Environmental Finance

Reaping an Earth Dividend

30 May 2019

Earth Capital Partners has been tracking down investments that have a positive impact on the planet for more than a decade. Its CIO Gordon Power talks to **Elena K. Johansson.**

Numerous private equity firms have launched impact-themed funds in recent years, but Earth Capital Partners was one of those leading the pack.

The term impact investing had only recently been coined when the firm was originally created in 2008 by Lord Stanley Fink, formerly CEO of Man Group. Today, Earth Capital Holdings has some $1.5 billion of assets under management.

The definition of impact investing has evolved over the past decade, with the Global Impact Investing Network describing it as investments that have intentionality to have a positive impact, and commit to report on that impact.

But Gordon Power, CIO of Earth Capital Partners, has his own way of explaining the firm's approach to impact.

Earth Capital deals with the externalities of the companies in which they invest, he says, such as the waste or unsustainable materials they use or produce, which lead to "negative effects". Investors that focus on environmental, social and governance (ESG) factors, however, disregard these negative effects, which is why it "doesn't cut it as a way forward", he argues.

In summary, Earth Capital believes that ESG is changing finance, whereas impact investing is financing change.

To help guide its investment decision making, Earth Capital has its own model of assessing these impacts, called the "Earth Dividend" scorecard.

The Earth Dividend assesses positive and negative impacts of a technology solution with 30 considerations

Earth Capital believes that ESG is changing finance, whereas the impact strategy Earth across five areas—natural resources, ecosystem services, pollution, social and economic contribution, society and governance.

Capital pursues is financing change.

These considerations are mapped onto a spider web-like graph, which helps assess whether an investment has a positive or negative impact on the planet, according to each of these five considerations.

It then calculates a final score, whose value reflects the long-term sustainability of the technology or investment.

Crucially, Earth Capital's asset managers actively work to improve the negative impacts of an investment, to raise the overall Earth Dividend score, which is reported annually and externally audited, during their ownership of the business.

Power gives the example of a water-efficient toilet, a product of UK sanitation company Propelair, one of Earth Capital's investee companies.

"[The toilet] uses 1.5 litres of water instead of nine litres every time you flush. You'd think that was massively positive towards sustainability, except that, when we [first] invested in it, the components included plastic."

By reducing the environmentally unsustainable materials within the toilet, such as plastics, and replacing them with recycled materials, the Earth Dividend score was increased.

Earth Capital aims to turn negative effects of investments into profitable, sustainable solutions, explains Power: "At the end of the day, if you improve the score, at the same time that improves the margin, because less components mean less cost, which means better profitability."

This approach leads Earth Capital's managers to view themselves as "industrialists" rather than mere private equity investors.

But Power says understanding how to turn negative impact into positive impact is the difficult part.

"An ESG screen won't give you necessarily the answer to that, whereas an impact analysis would do," he says, arguing that ESG does not offer a complete solution to sustainability problems.

Power has earned the right to be outspoken – he can claim to be a pioneer in sustainable investing.

He founded ProVen Private Equity in the 1980s, where he began dabbling in "sustainable" investments.

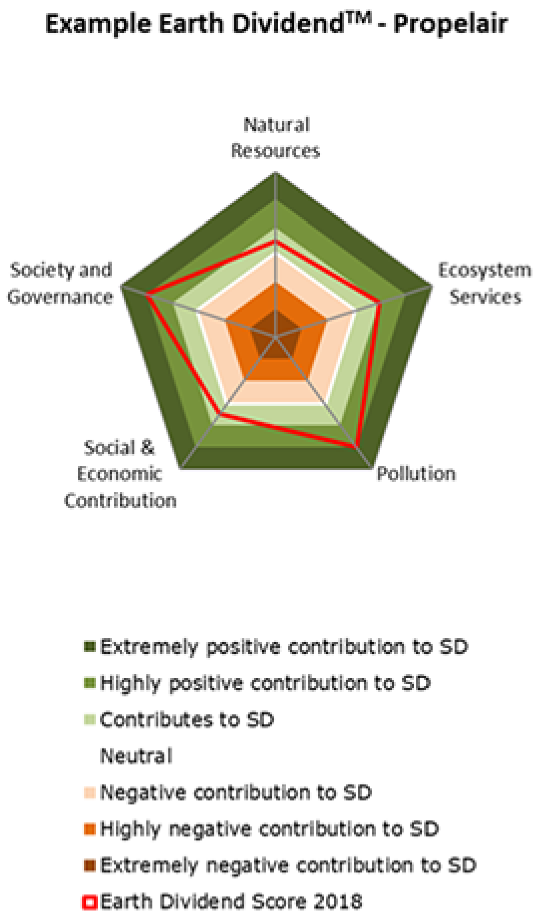

Figure 1: Example Earth Dividend™ - Propelair

In 2012, he helped lead the acquisition of Earth Capital Partners. It was bought by Earth Capital Holdings, which is owned by Lord Fink, a number of other partners and Guernsey-based international fund management business Sustainable Technology Investments (Guernsey), which is in turn owned by Gordon Power and Stephen Lansdown – co-founder of UK financial services and FTSE100-listed stock broker Hargreaves Lansdown.

Power claims to have made 30 "sustainable" private equity investments over a 34-year period, generating an average annual IRR of 45%.

Earth Capital Holdings has gone on to launch 15 funds, exited one, and is in the process of marketing three more.

Investors in Earth Capital funds include governments, sovereign wealth funds, family offices and pension funds.

Earth Capital's latest venture is the Nobel Sustainability Fund, which was set up in collaboration with the Nobel Sustainability Trust – which was founded by members of the Nobel family, related to Alfred Nobel, founder of the prizes that bear his name – and is managed by Earth Capital Partners.

The fund, launched in 2016, attracted $45 million of investment at its first close in December 2017. Initial investment has come from Sustainable Technology Investments (Guernsey) and Monaco Investment Corporation, the principality of Monaco's sovereign wealth fund.

The Nobel Sustainability Fund seeks to raise $800 million for a ten-year investment period, with a target internal rate of return of 15%. Its 18 investments so far include African horticultural firm Noka Farm, which not only grows produce, but also turns farm waste into gas and energy. Between 30% and 50% of its investments are in the UK, in companies such as Propelair, industrial water purification firm Arvia Technology, and software storage company SoftIron.

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"All our technology for sustainability was being funded out of Europe. There is this great gap appearing of underfunded technology businesses here in the UK, which is a fantastic opportunity," he says.

The water-efficient toilet has already been licensed in China for 'technology transfer'. Technology licensing is a contractual arrangement in which intellectual property may be sold or made available to a licensee.

"That means you don't necessarily take stocking risk and distribution risk. You share that [risk] with a partner in a different location," Power explains.

To help make up for losses that private equity funds often suffer in their early stages, Earth Capital seeks to use energy efficiency investments to generate early cash flows. Power says that about 15-20% of a fund is typically invested in energy efficiency businesses.

Earth Capital Holdings also owns 26% interest in Sustainable Development Capital Limited (SDCL), which last year listed the first energy efficiency focused investment trust on the London market.