Why Impact Investing for sustainable development?

The sustainability revolution

“We are in the early stages of a global 'sustainability revolution' that has the magnitude of the industrial revolution and the speed of the digital revolution."

Vice President Al Gore

The investment opportunities of this Sustainability Revolution are juxtaposed to Milton Friedman's view that business had one and only one social responsibility - "to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game.” [1]

At Earth Capital, we believe the rules of the game have fundamentally changed since Milton Friedman's days. As Blackrock CEO Larry Fink states, "Simply managing for short-term shareholder profit is not an acceptable management strategy. Society is demanding that companies, both public and private, serve a social purpose. To prosper over time, every company must not only deliver financial performance but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate".[2]

Today companies have a duty to improve the environment in which we live and embedding this duty within our investment process can improve investment returns.

By selecting Sustainable Development as our theme for Impact Investing, we protect and enhance value, address societal and environmental challenges as well as deliver superior financial returns.

Since the 1987 Report of the Brundtland Commission (formed to unite countries to pursue sustainable development together), Sustainable Development has been defined as, "development that meets the needs of the present without compromising the ability of future generations to meet their own needs”.

In 2008, we established Earth Capital to invest growth capital PE exclusively in Sustainable Development investment opportunities. Today we are the leading Impact Investor with Sustainable Development as our investment theme.

As a globally recognized leader in Sustainable Development, we signed the Principles for Responsible Investment (PRI) in 2009 and most recently scored A+ in two of the three PRI assessment categories and A in the other.

1: Capitalism and Freedom by Milton Friedman, University of Chicago Press 1962
2: https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter

Impact investing goes mainstream

With the entry of TPG, KKR and Bain Capital into the Impact Investing market in 2017 and 2018, the participation of institutional investors in this rapidly growing market has accelerated. With Impact Investing for Sustainable Development being the core competence of Earth Capital since our inception in 2008, we welcome the arrival of these prominent PE investment firms to the Impact Investing market.

The entry of institutional investors into the Impact Investing market suggests it may finally be going mainstream. Institutional investors are attracted to Impact Investing on the basis that they believe the returns can be comparable to, or even better than, non-impact PE investments while also having a demonstrable and measurable positive social or environmental impact.

The impact investing advantage

Impact investments distinguish themselves from other forms of sustainable investing mainly by their intention to achieve a positive social or environmental impact and their commitment to measure and report on the impact or outcome of the investments.

The ability to earn PE-comparable returns and do some good at the same time is the promise of impact investing - a growing subset of growth capital PE that seeks to generate a market rate PE financial return while simultaneously creating a measurable social or environmental impact.

As PE firms target IRRs from Impact Investing above 15% net of all fees, they also intend to deliver at the same time specific, measurable impact. TPG's Rise Fund, for example, commits to generating a specific "impact multiple of money"[4] from each investment. KKR requires companies under its ownership to measure and report on specific impact outcomes, which KKR will in turn report to investors annually.[5]

We believe that we can generate private equity returns, while driving positive impact to global challenges.[3]

KKR

3: https://impactalpha.com/what-we-know-about-kkrs-1-billion-global-impact-fund/ April 30, 2018
4 & 5: https://impactalpha.com/the-rise-funds-impact-multiple-of-money/

Measuring social impact

Bain Capital partners[6] with the nonprofit B Lab to measure the social impact of portfolio companies and to track progress over time. B Lab's Impact Assessment tool uses GIIRS Ratings to assess social and environmental performance utilizing comparable metrics.

Earth Capital measures the impact of its investments through the Earth Dividend.™

In exceeding the standard of others in the Impact Investing market, we require our investee companies to make annual improvements in all areas that the Earth Dividend™ measures - i.e. across the United Nations Social Development Goals which benchmark impact.

Effective management of ESG risks and opportunities with the Earth Dividend™

Earth Capital believes companies that effectively manage Environment, Social and Governance (ESG) risks and opportunities to quantify Sustainable Development perform better over time.

We measure ESG criteria and quantify their impact by the Earth Dividend™ which provides an annual measure of the Sustainable Development impact an investment has across five categories of ESG issues:

-Natural resource consumption

- Ecosystem Services

- Pollution control

- Social & economic contribution

- Society and governance

ESG criteria are a set of measurements used to evaluate a company's environmental, social, and governance practices. A sampling of the sustainable development factors considered in an ESG score include impact on climate change, diversity and inclusion in employment, and management considerations such as executive compensation and audit committee structure. Impact investors use ESG data to analyze and monitor potential investments.

