MIDDLE MARKET

Growth

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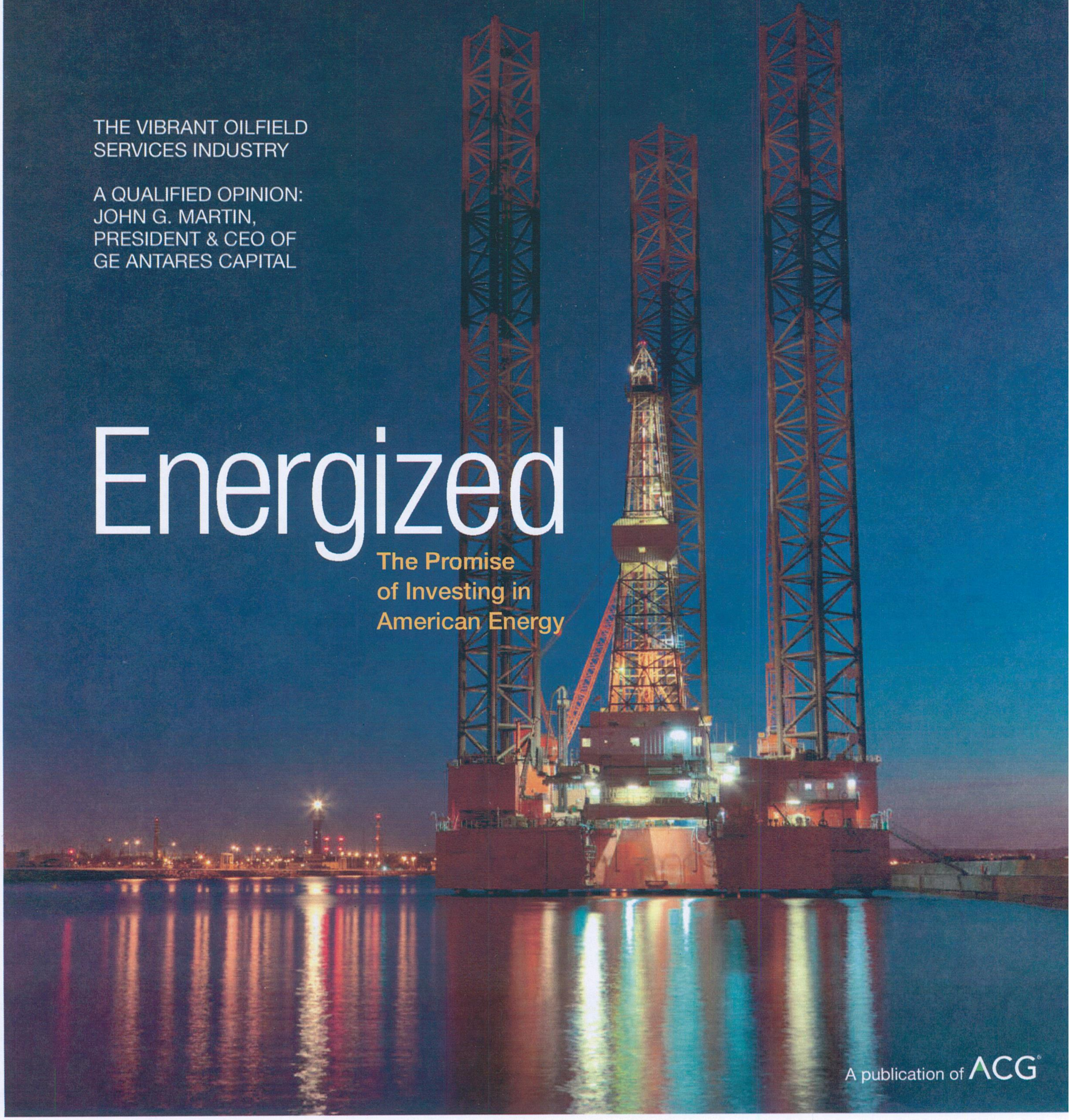

THE VIBRANT OILFIELD SERVICES INDUSTRY

A QUALIFIED OPINION: JOHN G. MARTIN, PRESIDENT & CEO OF GE ANTARES CAPITAL

Energized

The Promise of Investing in American Energy

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ENVIRONMENTAL RISKS

Pitfalls and Knowledge that Could Make or Break a Deal

What is environmental liability?

