Aligning ESG with Commercial Growth
Midwest M&A / Private Equity Conference
May 5, 2022
Columbus, Ohio
What is ESG?

Doing business in a way that considers environmental, social & governance elements

Top of mind for boards, investors, customers, employees, suppliers, and regulators

Philosophy that social & environmental issues should be of equal concern as profits

Increasing scrutiny, activism

Environmental
- Climate change, waste, water, chemicals, emissions, biodiversity

Social
- Modern-day slavery, safety, diversity, working conditions, environmental justice, fair access to healthcare

Governance
- Board diversity, climate competency, executive compensation, lobbying & political contributions
A Crowded Disclosure Landscape

MULTIPLE ORGANIZATIONS

FIT IN 4 DISTINCT GROUPS:

1. Publish guidance for voluntary disclosure, often with company feedback loops
   - CDSB
   - GRI
   - SASB Standards Board

2. Request data from companies via questionnaires
   - CDP
   - Sustainalytics
   - Refinitiv
   - Bloomberg

3. Aggregate publicly-available data from companies
   - FTSE4Good
   - ISS ESG

4. Create assessments of companies based on public and/or private information to sell to investors
   - MSCI
   - RepRisk
   - Sustainalytics
   - TruValue Labs

Source: Value Reporting Foundation
ESG-Related Activism On The Rise

- Record 529 ESG shareholder resolutions filed – up 22%
- Climate issues top the agenda at 110 proposals
  - Near total focus on GHG emissions and transition plans
- +20 shareholder proposals filed with 14 electric utilities
  - 1/3 focus on diversity, equity and inclusion

Source: proxypreview
Disclosure is Challenging

- Frameworks, standards, ratings, rankings
- Fast-changing ESG landscape – globally
- Goalpost keeps moving, bar getting higher
- Activism increasing
- SEC climate disclosure rule sets the stage
2022 ESG/Sustainability Trends

ESG Trends to Watch

- Corporate Purpose
- Climate Transition Plan
- Just Transition/Climate Justice
- Human Capital Management
- ESG Regulation
- Stakeholder Capitalism
- Supply Chain Resilience

More pressure to link executive comp to ESG performance

Companies will adapt technology to bridge the digital divide

Growing scrutiny of net-zero carbon goals – transition plan

Corporate purpose will be important to engaging, retaining employees

Workplace flexibility, worktime will change how companies operate

Enhanced human capital management disclosures

Better insights into DEI practices at all levels

Growing focus on supplier diversity

Greater supply chain transparency & tools to manage risk

Leverage economic influence to demand action on social issues employees, customers care about

Source: SustainAbility Institute at ERM
Drivers of ESG in M&A and PE

• Investors are increasingly focusing on ESG
  • BlackRock’s Annual CEO Letter

• Investors and potential acquirers are evaluating a company’s ESG strategy as part of their value

• Impact investing and ESG Funds

• United Nations Principles for Responsible Investment (UN PRI)
ESG Investing by the Numbers

ESG ranked as the top asset class for increased allocations in 2021

Source: J.P. Morgan
Benefits of ESG for PE and M&A

- Manage Risk
- Value Creation
- Market Differentiator
- Future Proof Business
For Consideration

• Who are your stakeholders and what do they care about? How can you deliver to their expectations?

• What are the ESG topics that are material to your business?

• Do you have an ESG Strategy?

• What about a roadmap and implementation plan?

• ESG Due Diligence is key to understanding risks and effective integration of M&A

  • Make sure that you have the data to back-up your claims!
## Example Portfolio Company ESG Activities

### ESG Due Diligence & Integration Planning:

**Inputs:** Utilize SASB, GRI & other evaluation standards depending on PEG philosophy and investment thesis

**Outputs:** Buildout of an ESG Profile with emerging risks and opportunities identified

### ESG Roadmap:

**Inputs:** DD findings, observations from business leaders & Gap Framework assessment

**Outputs:** Prioritized recommendations and implementation guidance based on benefit and maturity

### ESG Strategy Execution (many elements):

**Inputs:** ESG Roadmap project plan

**Outputs:** Service execution across 3 major dimensions: Environmental, Social & Governance

### Sell-side CIM, roadmap strategy and DD prep support can provide enhanced value at exit
“Today, investors representing literally tens of trillions of dollars support climate-related disclosures because they recognize that climate risks can pose significant financial risks to companies, and investors need reliable information about climate risks to make informed investment decisions.”

SEC Chair Gary Gensler

March 21, 2022

SEC Proposed Rule on Climate-Related Disclosures

- Released March 21, 2022
- Comment period open though May 20, 2022
Proposed Disclosures

- **Financial statement footnote disclosures:**
  - Impact on financial statement line items related to severe weather events and other natural conditions and transition activities if more than 1% of the related line item.
  - Expenditures related to mitigating the risk of severe weather events and other natural conditions and transition activities if more than 1% of the total amount expensed or capitalized.
  - How severe weather events and other natural conditions and transition activities affected estimates and assumptions are reflected in the financial statements.

- **GHG emission disclosures:**
  - Scope 1 and Scope 2 GHG emissions separately disclosed on a disaggregated (by each GHG) and aggregated basis.
  - Scope 3 GHG emissions in gross terms, if the company has set a GHG emissions target or goal that includes Scope 3 emissions or if Scope 3 emissions are material.