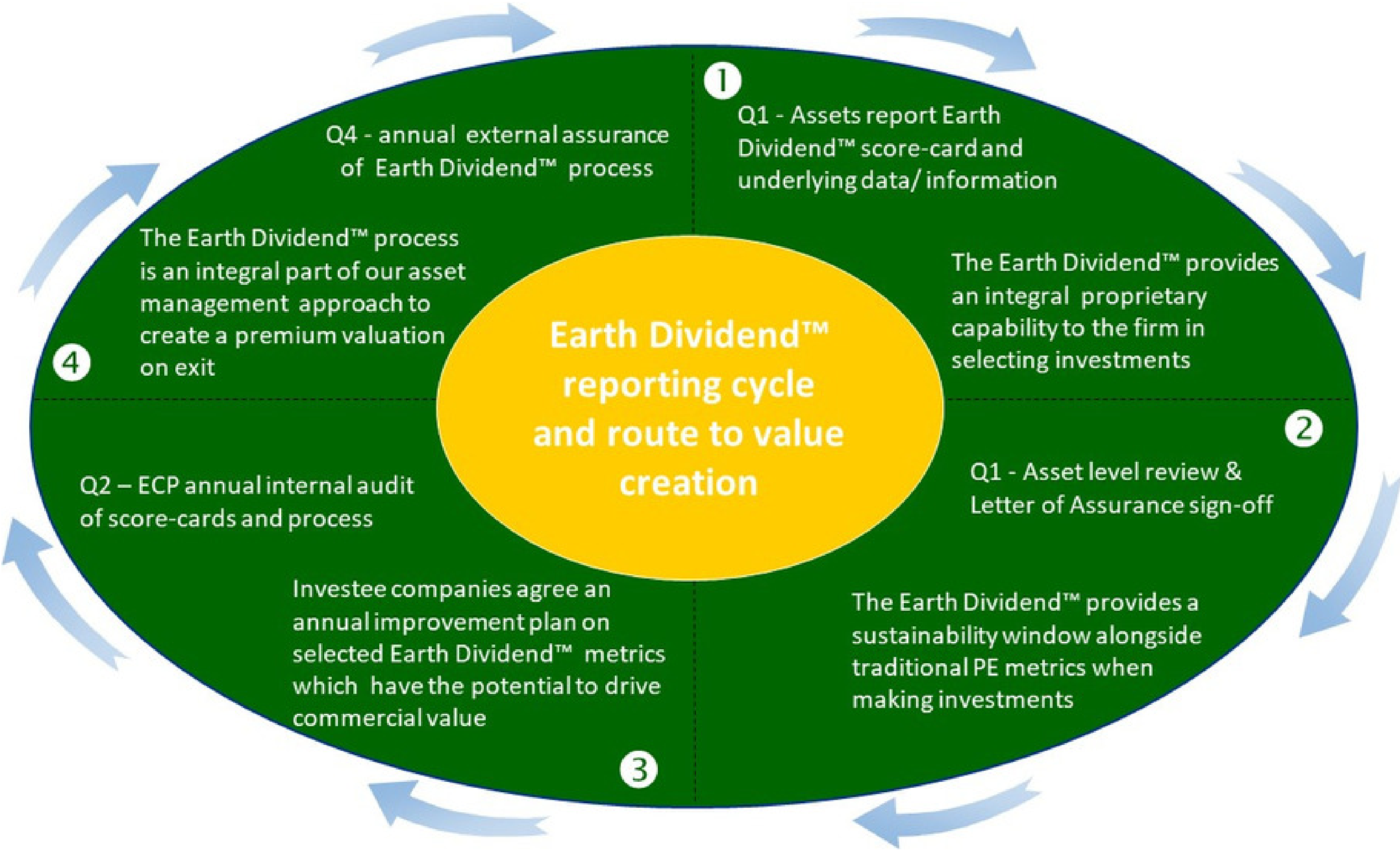
6: https://www.baincapitaldoubleimpact.com/strategy

Understanding the risk

Among Impact Investing funds, the Earth Dividend™ uniquely enables us to holistically understand risk and the impact of Sustainable Development; understand where our investments make a positive or negative impact; and, identify those areas where we can make a business more resilient and drive value. Using the Earth Dividend™ we also uniquely seek annual ESG improvements and report the progress to our investors.

These 5 issues feed into 30 wider ESG indicators which are consistent with the UN SDGs. The Earth Dividend™ is established for each company as part of the due diligence process and reported annually. Each company must agree on an annual improvement plan which targets improvements in the asset's contribution to sustainable development to enhance the underlying commercial performance of the asset. As a result, the Earth Dividend™ ensures that we invest in leading-edge technology and take sustainable development actions to attract a premium valuation on exit. To ensure that the Earth Dividend™ scorecard is representative, complete and accurate, a three-tier assurance process is implemented. This includes independent external assurance by a specialist assurance provider and a related public statement of their findings.

ESG investing leads to higher returns



Today several published studies consider how ESG investing leads to higher returns.

