Dear Friends,

2019 was the Year of ESG (Environmental, Social Responsibility and Corporate Governance) the Financial Times reported. In August, the Business Roundtable in the US redefined the responsibility of a company from benefitting *solely* shareholders to benefitting all stakeholders such as employees, suppliers, communities *and* shareholders. In January 2020, Larry Fink, Blackrock's CEO, wrote in his annual investor letter that *"Climate change has become a defining factor in companies' long-term prospects. [...] A company cannot achieve long-term profits without embracing purpose and considering the needs of a broad range of stakeholders".*

So how do you use ESG to create more value with less risk? A growing number of private equity firms are adding management of "externalities" and ESG to their existing capabilities. We called this development Private Equity 4.0. When we published our Private Equity 4.0 model in the Journal of Applied Corporate Finance in the Spring of 2019, we outlined how, but did not anticipate *how fast*, the industry and investors would integrate ESG as a driver for creating superior long-term returns.

There are strong reasons to be optimistic.

We are convinced that our industry will make substantial improvements to the world, environmentally and socially.

So, we ask, **is ESG the new "dot-com" bubble?** ESG is like the internet during the dot-com boom in the 1990s. Internet and ESG are here to stay, but the winners of tomorrow are hard to spot today. Like with the internet in the early phases, there is a lot of confusion about how to transform in the right way, or how to integrate ESG in the investment process to deliver superior returns.

The world-leading Harvard professors Michael Porter and George Serafeim recently wrote an article titled "Where ESG fails", published in Institutional Investor. We are proud that Summa Equity was highlighted and recognized as a private equity firm that is integrating ESG in a way that is creating value. The authors conclude that the **traditional ESG approach has no impact on superior returns**. Today, many companies are struggling with integrating ESG into their investment process or portfolio companies, although investors and companies are broadcasting their strong focus on ESG and how they use the UN Sustainable Development Goals (SDGs) as their framework.

Our approach goes deeper and is embedded from the beginning of the investment analysis with themes from the SDGs; examining companies in terms of social, environmental and financial performance; developing a framework for sourcing; investing, developing and exiting companies; and expecting that all portfolio companies measure, manage and report on their impact on society.

We call our ownership framework "Via Summa" and it embeds sustainability throughout our entire value creation approach.

As an industry we need to set the standard and show real commitment, as opposed to "green washing" – which will not drive outperformance.

To outperform, there needs to be a positive and real long-term correlation between what the businesses do and their impact on externalities.

Summa was awarded several ESG prizes within Private Equity in 2019, and we are grateful that the industry is recognizing our efforts. But, while Porter and Serafeim believe in Summa's PE 4.0 approach, it will take some time for us to fully prove that our thesis is correct. The first results are positive.

We just did one of our first exits with EcoOnline, a leading European software company helping customers optimize safe handling of chemicals and ensure occupational safety. EcoOnline's performance, yielding over 50% yearly return, has been strong due to future-proofing of the company by strengthening the organization, investing in R&D, executing several add-on acquisitions to expand its services and geographic presence, and aligning the strategy with the UN Sustainable Development Goals (SDGs). The secular megatrends and tailwinds also drove the increase in valuation.

This reflects recent discussions with a couple of our investors who have informed us that the parts of their portfolio that clearly have negative impact on externalities are seeing lower returns. And we see that when companies align ESG and the SDGs that risks are mitigated and financial performance improved.

So, any ESG greenwashing or SDG rainbow-washing distract us from our real purpose of creating value. We will likely see an ESG bust, similar to the dot-com bust, unless we all succeed in creating positive impact on externalities as outlined in the SDG framework.

It is a sobering backdrop that **we only have ten years left to meet the SDGs**. The task at hand is big and growing: CO_2 emissions should have been reduced by 7.6%[1] in 2019 according to the Paris Agreement, but instead CO_2 emissions increased by 0.6%[2]. For the first time, the World Economic Forum's Annual Risks Report stated that all five of the most likely risks in 2020 were related to climate change and environmental degradation.

Although ten years seems like too little time to create the necessary substantial changes needed to improve our planet and society, fortunately, **we are seeing positive structural changes in the financial sector**. Change is happening faster than anticipated. To further accelerate the positive momentum, Summa has engaged with UNDP SDG Impact, which is an initiative that provides investors with insights and tools to align their investments with the SDGs.

It is when the business is aligned with the SDGs and addresses externalities that we will see growth, innovation, improved value chains and changing market behavior. This is why Summa "Invests to Solve Global Challenges", whether it is in health, in recycling, in food production, in energy usage, or in security.

Summa Summarum, while 2019 was the Year of ESG, we believe 2020 will be the Year of the SDGs.

Sincerely,

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[1] https://www.unenvironment.org/interactive/emissions-gap-report/2019/

[2] https://news.stanford.edu/2019/12/03/global-carbon-emission-increase/