- **Qualitative disclosures:**
  - Prospective risks and material impacts on company’s “strategy, business model, and outlook” caused by climate change over the short-, medium- and long-term.
  - The processes for detecting, evaluating, and managing climate-related risks and whether those processes are integrated into the company’s broader risk management program.
  - Any internal carbon price, the registrant’s internal carbon price and how such price is determined.
  - Any scenario analysis to assess its business in the context of climate-related risks, a description of the scenarios, assumptions, and projected financial impacts.
  - Any climate transition plans, a description of such plan as well as relevant targets and metrics.
Goals, Oversight and Timing

Publicly Disclosed Goals

Scope, timing and interim targets.

Plans for how goals will be achieved.

Annual update of progress toward the targets or goals and how such progress has been achieved.

Information about carbon offsets or renewable energy certificates (RECs), including how much of the progress made is attributable to offsets or RECs, if they are part of the company’s climate-related targets or goals plan.

Board Oversight

Provide detailed governance disclosures

Detail Board and management oversight of climate-related risks, the risk management process, and the company’s response.

Detail the climate related experience of Board, management or ESG committee

How & When

Include the disclosures in company’s registration statements as well as annual reports.

The disclosures outlined in the financial statement footnote disclosures would be required in the financial statements.

Form 10-K would include other disclosures, including GHG emissions, immediately before MD&A.

Timing: The disclosures would be due at the same time as the company’s annual report.
Emissions Disclosures

**Scope 1 & 2**

- **Scope 1:** direct GHG emissions from sources that are controlled or owned by the company
- **Scope 2:** indirect GHG emissions from upstream and downstream activities
- Required on a gross basis (before consideration of any offsets) and relative to intensity, if company set a GHG emissions target or goal that includes Scope 3 emissions or if Scope 3 emissions are material.

**Note:**
- Required FY 2024 (filed in 2025)
- Independent audit not required
- Provides safe harbor for for liability from Scope 3 emissions disclosure

**Scope 3**

- GHG emissions not within company’s Scope 1 or 2, but result from activities and assets not owned or controlled by the company, but that the company indirectly impacts in its value chain
- Separately disclosed on a disaggregated (by each GHG) and aggregated basis.
- Required on a gross basis (before consideration of any offsets) and relative to intensity (e.g., tons of carbon dioxide per dollar of revenue).

**Note:**
- Required FY 2023 (filed in 2024)
- Audited with “limited assurance” for FY 2024
- Audited “reasonable assurance” for FY 2026

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**GHG Protocol: List of scope 3 categories**

<table>
<thead>
<tr>
<th>Upstream or Downstream</th>
<th>Scope 3 Category</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upstream</td>
<td>1. Purchased goods and services</td>
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<tr>
<td></td>
<td>2. Capital Goods</td>
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<tr>
<td></td>
<td>3. Fuel- and energy-related activities (not included in scope 1 or scope 2)</td>
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<td></td>
<td>4. Upstream Transportation and distribution</td>
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<td>5. Waste generated in operations</td>
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<tr>
<td></td>
<td>6. Business travel</td>
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<td></td>
<td>7. Employee commuting</td>
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<td></td>
<td>8. Upstream leased assets</td>
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<tr>
<td>Downstream</td>
<td>9. Downstream transportation and distribution</td>
</tr>
<tr>
<td></td>
<td>10. Processing of sold products</td>
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<td></td>
<td>11. Use of sold products</td>
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<td></td>
<td>12. End-of-life treatment of sold products</td>
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<td></td>
<td>13. Downstream leased assets</td>
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<td>14. Franchises</td>
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<td>15. Investments</td>
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**Carbon Emissions Reporting at U.S. Companies by Index**

- **US S&P 500:**
  - 88% reporting quantitative metrics about GHG emissions
  - 70% disclosing total Scope 3 emissions

- **Russell 3000:**
  - 26% reporting quantitative metrics about GHG emissions
  - 10% disclosing total Scope 3 emissions
Assuming the proposed rules are adopted with an effective date of Dec 2022, and the filer has a fiscal year ending Dec 31:

SEC’s Proposed Mandatory Reporting Timeline

<table>
<thead>
<tr>
<th>Registrant Type</th>
<th>Disclosure Compliance Date</th>
<th>GHG emissions metrics: Scope 3 and associated intensity metric</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large Accelerated Filer</td>
<td>Fiscal year 2023 (filed in 2024)</td>
<td>Fiscal year 2024 (filed in 2025)</td>
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<tr>
<td>Accelerated Filer and Non-Accelerated Filer</td>
<td>Fiscal year 2024 (filed in 2025)</td>
<td>Fiscal year 2025 (filed in 2026)</td>
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<tr>
<td>SRC</td>
<td>Fiscal year 2025 (filed in 2026)</td>
<td>Exempted</td>
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<thead>
<tr>
<th>Filer Type</th>
<th>Scopes 1 and 2 GHG Disclosure Compliance Date</th>
<th>Limited Assurance</th>
<th>Reasonable Assurance</th>
</tr>
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<td>Large Accelerated Filer</td>
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<td>Fiscal year 2026 (filed in 2027)</td>
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<tr>
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<td>Fiscal year 2024 (filed in 2025)</td>
<td>Fiscal year 2025 (filed in 2026)</td>
<td>Fiscal year 2027 (filed in 2028)</td>
</tr>
</tbody>
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See https://www.sec.gov/files/33-11042-fact-sheet.pdf
Breakdown of Retail Emissions

Breakdown of Scope 1, 2, and 3 Emissions

- Scope 1: 2%
- Scope 2: 3%
- Scope 3: 95%
Breakdown of Retail Emissions

Breakdown of Scope 3 Categories

**Calculated from scope 3 reporting to 2020 CDP Climate Change Questionnaires from retailers with an approved Science-Based Target (except Home improvement/DIY, which used 2020 CDP Climate Change Questionnaire reporting from The Home Depot & Lowe’s Companies)**
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