In late 2017 MSCI released Part I of their study titled "Foundations of ESG Investing"[7] to argue strongly that companies that manage effectively their ESG risks and opportunities perform better over time. This conclusion was based on the rationale that:

Stronger cash flows	High ESG-rated companies are more competitive and can generate abnormal returns, leading to higher profitability.
Less idiosyncratic risk	High ESG-rated companies are better at managing company-specific business and operational risks and, therefore, have a lower probability of suffering incidents that can impact their value.
Higher valuations	High ESG-rated companies tend to have lower exposure to systematic risk which results in a lower beta. Consequently, their expected cost of capital is lower which leads to higher valuations on a DCF basis.

7: https://www.msci.com/documents/10199/03d6faef-2394-44e9-a119-4ca130909226

Sustainability can drive financial outperformance

80% of the reviewed studies demonstrate that prudent sustainability practices have a positive influence on investment performance

This view is increasingly shared among mainstream investors. Blackrock argues in a May 2018 study that we have moved from a "why" to a "why not" on ESG integration.[8] Based on their own 2018 analysis, they state there is no need for equity investors to choose between returns and ESG as annualized returns on ESG-based indices since 2012 have matched or exceeded the standard index in both developed and emerging markets and with comparable volatility.

Robeco[9] argue that by focusing on issues that are financially material, ESG adoption leads to better-informed investment decisions and outperformance. They draw also on recent academic studies which underpin the analysis.

A 2015 study, 'From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance' by Oxford University and Arabesque Partners[10] examined more than 200 sources including academic research, industry reports, newspaper articles and books, and concluded that "80% of the reviewed studies demonstrate that prudent sustainability practices have a positive influence on investment performance".

A second meta-study by Deutsche Bank's Asset & Wealth Management division in conjunction with the University of Hamburg[11] went further and examined the entire universe of 2,250 academic studies published on this subject since 1970, using data spanning over four decades until 2014.

It concluded that ESG made a positive contribution to corporate financial performance in 62.6% of studies and had negative results in only 10% of cases (the remainder were neutral).

Thirdly on the point of materiality[12] a 2016 Harvard study revised in 2017 - Corporate Sustainability: First Evidence on Materiality argues that firms with good ratings on material sustainability issues significantly outperform firms with poor ratings on these issues.

Robeco concludes that a growing body of evidence points to the fact that companies which are progressively more sustainable today will reap the rewards in the future.

8: https://www.blackrock.com/investing/insights/blackrock-investment-institute/sustainable-investing-is-the-answer
9: https://www.robeco.com/uk/insights/2017/12/fact-or-fiction-sustainability-means-sacrificing-performance.html
10: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2508281
11: https://institutional.dws.com/content/_media/K15090_Academic_Insights_UK_EMEA_RZ_Online_151201_Final_(2).pdf
12: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2575912

ESG integration is going mainstream

Mainstream ESG integration

While naysayers still exist,[14] the evidence suggests that ESG integration is going mainstream and the rationale is firmly based on risk management and increasingly on enhanced return potential.

A recent FTSE Russell survey of 185 assets owners globally[15] reported that "nearly 40% of respondents anticipate applying ESG considerations to a smart beta index-based investment strategy in the next 18 months.

Among those, 63% are motivated by societal good, a shift from last year's top driver of avoiding long-term risk (now 54%). However, asset owners also reported performance (44%) as a top reason for consideration, up 13% since last year when ESG smart beta awareness and usage was first measured."

In summary, Earth Capital believes a focus on financial criteria together with ESG criteria results in better performance over time and relies on the Earth Dividend™ to quantify the impact from the inclusion of ESG criteria. We have the performance track record to prove it.

Private equity and ESG

PE offers the potential for more immediate impact and faster company growth than other asset classes.

PE gives the investor more leverage over investee companies. It provides a greater ability to engage with and influence the investee management teams in the portfolio over the longer horizon of the shareholding.

This presents the opportunity to build resilience into a businesses' value chains and enhance valuation on exit in a way that far exceeds the ability of institutional investors to influence the performance of listed equities and bonds.

Stronger cash flows are targeted by managing the idiosyncratic risks that impact enterprise value. As a result, an emphasis on Sustainable Development creates the higher exit multiples typical for the type of growth capital PE investments targeted by us.

Earth Capital is a responsible investor and targets investments which make a positive impact. We also seek to provide an attractive return to our investors by concentrating on growth capital PE investments in sustainable technologies providing resource efficiencies for agriculture, energy, food, water, waste and renewable energy infrastructure.

14: http://www.investmentnews.com/article/20180210/FREE/180219999/is-esg-investing-going-mainstream
15: http://www.ftserussell.com/blog/institutional-asset-owners-focus-multi-factor-esg-2018-smart-beta-survey

Impact Investing with the Nobel Sustainability Fund®

The challenges of Sustainable Development are the Nobel Sustainability Fund®(NSF) investment theme for Impact Investing. NSF targets for growth capital PE investment in sustainable technologies providing resource efficiencies for energy, food, water and air/environmental as well as investments in clean energy renewables and storage.

