RI *Spotlight*
SEPTEMBER 2022

Sustainability in the supply chain

Triton

Triton at a glance

Founded in
1997

Professionals accross
12 offices

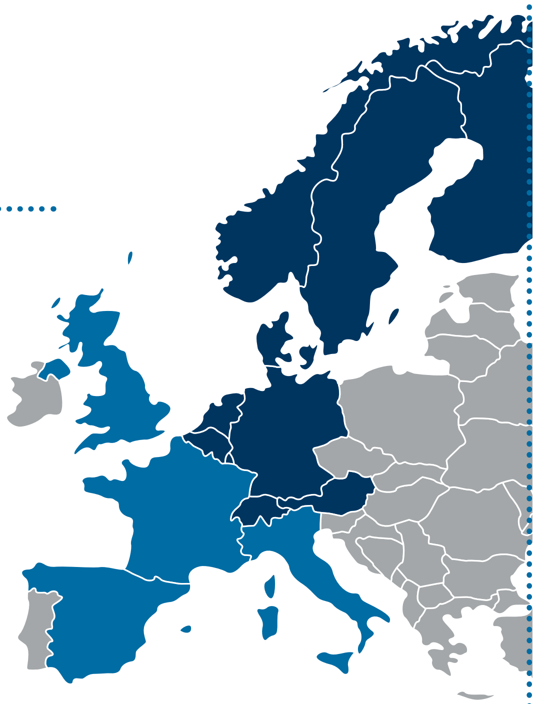
Integrated operating & specialist teams

€16 billion
raised since inception

190+
institutional investors

130+
Investment and operating professionals across four sector teams

30+
Specialists supporting value creation throughout the investment life cycle



Portfolio companies

90+
Investments since inception

450+
Add-on acquisitions completed

€18 billion+
Combined portfolio revenues

100,000+
Full-time employees at portfolio companies

Core Triton sectors

- Services
- Industrial Tech
- Consumer
- Healthcare

Strategies

Capital raised

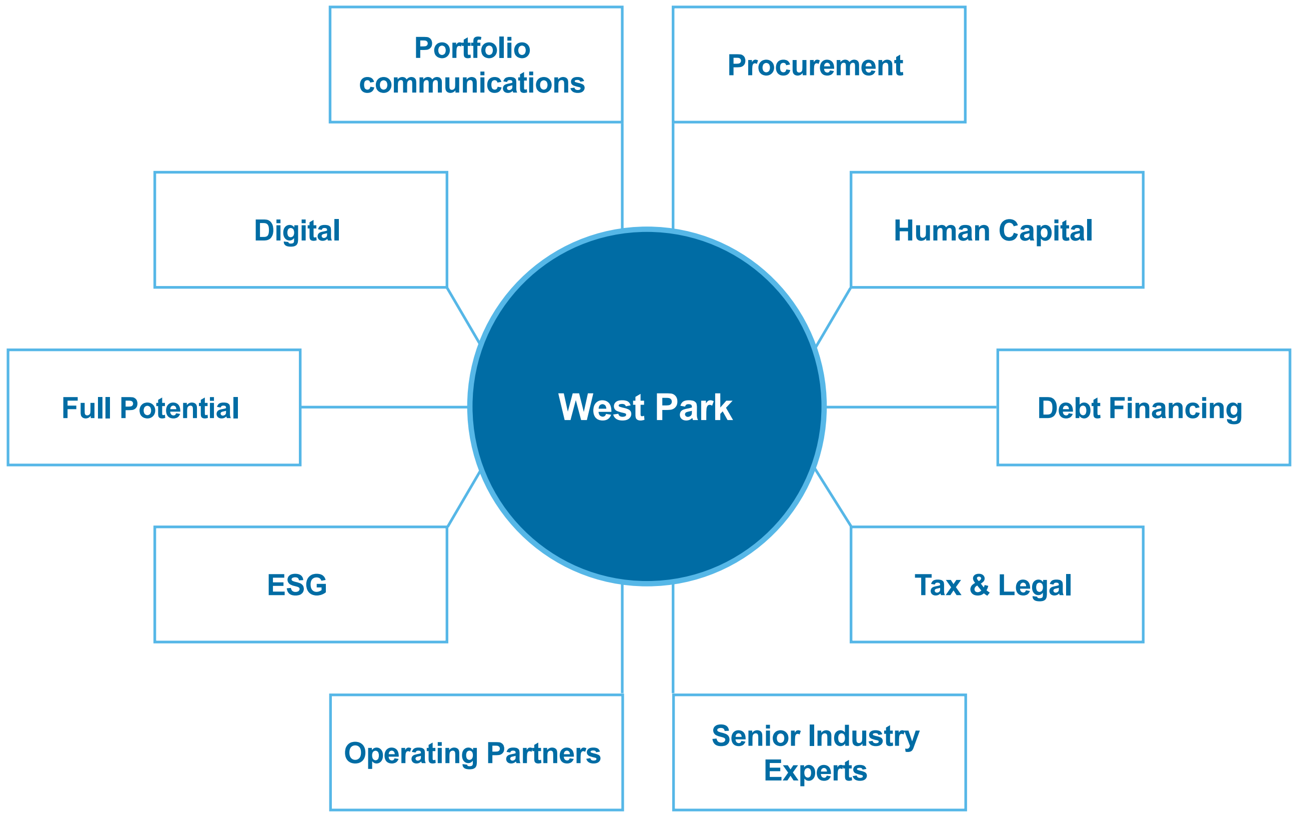
€13.2bn
Mid-Market PE

€1.3bn
Smaller Mid-Market PE

€1.5bn
Credit

Triton and its portfolio companies benefit from West Park and the services provided by it. Since its formation in 2007, West Park has become a core part of Triton's "Building Better Businesses" strategy and approach. West Park is able to provide a range of value-adding services to support the investment process and Portfolio Companies that would otherwise be provided by third parties.

Through West Park, the Investment Team has access to a pool of more than 80 professionals bringing a range of skills including deep industry and operating expertise, as well as functional specialisms such as digital, ESG, debt financing, and procurement capabilities. West Park professionals advise on and provide insights into strategic, operational, and commercial due diligence; structuring and financing advice on potential investments; consulting services such as ESG, Human Capital and Digital as well as tax, structuring, and legal support. West Park professionals can also support and advise on sourcing, network activity, and sector work.



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Welcome from our Managing Partners

Peder Prahl
CEO & Managing Partner

Martin Huth
Managing Partner

No company operates in isolation. For every business activity - whether it is in extraction, processing, assemblage, manufacturing or services - other companies are involved in the supply chain.

In the past, the responsibility companies have had for how responsibly their supply chain partners operate has been limited. But this is rapidly changing. In today's world, the focus on who businesses choose to partner with is increasing, for their raw materials, auxiliary services, production at different stages of the value chain, and distribution. And the pressure from consumers, regulators and investors, in this regard, is growing.

