Integrating environmental, social and governance (ESG) due diligence into deals

How KPMG can help

kpmg.com/sustainability

Deal or no deal?: Why ESG due diligence matters

KPMG professionals can help

In today's business world, issues like child labor, carbon emissions, fair tax and corruption bring complex and costly risks as well the opportunity to gain competitive advantage by doing things differently.

In short, the way a company handles environmental, social and governance (ESG) issues can affect its long-term performance and its valuation.

That's why, in today's merger and acquisition (M&A) market, ESG due diligence can seal the deal or break it.

In a recent global survey of private equity general partners, over half (54 percent) had reduced a bid price after ESG due diligence and one third (32 percent) had increased one.[1]

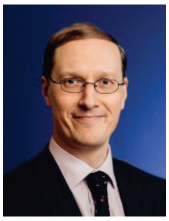
So it's no surprise that comprehensive ESG due diligence is now a core part of the deal process. A complete view of all relevant risks and opportunities is critical in order to negotiate the right price and the right terms for a deal.

KPMG member firms have a network of sustainability experts specialized in identifying ESG risks and opportunities as part of the deal process. Their due diligence regularly results in material adjustments to company valuations in an M&A context.

Our ESG experts work side-by-side with financial and legal experts in KPMG Deal Advisory to offer buy-side, joint venture and sell-side clients a truly integrated and efficient due diligence service at every stage of the transaction.

[1] Capital Dynamics (2017) *Responsible Investment in Private Equity – a key component of operational value creation*

Contact us to find out how KPMG member firms can help you.



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With over 20 years of work experience, Tomas has worked with dozens of institutional investors and asset management companies to understand and integrate ESG into their investment policies, and measure the impact of this for their business. He is well connected with key organizations in this space such as the UN Principles for Responsible Investment (PRI).

Martin Viehöver

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Martin is an expert in identifying, assessing, managing and reporting on ESG issues for large companies and institutional investors. Over the past 10 years, he has provided ESG due diligence for mergers and acquisitions both on the buy-side and sell-side on behalf of clients in a wide range of industries.

How we can help

KPMG ESG due diligence professionals go much further than traditional environmental, health & safety assessments.

KPMG specialists look at a wide range of potential liabilities, compliance issues and hidden risks that could reduce the deal price or opportunities that could increase it. Therefore KPMG firms also search for value creation opportunities that might improve the divestment valuation of the business.

The KPMG ESG due diligence service includes:

- Overview of how emerging social and environmental megatrends are likely to affect the company and its market
- Comprehensive assessment of the business's material ESG risks, liabilities and opportunities
- Benchmarking of the company's ESG policies, procedures and performance against peers and sector best practice
- Assessment of compliance with national regulations and international treaties
- Insight into how the company's ESG performance could affect its most valuable intangible assets including reputation, brand value, trust and relationships
- Estimates of how potential liabilities could affect costs, cash flow and the deal timeline
- Recommendations on adjustments to the valuation

As an integrated part of your KPMG Deal Advisory team, our ESG due diligence professionals know how to keep deals on track in time-sensitive situations. And, with experts across the KPMG global member firm network, we have local expertise ready to support multinational deals wherever the company's operations are located.

A broad-based approach to ESG due diligence

The KPMG ESG due diligence approach covers a wide range of performance, risk and compliance issues. They include, but are not limited to:

Environmental

— Pollution of air, buildings, land and water
— Impacts on ecosystems and biodiversity (e.g. deforestation and the use of pesticides)
— Exposure to extreme weather
— Energy efficiency strategy and carbon management
— Use of scarce resources
— Sourcing practices such as the use of responsibly sourced materials
— Management of waste and recycling
— Use of water, especially in water scarce regions
— Readiness to respond to changing regulations on environmental performance

Governance

— Compliance with accounting standards
— Examples of anti-competitive behavior
— Audit Committee and Board structure
— Bribery, corruption and responsible tax record
— Executive remuneration
— Succession planning
— Lobbying record and political contributions
— Robustness of ESG risk management processes
— Presence of appropriate whistleblower and grievance mechanisms

Social

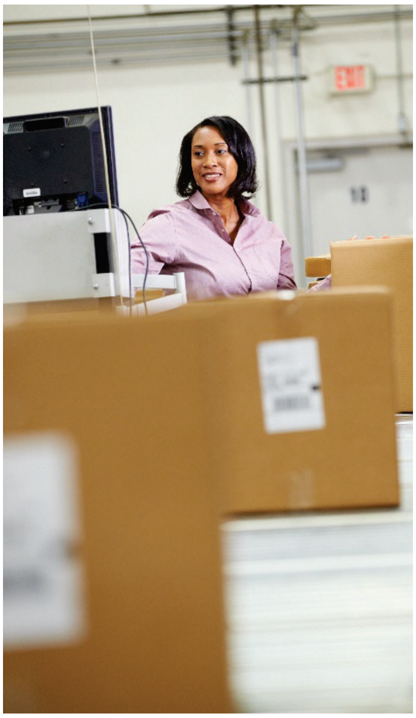
— Level of customer satisfaction
— Protection of customers' data and compliance with privacy laws
— Approach to human rights risks such as labor standards, child labor and modern slavery
— Strength of relationships with workers and communities
— Worker safety
— Supply chain risks, such as standards of working conditions in the supply chain
— Approach to diversity and equal opportunities
— Employee attraction and retention record
— Appropriate and lawful use of marketing communications
— Product safety

Strategic

— Readiness for transition to a low-carbon economy
— Resilience of the business model and strategy to social and environmental megatrends
— Strength of relationships with regulators and investors around ESG issues

Client stories

01 Deal price reduced due to multiple ESG risks



A Chinese foreign investor was negotiating a deal to acquire a Europe-based manufacturer of tableware. Sustainability experts at KPMG in Germany, working as part of an integrated KPMG financial, legal and ESG due diligence team, uncovered many ESG risks including environmental liabilities, poor working conditions, potential for labor disputes and unsound Board processes.

As a result the client reduced the offered deal price by US$10 million. Integrating the financial, legal and ESG due diligence processes increased the efficiency of the assessment and saved the client time and money. KPMG delivered its report within a tight time frame of only two weeks.

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02 Missing environmental permits drive down the deal price

A private equity firm sought to acquire a marine equipment manufacturer in South America and needed to identify material environmental, social or governance (ESG) risks that might affect the deal. On behalf of the prospective buyer, KPMG in Brazil carried out due diligence that included inspections of the group's sites and facilities, interviews with senior managers, and a review of management systems, policies, procedures and reports.

KPMG discovered that the acquisition target had failed to secure a number of mandatory environmental licenses and permits, putting it at potential risk of financial penalties, factory closures and criminal prosecution of its executives. With the support of KPMG, the client successfully negotiated a reduction in the deal price and addressed the risks in the transaction.

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