KEYNOTE INTERVIEW

Food for thought

There is an opportunity to align closely with portfolio companies and investors to address global challenges such as food supply, climate change and poor health, say Kevin Schwartz, Renata Dinkelmann and Natalya Michaels at Paine Schwartz Partners

Q How closely aligned is the food and agribusiness sector to impact investing?

Kevin Schwartz: Of any industry, we believe food and agribusiness presents the greatest opportunity to simultaneously create value and drive positive impact through responsible investment practices.

Food supply is a critical global challenge, as current agricultural practices may be insufficient to feed the planet by 2050. Population growth, volatile supply dynamics, rising inflation and the situation in Ukraine have all exacerbated this issue. In addition, farming and food processing drive almost a third of the global carbon footprint, so there are many potential solutions that companies we invest in can develop to help manage climate change. This sector also touches other important issues such as health and nutrition, given that poor diet is the primary risk factor for deaths in most countries around the world.

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Our investment themes of productivity and sustainability, alongside health and wellness, were defined based on the opportunities associated with such challenges. As a result, they are squarely aligned with the UN Sustainable Development Goals, with SDG 2 – zero hunger – being the most notable example.

Our portfolio company Advanced Agrilytics, an agricultural consulting and data services provider for farmers, limits overuse of agricultural inputs, allowing its customers to use 20 percent less nitrogen per bushel of corn than the industry average. AgBiTech, meanwhile, provides an alternative to chemical insecticides, using a biological solution that allows farmers to control pests and reduce crop loss. AgroFresh provides solutions across the food supply chain to extend the shelf life of fresh apples, thereby reducing waste. These are just a few examples where there is alignment between the companies in which we invest and their impact on the global food chain.

Q What infrastructure do you have in place to help manage your efforts in ESG?

KS: We are aiming to maximise the impact of our thematic investment strategy through robust integration of ESG practices into all our processes, including firmwide governance, thematic alignment of our sourcing efforts, investment due diligence, value-creation strategies and the tracking of all of this information.

To govern the programme, we have created an ESG committee, which is a cross-functional group that includes representatives from the investment team, portfolio excellence platform, human capital, investor relations, legal and compliance. I head up that group and our role is to guide the overall prioritisation of ESG.

We have also increasingly adopted frameworks to identify SDG-aligned value propositions as part of our sourcing and diligence of new investments. Although we have always carried out ESG due diligence, we are transitioning from what has historically been a focus on risk mitigation toward something that is more focused on identifying opportunities to drive positive outcomes.

Monterey Mushrooms, for example, is a vertically integrated platform for mushroom genetics and production. The company has an incredible sustainability proposition across biotech, production and nutraceuticals, with a real opportunity for us to expand the scope of these benefits. First, the company produces nutritious and natural food products and is well-positioned to capture market growth driven by consumer demand for produce centred around health and wellness. Second, the company's genetics business is focused on increasing crop productivity through improved spawn quality that can reduce browning, and therefore waste, and also improve taste, which should increase the consumption of healthy products.

Even before we invested in the business, we had created an immediately actionable 100-day plan alongside our shareholder partners incorporating strategies to expand these sustainability advantages. We also have 12 specific ESG-focused initiatives to ensure best-in-class environmental health, food safety and labour practices.

Q What have you found to be the most effective ways to align on ESG with your management teams?

Renata Dinkelmann: For the first time in 2022, we set specific ESG goals at our portfolio companies as part of our annual budgeting process, including several sustainability and DE&I goals. Incentives to achieve these goals are aligned with up to 10 percent of total CEO compensation based on the successful execution of these goals.

We believe the delivery of these objectives is key to how we create value in our investments and want to ensure that our management teams and boards are aligned in that view. This method of ESG alignment is probably the most powerful tool we have implemented to date and has yielded the greatest results.

Not all the companies in which we invest have a fully developed ESG programme, of course, so our work will vary in scope. For a company that is less mature in its ESG evolution, the goals might be as simple as defining key areas for improvement and reporting on them consistently. For a company with products that are not immediately aligned with our views on sustainability or where it is a smaller part of the business, the goal might be to increase the percentage of its revenue base driven by sustainable or healthy products.