"Future-proofing supply chains by collaborating with suppliers can reduce costs, increase productivity, and help companies to innovate and address rapidly changing customer expectations."

The risks to businesses are real. In the listed world, where ESG risks have resided with supply chain partners and problems have emerged, this has caused material, multi-year difficulties for some of the world's largest companies. Across many sectors, it has led to accusations of poor management of supply chain risks. While facing less public scrutiny than these global megacap companies, private companies and their investors face similar risks.

Pressures on supply chain resilience are also growing. Both the pandemic and the Ukraine crisis have shown how supply and distribution networks can be severely disrupted, see rapid price escalation, or even cease. International trade agreements can improve, or roll back, access to goods and services. In some cases, supply chains may get shorter and more localised. All of these factors increase the pressure on our portfolio companies to ensure that they have robust approaches to procurement in place. It also means potentially carrying out more frequent supplier due diligence, as existing chains fracture and new procurement pathways are required.

At Triton, we are active managers of supply chain risks.

Triton requires its portfolio companies to consider supply chains within their ESG management systems. The optimal approach sees companies implement a consistent set of actions across to improve management of their supply chains. This can include training of procurement employees, integration of ESG into the supplier engagement process, measurement of KPIs and implementation of improvement actions.

On page 6, we outline how we require portfolio companies to set supply-chain policies which include a range of ESG topics, including bribery, forced labour, and safety. Another key focus is seeking clarity on whether ESG issues are considered in due diligence, onboarding and audits of suppliers, and supporting portfolio companies to meet the requirements of new laws on supply chain management.

You can email us at:
esg@triton-partners.com

Supply chains in the Responsible Investment Framework

"Companies must be alert to longstanding and nascent risks in their supply chains. Whether from disruption in commodity markets, high carbon footprints or human rights abuses, the risks to business activities can trickle up. That is why we work with our portfolio companies to help manage their supply chain risks and establish resilient procurement frameworks."

