 2023, Amcor, a global packaging company, announced it had entered agreement to acquire Phoenix Flexibles, a flexible packaging manufacturer in India. The deal rationale was to expand Amcor's capacity in the high-growth Indian market but to also acquire advanced film technology that can enable local production of more sustainable packaging solutions.[30]
E-Waste	Drivers and pioneers	In 2024, Australian e-waste company Sircel wholly acquired the assets of e-waste processor Scipher Technologies. The acquisition rationale was to increase processing capability, deepen specialist expertise and acquire Scipher's customer base.[31]
Media	Transformers and pivoters	Rainmaker Group, an Australian researcher and media publisher, later bought by Institutional Shareholder Services in 2021, acquired sustainable investment publication The Sustainability Report and Audacious Investing in 2019. The acquisition rationale was to tap into the growing investment interest in ESG from both companies and consumers.[32]

Human rights in supply chains

There is increased focus on human rights in supply chains across many sectors. Some companies are seeking to source raw materials and components from suppliers and geographies with higher standards, while others are looking for vertical integration opportunities to gain greater control over the supply of raw materials and labour conditions.

Example	Persona	Description
Automotive	Transformers and pivoters	In 2023, Volkswagen's battery unit PowerGo, Dutch automotive company Stellantis and mining company Glencore agreed to back a US$1 billion deal to purchase two Brazilian mines (Nickel Sulphide and Copper) by UK-listed SPAC ACG Acquisition Company. The acquisition rationale was to guarantee critical mineral supply for use in their EV battery manufacturing.[33]
Cocoa	Drivers and pioneers	In 2019, global food and agri-business, Olam International Limited, acquired 85% of BT Cocoa, Indonesia's largest cocoa processor. The acquisition rationale was to ensure Olam could continue to be a world leader in traceable cocoa sourcing and processing by gaining ownership of a major processor in its supply chain, and meet growing demand for products requiring sustainable cocoa powder.[34]
Cotton	Transformers and pivoters	Both Singapore-based Olam Agri and France-based Louis Dreyfus Company are currently bidding for Namoi Cotton, an Australian cotton ginner. An ongoing transaction, the acquisition rationale for both is to leverage Namoi's focus on sustainable cotton, long-standing reputation and assets to complement their existing operations.[35]

Rebalancing your portfolio to fuel growth

Becoming ESG prepared

The transition to a sustainable low-carbon future is inevitable and will impact every sector. It will create challenges for companies in Asia Pacific that will need to wrestle with changing operating parameters and business environments. The result will, inevitably, be a rebalancing of portfolios as companies seek to strategically refocus and divest assets that no longer fit or align with their positioning in a sustainable low-carbon future.

ESG preparedness will become a distinct advantage, with companies that can demonstrate a compelling ESG story around risk and return and strong ethical positioning, likely to be significantly more attractive to prospective buyers. There is potential for higher trading multiples. In fact, in our portfolio rebalancing survey, companies that very frequently discuss ESG considerations are nearly six times more likely to report receiving a significantly higher deal value than expected compared to those companies that have these conversations only occasionally. Having strong ESG credentials will also be key to building trust with a company's investor base, particularly activist investors, and the broader market.

To achieve ESG preparedness, business leaders need to first understand what ESG means for their company and sector, particularly the implications of a sustainable low-carbon future on their current business (core and non-core). They will need to align ESG with corporate strategy, with strategic considerations including factors such as revenue, cost base, customer and market preferences, and regulation. However, the baseline is that business leaders need to show stakeholders that they are actively meeting and embracing the fundamental shift in the economy.

By embedding ESG into an organisations' DNA, there is an opportunity to drive growth through ESG value creation and realise other ESG-linked synergies, such as business longevity. This can be articulated into a credible narrative around how ESG can generate quantifiable commercial and sustainable impact, particularly as it relates to divestitures. In one way or another, ESG has become a consideration in the M&A process and is here to stay.