

# AGENDA

## Green Deals Tripled Last Year Amid Emissions Crunch

Experts say due diligence is key

By Lindsay Frost | March 21, 2022

In the race to lower carbon emissions, companies are exploring M&A deals that will help them not only meet emissions targets, but convert to renewable energy, get access to innovations such as carbon capture technology, and accelerate the shift to electric vehicles.

So-called green deals are growing at an exponential rate and becoming more valuable. Deals involving sustainable companies more than tripled in 2021 from 2020 levels, according to **Refinitiv**. The all-time record, hit last year, was 1,270 transactions worth \$197 billion, a February report from the firm showed. The value of ESG-related transactions jumped from \$35.7 billion in the first half of 2020 to \$96.5 billion in the first half of 2021, according to **EY**.

“Given how devastating climate change is today, it’s causing a wake-up call and resulting in a real economic impact,” said **Tom Burton**, chair of law firm **Mintz’s** energy and sustainability practice. “That’s what is pretty exciting about the space, because this results in more M&A and investment and growth.”

For example, **Peabody Energy**, one of the largest coal producers in the world, earlier this month announced the formation of a joint venture to develop solar power and battery storage capacity, called R3 Renewables LLC. Greenhouse gas emissions have rebounded to their highest level in history, largely due to heavy reliance on coal, according to a new report from the **International Energy Agency**.

According to **Jim Grech**, president and CEO of Peabody, the joint venture will create additional value from Peabody’s existing assets and support its and its customers’ environmental, social and governance goals. It will also “provid[e] added economic benefits for the communities in which we work and live,” Grech added in a press release on the deal.

As boards continue to hold discussions on their companies’ climate strategies, experts say M&A is increasingly an important part of the conversation. But sources told Agenda that companies shouldn’t jump the gun and rush into what looks like a sustainable deal without doing due diligence.

After all, carbon accounting is more difficult to track than revenue, said **Marc Lino**, partner and leader of ESG at **Bain & Company’s** private equity practice.

Indeed, according to an October 2021 survey of 400 U.S. and U.K. deal-makers from **Datasite**, 44% expect climate change to be the biggest M&A dealbreaker in the next 12 months.