Helmut Safar,
Triton Head of Procurement

In 2021, Triton focussed particularly on sustainable supply chain practices, and it will continue to be a focus in 2022. We supported our portfolio companies ("PCs") with workshops focussed on supply chain due diligence assessments, enabling identification of risks and opportunities, such as shifts to more sustainable materials, and outlining best practices in procurement sustainability. We also supported PCs with third-party software to manage supply chain reporting, such as measuring PC Scope 3 (supply chain emissions). In 2022, Triton continues to support its PCs to meet the requirements of new laws and expectations on supply chain management.

Triton requires its PCs to consider supply chains within their ESG management systems. Each PC will implement a consistent set of actions across its entire organisation to improve ESG management in the supply chain. This can include training of procurement employees, integration of ESG into the supplier engagement process, measurement of KPIs, and implementation of improvement actions. To allow Triton to help manage these actions, PCs must report on the following items under the annual ESG reporting regime:

1. Do you have a group-wide supply chain policy in place?

2. Which ESG topics are included in your supply chain policy?

- compliance with all laws
- bribery and corruption
- conflicts of interest
- information security
- reasonable working hours
- child labour
- forced labour
- fair wages
- collective bargaining
- health and safety
- reducing / managing environmental impact
- other: please state

3. Do you have a group-wide supply chain programme in place?

4. Are ESG issues considered as part of the following?

- supplier due diligence
- supplier onboarding
- supplier audits
- supplier performance assessment

Triton supports PCs in developing their business partner policy, which covers areas including compliance with legal requirements; anti-bribery and corruption; ethics and integrity; equal opportunity and human rights; and the environment. Triton also informs and encourages PCs in managing their supply chains by participating in multi-sectoral standards, such as Ecovadis and SEDEX.

Given the increased scrutiny on supply chain management from stakeholders and authorities, Triton will, in future, require more focus on supply chain sustainability, as it considers important factors such as biodiversity, climate change, and resource protection.

There are many supply chain sustainability factors which companies must face

Climate change
Greenhouse gas emissions, caused by burning fossil fuels for energy and in other industrial and agricultural processes, are classified into three 'scopes' – Scope 1 (direct), Scope 2 (via procured power), Scope 3 (supply chain). The focus on companies' Scopes 2 and 3 is increasing.

Environmental impacts
Environmental risks in supply chains may involve water use and pollution; air and soil pollution; deforestation; and loss of biodiversity.

Poor risk management in the local environment by supply chain partners can bring major problems for suppliers. For example, the 2010 Macondo oil spill resulted in both a loss of life and massive oil spill in the Gulf of Mexico, leading to significant damage to the marine ecosystem. British energy company BP plc, owned the well. Although energy service companies carried out much of the operations, it bore much of the responsibility to remediate and, as a result, lost licences-to-operate and faced considerable financial downside.

Human rights and labour
Workers have varying levels of protection from unfair working conditions, in different countries around the world.

US apparel company The Gap, faced considerable reputational and operational challenges when child labour was found in factories producing its goods in 2004. In 2010, US technology giant Apple Inc, faced huge pressures when a spate of suicides occurred at the largest manufacturer of its products, the Foxxconn Longhua plant in China. It was reported that suicide notes and survivors told of immense stress, low pay, long workdays and harsh managers.

Given such occurrences, it is perhaps unsurprising that new supply chain laws are focussing on human rights.

Safety
Companies may be held accountable by stakeholders when loss of life occurs at suppliers.

The 2013 Rana Plaza disaster in Bangladesh, in which a garment factory collapsed killing over 1,100 workers, led to widespread criticism of Western fashion brands for their management of employee safety down their supply chains.

Meanwhile, other drivers emerge...

Energy security
All companies need energy in some format, but the energy intensity of revenues varies, making certain activities much more susceptible to market price volatility.

The economic recovery from the pandemic and the Ukraine crisis have driven raw commodities and power prices sharply upwards. Many companies will face margin pressures as a result and may choose to invest in alternative energies and efficiency solutions.

Technology
As regulations increase and companies face pressure from their customers and investors, the requirements to track supply chain goods in a robust, verifiable, and transparent manner will grow.

This can be complex, but technology will provide some of the solutions. Sensors, cameras, and satellite imagery can prove that, for instance, a specific ecosystem is being damaged to provide raw materials. Chips and radio frequency identification tags and readers can show chain-of-custody from producer to customer.

Controversial and sanctioned jurisdictions
Hostile actions from countries may lead to counter-actions from governments across the globe. These may include economic response strategies, including sanctioning regimes.

Where companies source from a country that becomes a sanctioned state, alternative suppliers may need to be found, and sometimes very quickly to ensure business continuity.