Q How do your sustainability practices match up with creating value at exit for your portfolio companies?

KS: Many buyers are attracted to productivity and sustainability benefits and initiatives beyond their impact on profit and loss. SNFL, a leader in the research and development, licensing and marketing of proprietary table grape varieties, is one example. We completed a partial realisation for this investment where the source of liquidity was EQT Future, an impact-driven fund. The fund's attraction to SNFL was not just the quality of the business, but also the role that the company plays in minimising the use of resources, specifically fungicides, in the production of table grapes.

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KEVIN SCHWARTZ

Some of the company-specific sustainability goals include reducing waste by a certain percentage; increasing the proportion of recycled packaging used; having a larger share of the R&D budget used for sustainable products; creating products that reduce greenhouse gas emissions or those that are biological replacements for typically chemically formulated products; or exploring industry resources to increase awareness of best practices. On the DE&I front, some examples of company-specific goals include adding at least one DE&I candidate to the board; focusing efforts to increase the number of diverse hires; and developing reporting tools to track diversity. In all cases, the goals are combined with tangible metrics that we can monitor over time.

Q How are those metrics determined and what form does the monitoring take?

RD: We help our portfolio companies establish KPIs that are specific to their goals. We have also established reporting requirements that are consistent among all our portfolio companies, such as greenhouse gas emissions, energy consumption, water usage, waste, employee safety and diversity.

Similar to how management teams report to their boards on progress towards their budget or hiring goals, our companies also report quarterly to their boards on their sustainability and DE&I goals. The objective is to ensure that, over our holding period, real measurable changes are made in terms of improving our sustainability and social impact footprint in ways that are consistent with driving returns.

Q How do you engage with investors on ESG?

Natalya Michaels: We believe that transparent and consistent reporting on ESG and DE&I factors is essential to driving results for our portfolio, as well as for our organisation. To that end, we engage with investors on a regular basis on this topic. This may involve completing detailed questionnaires on our current ESG practices, presenting to investor ESG committees, or sharing views on key sustainability challenges and trends across the food and agriculture industry. We have also made a priority of sharing progress on ESG goals at each portfolio company during our quarterly investor updates.

On an annual basis, we summarise our strategy and performance on all ESG-related topics in our Sustainability Report, now in its fifth year of publication. Each year, the reporting has grown deeper and broader and is shared publicly on our website. In addition to reporting on ESG performance, Paine Schwartz has also begun to track its own emissions and energy footprint, as well as internal diversity metrics.

Q What have you found to be the most effective ways to align with LPs on ESG?

NM: A lot of the progress we have made in our ESG practices has come from suggestions made by our investors. We try to have an open dialogue on this as part of LP due diligence where the learning goes in both directions. We also engage with investors on best practices for transparency and reporting.

We are proud to be involved with many important ESG organisations and initiatives. We have been a signatory to the Principles for Responsible Investment since April 2019, for example, and we became a signatory to the ILPA Diversity in Action initiative in 2022. We have conducted a gap analysis for formal alignment with the Task Force on Climate-related Financial Disclosures, which we are working towards closing, and we use Sustainability Accounting Standards Board guidance for the food and beverage industry to identify material ESG focus areas. We are also undergoing a gap analysis against the Global Reporting Initiative, which seeks to provide best practice for sustainability reporting around the world.

Additionally, we appreciate the engagement of our ESG and impact-orientated investors (a growing proportion of our LP base) and would love the opportunity to deepen the level of investor dialogue on this topic going forward. As a result, we are excited to introduce an LP Sustainability Council. With this group, we hope to create a forum to discuss best practices, emerging trends and key challenges on this topic. We recognise that we have the opportunity to influence not only Paine Schwartz, but also our portfolio, our LPs and the industry more broadly – this Council is one step in trying to accomplish that. ■

Kevin Schwartz is CEO of Paine Schwartz Partners, Renata Dinkelmann is head of human capital and Natalya Michaels is head of investor relations at the firm