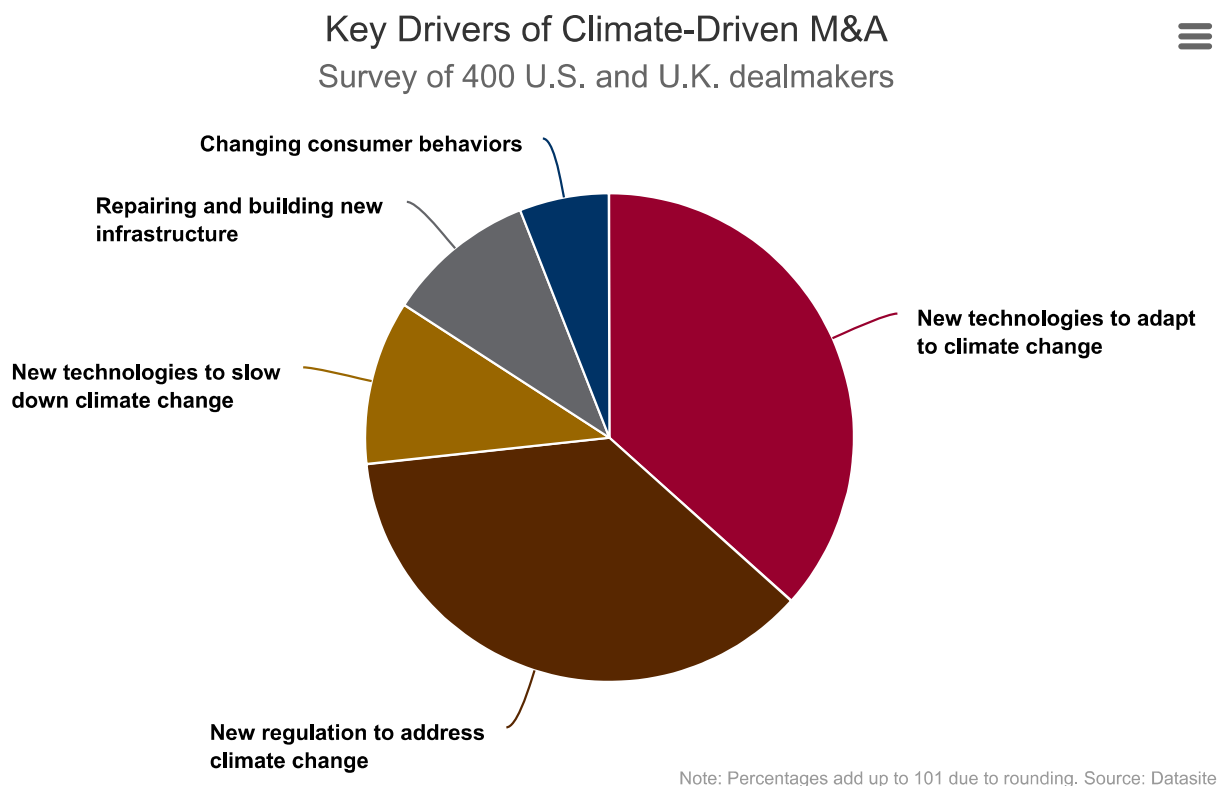
M&A Opportunities

According to a survey of more than 2,000 global CEOs from **EY** earlier this year, 20% said they would prioritize deals that would improve ESG positioning and sustainability footprints. Almost all (99%) of respondents said they factor ESG and sustainability into their buying strategies.

“Business strategies these days have a more explicit linkage to the climate transition, and M&A is a natural extension of that strategy,” Lino said. Lino said he is seeing a correlation between stronger ESG performance and deal valuation, driven by deals that help companies curb emissions. “You can definitely pay a premium for something like that,” Lino added.

There are numerous M&A opportunities related to climate change available to companies, sources said. According to the Datasite survey, 37% of respondents said new technologies to adapt to climate change will drive the most M&A opportunities, while 37% said regulation would be the key driver. Additional M&A drivers included new technologies to slow down climate change (11%), repairing and building new infrastructure (10%) and changing consumer behaviors (6%).

**Mark Williams**, chief revenue officer for the Americas at Datasite, said he’s seen an acceleration of investments into clean technology initiatives. He’s also seeing assets that have a “very clean” or “carbon neutral” footprint trade for higher than companies in their respective peer groups, which is attractive for deal-makers.



Burton works closely with venture capital funds, and he sees a lot of investing in companies developing tech at scale that is clean and renewable.

“The core of those businesses is all about the E in ESG, and they are finding ways to build profitable companies while providing needed services,” Burton said. “They are getting high valuations as growth companies in the marketplace because there is a real demand for that.”

The respondents to the Datasite survey said they expect to see the most climate-related investment in green energy initiatives (65%), infrastructure financing (11%), agriculture and sustainable farming (11%), life science and health care (8%) and environmental waste management (6%).

For example, some of the largest oil and gas corporations have made public announcements related to the energy transition and then made acquisitions that have positive climate impacts, including in areas “you wouldn’t expect,” such as electric vehicle infrastructure, Burton said.

**Chevron**, for instance, last month announced it had acquired the Renewable Energy Group for a little over \$3 billion. The deal will help the company reach its goal of producing 100,000 barrels per day of renewable fuels by 2030, according to the company’s press release.

Another example of this, Burton said, is companies’ making acquisitions that generate “substantial” carbon credits, which will help offset emissions. Offsets, along with renewable energy plants and reforestation projects, are becoming popular purchases, Burton added.

The electric vehicle market in particular is continuing to grow, sources said. **BorgWarner**, an automobile supplier, in October 2020 acquired Delphi Technologies for roughly \$3 billion in order to expand its electronics and power electronics technology portfolio. Post-acquisition, BorgWarner is seeing “tremendous wins,” wrote **Paul Farrell**, executive vice president and chief strategy officer at BorgWarner, in an email.

The company aims to have 45% of its revenues from electric vehicles by 2030. The Delphi Technologies acquisition was the largest in the company’s history and Farrell said it’s a “key building block in our electrification journey and in helping us achieve our [electric vehicle] objectives.”

“From a sustainability and environmental perspective, BorgWarner brought best practices to Delphi Technologies as we fully integrated the two entities,” Farrell wrote. He added that climate change and environmental issues are an “important” part of the company’s M&A strategy. Farrell noted that other acquisitions including Remy, Sevcon, RMS and AM Racing, and Akasol AG, along with the pending acquisition of **Santroll**’s light vehicle motor business, will help the company achieve its environmental goals.