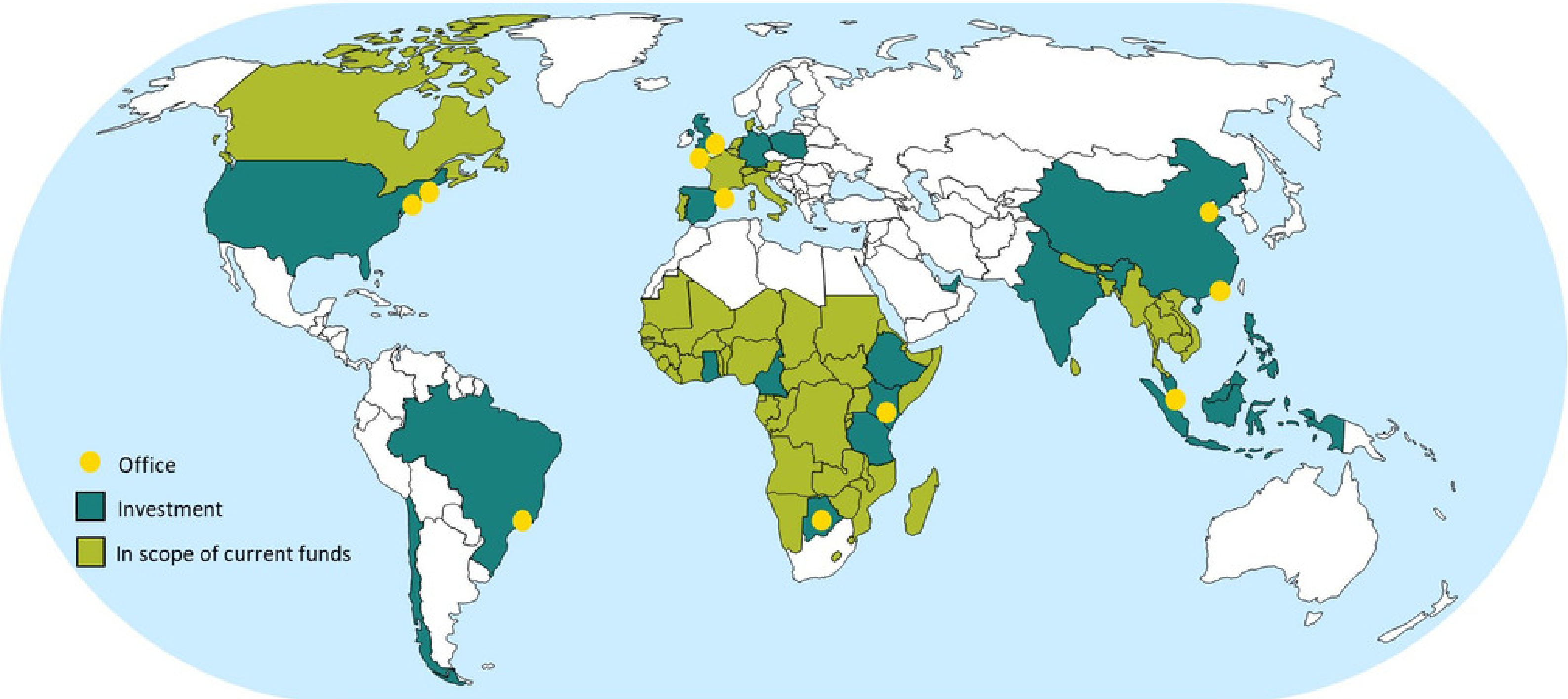
NSF is a global multi-phase, multi-geography fund to finance, incubate and accelerate the development of clean, sustainable technologies. NSF has a targeted return of 15% net of fees which we aim to achieve by combining financial metrics with ESG criteria to make investments with measurable impact.

There are three distinct advantages to Impact Investing by participating in NSF to earn its targeted return for growth capital PE of net 15%:

The compelling performance track record of Gordon Power and the ECH members. Since 1984, Gordon Power's portfolio of 247 investments has earned an IRR of 28.4% and the 30 Sustainable Development investments thereof have earned an IRR of 45%.

The Earth Dividend™ to quantify and annually report on the integration of ESG in combining ESG criteria with financial metrics to construct and manage the NSF Sustainable Development portfolio; and,

The ECH global footprint of affiliated Sustainable Development private equity investment managers with an AUM exceeding US$1.6 billion and the ability for technology transfers between members of the group.



Learn more

To learn more, visit the Nobel Sustainability Fund® data room to access the Information Memorandum, DDQ and all related information. If you have not received your access invitation, access is available upon request from Neil Brown at neil.brown@earthcapital.net

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