— Chanticleer

PEP's ESG revolution is all about returns

PEP's Secure Asset Fund will use aggressive incentives to drive better ESG performance in portfolio companies, as the premium for firms with strong ESG records jumps.

Jun 18, 2021 – 10.20am

Save Share

As Australia's biggest private equity firm, Pacific Equity Partners has built a reputation for canny deal making over more than two decades.

But if you think the firm's new emphasis on aggressively improving the ESG (environmental, social, governance) performance of its portfolio companies will change its laser-like focus on returns, think again.

This is good old-fashioned capitalism – albeit with a green twist.

PEP knows it can reap higher returns for businesses with good ESG metrics. **David Rowe**

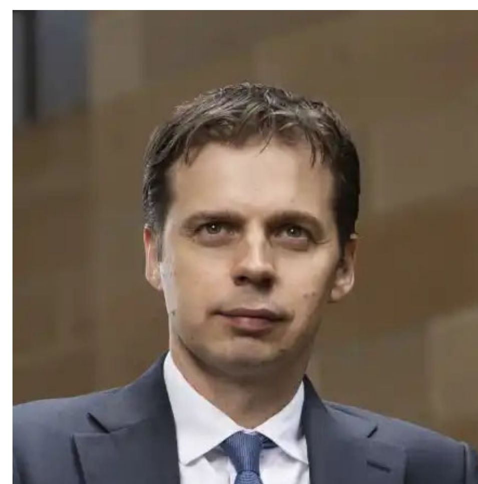
PEP's $700 million Secure Assets Fund (SAF), which it started a few years ago to invest in businesses with infrastructure-like properties, is rolling out aggressive incentives for management inside its portfolio companies based on ESG metrics.

The move has been driven by a carefully considered shift in philosophy inside the fund,

which, according to PEP's most recent investor update obtained by *The Australian Financial Review*'s Street Talk column, has become one of the firm's best performers; a second SAF is now under consideration.

PEP managing director Andrew Charlier, who runs the SAF and originally trained as an environment engineer, says the fund previously viewed ESG through a risk lens – that is, a business' valuation might be reduced if it performed poorly on ESG measures such as carbon emissions or safety.

But it is now clear the market is putting a premium on businesses that can demonstrate strong ESG credentials. Charlier points to the disparity between the huge valuation achieved by trans-Tasman renewable energy developer Tilt Renewables in a $2.75 billion takeover announced in April, and the sharp selloff in AGL Energy in recent months – a business with arguably stronger cash conversion – as a neat example of this premium in action.


PEP's Andrew Charlier. **Dominic Lorrimer**

So just as PEP looks for opportunities to maximise profitability when it invests in a business, now it will look for ways to drive measurable improvements in ESG metrics, knowing it will be rewarded when it comes to sell the business after a hold period typically between five and 14 years.

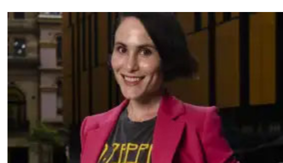
Incentivising management at portfolio companies effectively incentivises PEP's executives to deliver better returns for PEP's investors.

"We are saying this does drive value, so let's make sure that our portfolio companies have that clear in their alignment," Charlier tells *AFR Weekend*. "And if that all works, then ultimately my own incentives and the incentives of the partnership will benefit from that."

An example of the philosophy in action is provided by WinConnect, a business PEP acquired in late 2019. The business is essentially an operator of micro grids. Working with property developers, it manages the energy needs of a building's tenants – in an apartment block or a shopping centre, for example – in return for a slice of the savings it generates by effectively buying energy in bulk. It also uses some of those savings to invest in clean energy infrastructure, such as solar panels or electric vehicle charging stations.

WinConnect had about 60,000 end users when PEP bought it and now has 100,000, with a growth annual growth rate around 30,000 users. So far, it has 60 sites where it either operates solar power or EV charging stations, but PEP wants to go much faster. If chief executive Phil Baxter and his team can quadruple that number they will unlock a package of lucrative management options.

RELATED
PEP pedals hard to recreate glory years: investor update


RELATED
The top 20 dealmakers under 40

Baxter is quick to (half) jokingly agree with Charlier's description of PEP as "impatient capital" and sees the incentives as a small part of a broader picture.

"Our clients are demanding it...governments are demanding it, even our employees are demanding it." But Baxter says the incentives are driving behaviours and in the same way safety has become part of the fabric of the business, sustainability is now a standing agenda item at twice-weekly management meetings.

Charlier says PEP, which is currently hunting to fill a head of ESG-type role, may be slightly ahead of its clients in its thinking on ESG, with many investors still seeing ESG as a compliance or risk mitigation issue. Others have a narrow definition of what improving ESG performance looks like.

"There are some ESG investors who just want the positive story – we're only ever going to invest in a solar farm or wind farm – but I think there are a set of opportunities that exist in businesses that are good businesses, but you can make significantly better through these initiatives," he says.

"Every portfolio company, every PE firm is on its own journey. I think we'll see a transition across the industry as more and more value gets associated with [ESG]."

Charlier does not believe the new ESG focus will restrict the potential investments the SAF will make, arguing it may actually increase it. The businesses where the biggest uplifts in ESG premiums are possible may be in what might be considered the dirtiest industries; last year the fund acquired remote power generator Zenith Energy and is working to increase its use of solar energy and reduce its reliance on diesel.

"We will invest in businesses that need to go through decarbonisation. We will invest in businesses that need to go through a transition, whether that's electrification or the like."

The country's most expert opinion and analysis.
Sign up to our weekly newsletter.

SIGN UP NOW

James Thomson is a Chanticleer columnist based in Melbourne. He was the Companies editor and editor of BRW Magazine. *Connect with James on Twitter. Email James at j.thomson@afr.com*

Save

Share

License article

READ MORE AND FOLLOW TOPICS

Chanticleer Opinion Private equity Climate policy

LATEST STORIES

Live Need to Know

NSW brings back masks after 'fleeting contact' case

15 mins ago

AFR Magazine

The young team behind Brisbane's most talked-about restaurants

25 mins ago