“Hybrid and full-electric vehicles reduce or eliminate the direct fossil fuel consumption associated with transportation and mobility,” Farrell wrote.

When focusing on the strategies companies explore to achieve climate goals, Datasite respondents cited restructuring (26%), vertical acquisitions (23%), expansion into new markets (22%), disposals and spin-offs (14%) and partnerships and joint ventures (10%), among other responses.

Boards need to think about whether a deal will be a “shield” or a “sword,” Lino said.

“Shields are those areas you must focus on in order to compete and be relevant in an industry, a bit more from the risk angle,” Lino said. “The swords are how you differentiate. Those deals allow you to be more value-creating and gain market share. You use the deal as a way to lower your operating and capital expenses.”

Beware of Destructive Deals

However, deals can easily fall apart due to climate-related issues too, sources said. For example, Lino said that an acquirer might think twice about a target that could slow down progress on meeting emissions goals.

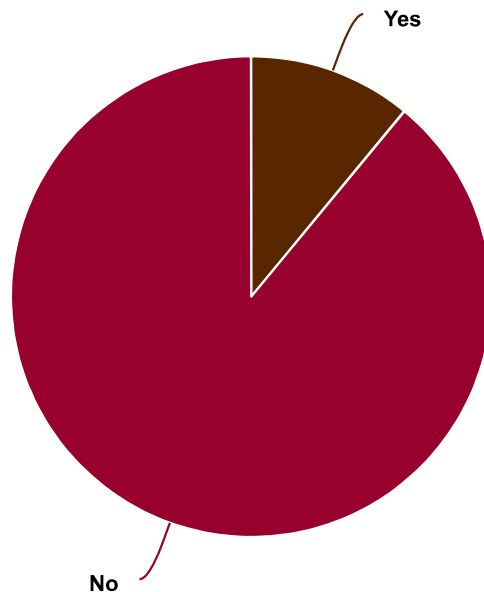
Additionally, Williams said value destruction is “common.” An asset might look good financially. “But once they own it, there may be an environmental cost that hadn’t been considered, which leads to a negative outcome.”

Plus, companies need to consider the impact of potential litigation over greenwashing claims related to a deal, Burton said.

Meanwhile, although companies are touting the value of ESG-related deals, they may not be applying rigorous due diligence to the matter, a recent Bain survey of 281 M&A executives suggests. The survey showed that only 11% “extensively” assess ESG issues in the deal-making process. Out of the 10 critical elements of the corporate M&A process identified by Bain, ESG was the least emphasized dimension, according to the firm.

### Companies Largely Not Considering ESG in M&A ≡

Does your company extensively assess ESG in the deal-making process on a regular basis?



Note: Out of 281 global M&A executives. Source: Bain & Company

Due diligence should include a number of factors, sources said. For one, Lino said, acquirers want to see that the target company has a climate transition statement in place and how strong emissions reduction goals are. Companies are also looking at whether targets have science-based emissions targets and where the company is in its emissions reduction journey, including what initiatives are in place, he added.

The Datasite platform, which allows deal-makers to search through data on companies and ask questions during the deal-making process, has seen growth in the number of climate-related concerns coming up, Williams said. For example, executives often ask questions surrounding the

climate impact of the supply chains of potential targets, he said.

Companies looking for targets also look closely at sustainability reports, what frameworks those reports use and whether the data behind them is verified, Burton said.

For example, Farrell wrote that at BorgWarner, local environmental considerations are part of its due diligence process.

Post-merger integration is also key, sources said. Once a company makes an acquisition, it needs to make sure it is tracking the realization of those climate-transition-related outcomes, Lino said.

“It’s second nature to track revenue and cost synergies and financial and operational and strategic measures like market share gain, but many people are not pushing it into the climate key performance indicators,” Lino said. “That’s where it gets hard, though. There are financial systems that allow you to track revenue and cost of goods, but on the carbon side that space is a bit less mature.”

Boards need to look closely not only at management’s due diligence, but at warranties, potential risks and outcomes of deals, Burton said.

“You can’t stick your head in the sand on this,” Burton said. “If you want to practice your fiduciary duties of care and diligence, you need resources at the board level to examine your company and the opportunities around carbon and climate and how they may materially impact the business.”

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