EXPERT COMMENTARY

An investment strategy that is intrinsically impactful with a strong focus on managing ESG risks will allow investors to ride out much of the uncertainty caused by covid-19, writes Sabine Chalopin, ESG and impact manager at Denham Capital

Creating impact and returns in a post covid-19 world

The world is eight months into one of the biggest societal and economic crises of the last century. Covid-19 has fundamentally reshaped the way each and every one of us goes about our daily lives, creating a world of uncertainty but, crucially, also one of opportunity. In my opinion, it is in such testing times as these that truly sustainable companies emerge.

Naturally, I have been asked on many occasions in the last few months how the pandemic will affect the future of our business, and my response has not changed: our investment strategy is intrinsically impactful – we invest in low-carbon projects including the developing markets through our International Power Fund (DIPF), which result in a number of positive social and environmental impacts that will be vital as the world looks to 'build back better' from covid-19.

SPONSOR

DENHAM CAPITAL

The Theory of Change model, popularised by the Aspen Institute, is one way to develop a pathway for impact. The Theory of Change for our fund is that investment in clean energy generation mitigates climate change and enables economic growth, including job creation. This Theory of Change includes measurable short-, medium- and long-term outcomes. The approach stipulates the problem, input, output, outcome and impact, and evidence has been provided by credible academic sources to support the Theory of Change through real-life examples in South-East Asia, Latin America and Africa, where the fund invests.

Developing and building low-cost clean energy assets, which help to power the economies in which we operate, is central to investing in a sustainable, impactful way. Development is at the core of our investment thesis because we strongly believe that mitigating

ESG risks can have a material, positive impact on investments, which we believe also shows in our returns.

In the context of infrastructure projects, poor ESG management can lead to unwarranted impacts on biodiversity, poor community relations, and weak governance. This in turn can lead to project delays, cost over-runs and reputational damage. Conversely, good ESG management can result in a project with reduced impacts on the environment, good occupational, health and safety records and positive relationships with communities – all vital considerations in a post-covid world.

Focusing in on the 'S' in ESG

Throughout the first quarter of the year, the 'E' in ESG seemed it would be the focal point underpinning much of the year's global capital market activity. Whilst the pandemic has only heightened calls for the acceleration of a green transition, I have also been encouraged to see that the pandemic has crystallised an understanding of what the 'S' in ESG stands for.

The interconnectedness between business performance and doing the right thing for employees, customers, local communities and suppliers has now become unquestionable for investors and was a key consideration for many of our LPs when engaging with them on our covid-19 response across our portfolio. For so long unable to shake the 'middle child' label often associated with it when looking at ESG, social considerations have now moved to front-of-mind for investors and are high on the agenda for company stakeholders and society at large.

It is this focus on social considerations that we hope will allow private capital to play its part in creating a

Building project resilience in Africa

In Africa, infrastructure investing and development has often been considered challenging, primarily due to the long lead times for project development, difficulty in obtaining approvals and challenges that may arise during construction.

Our view is that development needs to be done right the first time around, to avoid delays that typically arise when one needs to ensure that the development process meets bankability requirements. This inherently assists with building early project resilience and reducing development cost and time, making a project more attractive from an investor, off-taker and local stakeholder perspective. Africa offers great investment opportunities for those willing to look beyond perceptions of risk and dig into the reality for risk, and how to manage it.

However, projects should only be undertaken if developed and implemented in a sustainable manner. We have seen the benefits of this process, having developed, built and successfully monetised in 2015, three of the first privately owned wind and solar projects in South Africa.

Of primary importance is ensuring the right processes and protocols are followed from securing land, conducting environmental assessments, community engagement and conducting resource studies. Our approach has delivered success so far in 2020, with DIPF portfolio company Themis Energy gaining final notice to proceed on construction of the 44MW Singrobo Hydropower Project.

The full notice to proceed was the culmination of a rigorous development process, with Themis giving full consideration to potential ESG risks by engaging resettlement experts to develop and oversee implementation of a Resettlement Action Plan. Themis also engaged a leading biodiversity organisation which includes members of the International Union for Conservation of Nature commission who carried out a biodiversity assessment and designed an action plan. All the studies have been completed to ensure the project meets the requirements of the African Development Bank Operational Safeguards and IFC Performance Standards. The project is expected to reach commercial operation in 2022 and will provide an estimated 800,000 people with 214GWh of electricity annually.

Preparation of nurseries as part of the biodiversity work for the Singrobo project more effective response to the pandemic in Brazil. The scale of the country's covid-19 tragedy remains unclear, and while the sums committed for health and social security so far by the Brazilian government have been welcome, the magnitude of the challenge ahead calls for co-operation with the private sector, especially given the need to protect Brazil's more marginalised population.

Denham has invested in Brazil since 2012 through our portfolio company Rio Energy, a developer, owner and operator of renewable energy projects in the country, and have thus witnessed first-hand the unrest caused by the pandemic. Experiences to date have underlined our belief that ESG focused private capital can play its part in a holistic response to covid-19 that acts radically and decisively to protect local communities and employees.

Our greatest focus since the pandemic gripped the country has therefore been ensuring colleagues can prioritise their own and their families' health. Faced with the dual challenge of ensuring that our energy projects continue to provide power to nearly one million Brazilians and ensuring that employees and local communities are adequately protected, we took action early in the pandemic to scale down our workforce at construction sites to a skeleton team. We have now implemented covid-19 management plans, which include a clear communication and awareness campaign that enabled the workforce to resume.

Rio Energy has worked closely with the Brazilian Development Bank on a match funding campaign to provide protective health kits for doctors, nurses and other front-line health professionals in Brazil. There is plenty of progress still to be made but our experiences have shown that in responding to covid-19 a close focus on the range of issues sitting under the 'S' umbrella can provide useful risk mitigation and beyond the bottom line help the local communities where we operate in Brazil better respond to the pandemic.

"Long unable to shake the 'middle child' label often associated with it when looking at ESG, social considerations have now moved to front-of-mind for investors"

"Mitigating ESG risks can have a material, positive impact on investments"

Responsible investors have a duty to ensure that their management teams are good stewards in the communities in which they operate.

As we look forward, we believe now more than ever that right across private equity portfolios their licence to operate and ability to deliver a return will be a function of how well they engage and manage stakeholders through this crisis; how they communicate this responsibility in a clear and transparent way and how they integrate impact considerations throughout the investment lifecycle.

Putting ESG first

We believe it is very important to commit to proactively implementing ESG-related impacts across projects and platforms. While at times this may mean projects take a little longer, we believe it is truly good for the communities in which managers and portfolio companies operate, and good for business.

Over the past months a lot of our theories have been tested as covid-19 has ravaged countries and communities and, so far, we believe ESG planning has helped.

While the covid-19 story is not complete, it has shown us that doing the right thing matters for our stakeholders and hopefully has helped other investors re-focus their efforts on the impacts investments can make on the environment and the communities in which they operate. ■