Environmental liability is the sum total of past, present and future costs of environmental damages associated with a property or business and is almost always an issue in manufacturing, chemical, energy and mining company transactions. In an M&A, the buyer is primarily concerned with exposures and costs post transaction. These become deal breakers when there is inadequate information or too much risk associated with the liabilities.

Can you give us a real-life example of where a company was made more profitable because of the work to assess the environmental liability?

One valuation that we led involved the Aleut Corporation and U.S. Navy at Adak Island, an important port and fueling station in Northern Alaska. The original clean up estimate of $1.5 billion was prohibitive: truly a deal breaker but not at first glance unreasonable, as the remediation involved 65 Superfund sites, 39 landfills, seven sediment cleanup sites, more than 450 other petroleum and hazardous waste sites, and 500 UXO sites. Our team of experts was able to consolidate and quantify the risks in a very granular valuation process. Our estimate came in at $200 million. This number was deemed reasonable and covered the costs and risks, making it possible for the deal to close at a fraction of the original estimate.

How can the findings of an environmental valuation hurt or help your brand?

Environmental liability itself is NEVER good for brand. Just think of any major oil spill and you know it costs millions, if not billions, of dollars in lost opportunity along with a PR and confidence crisis across stakeholders and shareholders. An environmental valuation will bring to light issues and data associated with short and longer term brand impacts. The valuation might reveal conditional NFAs (no further action) or closures that allow for only certain types of property usage that could be incompatible with acquirers brand. Alternatively, a company might use the valuation as a tool from which to negotiate a liability buyout or other way of cleansing the balance sheet thereby mitigating any risk of brand damage from environmental liability associated with the acquisition. The valuation could also be used in a positive way to preempt negative press by providing transparency and responsible accountability for risks associated with the liability. How a company handles its environmental liabilities is an important piece of a corporation's sustainability or environmental social and governance (ESG) platform, thereby having more impact on brand.

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THE ROUND

NEWS THAT MATTERS

How important is sustainability/greening to the health and profitability of businesses in the middle market?

The mid-market, with the exception of renewables and green energy companies, has been slower to adopt sustainability platforms and procedures than the large cap and global companies. Family office PEs might be the exception, as a number of them have embraced sustainable and green energy initiatives to reduce costs and increase profitability, especially those connected with logistics. Even so, there is increasing evidence that ESG issues are financially material and can significantly affect a corporate bottom line. With the advent of pension fund investment through private equity firms, where requirements for ESG investment by pensioners have trickled down, capital with ESG credentialing is often easier to obtain. In addition, acquisitions that have sustainability platforms can often expand their market share where B2B customers value knowing that suppliers have completed product life-cycle analyses and published under Global Reporting Initiative. Private equity firms such as KKR, Carlyle and TPG are integrating ESG risk and opportunity valuation into their assessments of the firms. We think this is a growing trend. Regulation and push/pull up and down the supply chain will be the catalysts and barometers for increased focus on sustainability.

What verticals use environmental liability to build a strategy around valuation? Is this crucial for every deal during the due diligence process?

It is not so much the "dirty industry verticals" as the companies or M&A teams with good environmental management and top-notch environmental advisers that glean strategic advantage in the due diligence and negotiation process. This is because the environmental liability on the balance sheets and reported in SEC filings represents a loose estimate by the seller and could be biased or not inclusive of significant issues or risks. From this perspective, including an accurate third-party valuation of environmental liability is indeed crucial in the due diligence process. //

—**Jeff Andrilenas** is environmental lead and **Frances Schlosstein** is president, both of the TBLS Group.