Some products themselves may be banned from certain jurisdictions, even if the country itself is not sanctioned – for instance, 'conflict minerals' can fund insurgent movements and buyers may need to source from other geographies.

Biodiversity
We are dependent on biodiversity in many ways – for food, materials and medicines. Yet human activity has depleted nature dramatically in recent decades.

Regulators and investors, are now increasingly seeking to ensure economic activities are carried out in ways that minimise their footprint on nature and ecosystems. This applies to supply chains, including procurement of timber, wild foods including fish, and minerals.

The emergence of regulation

Regulation of sustainability risk in supply chains is increasing. Worldwide there are numerous laws relating to supply chains – Canada's Supply Chain Transparency Act, the US Trade Facilitation and Trade Enforcement Act, the Dutch Child Labour Due Diligence Law, the French Corporate Duty of Vigilance Law, and Norway's Transparency Act, to name a few prominent examples.

Companies operating in Germany face new rules from next year under the German Supply Chain Due Diligence Act, which focus on direct suppliers. The EU is set to follow soon after, with rules covering entire supply chains. Germany has focussed on human rights abuses in supply chains, with the EU broadening from here to also capture environmental considerations.

Germany leads the way

In March 2021, the German cabinet passed the Supply Chain Act (*Lieferkettengesetz*). This ground-breaking legislation obliges German companies to ensure compliance with a comprehensive list of human rights and environmental requirements across their entire global supply chains. This includes health, forced labour, collective bargaining, and environment-related obligations.

This will come into force from 1 January 2023 for companies with over 3,000 employees, and 1 January 2024 for businesses with over 1,000 employees. The extent and speed of the required management response is determined by the level of potential impact. Businesses will therefore need to conduct analysis to determine how to manage the risks. Where risks are detected, the Act requires the appointment of a human rights officer who must report annually to management, and provide ongoing compliance management and transparent public reporting – typically on their websites.

Where violations occur, fines can reach EUR 800k, and for larger companies (with annual turnover of over EUR 400m), up to 2% of turnover. Businesses can also be excluded from public procurement processes.

It should be noted that companies implementing the EU Conflict Minerals Regulation or EU-CSR Directive are likely already in compliance.

EU takes a broader focus

The European Union's Corporate Sustainability Due Diligence Directive was proposed on 23 February 2022 and requires "a corporate due diligence duty on large EU and third-country companies, and smaller companies in certain 'high-risk' sectors, to identify and take steps to remedy actual, and prevent or mitigate, potential adverse impacts on human rights and the environment in the companies' own operations, and their subsidiaries and value chains."

It will apply to EU entities with over 500 employees and net worldwide turnover of over EUR 150m; or over 250 employees and net worldwide turnover of over EUR 40m, where half of turnover is from high impact sectors, including textiles, leather, agriculture, fisheries, food, metals, and minerals. It also applies to non-EU entities with net worldwide turnover of over EUR 150m, or net worldwide turnover of over EUR 40m (where half of turnover is from high impact sectors).

The main requirements under the proposed directive include establishment of due diligence processes and policies covering human rights and the environment, which are proportionate and commensurate to the risk of adverse impacts; provision of a grievance mechanism and remediation process; public disclosure and reporting; and new directors duties and personal liability regarding the management of such diligence.

The Directive is currently with the European Parliament and Council for approval. It would come into force two years after such an approval. Governments will have power to request information, investigate, and apply turnover-based fines and potentially other orders, including injunctions to cease trading.

International trade as sustainability lever

Companies may, via international trade agreements, find expanded markets in which to source and sell. However, new business activity can bring new risks, meaning enhanced monitoring and management systems are necessary to mitigate risks.

On one hand, greater global trade and economic activity may intensify natural resource extraction. On the other hand, trade policy may help promote climate measures and ecosystem protection, enhance environmental cooperation between countries, and reform subsidies that are harmful to nature.

Indeed, trade agreements are increasingly incorporating climate and broader environmental concerns. 110 trade agreements, signed over 1947 to 2018, include provisions to maintain the existing level of environmental protection, while 70 deals include commitments to increase the level of environmental protection. 28 deals also include pledges by parties to conduct environmental impact assessments of the trade agreement itself.

Such agreements should help to mitigate supply chain environmental risks, although companies must still be vigilant.

How Triton PCs are embedding sustainability in their supply chains

Triton portfolio companies are already actively managing their supply chain risks. These companies operate in a wide variety of subsectors and business activities, with footprints across numerous geographies, meaning risks can be disparate. Equally, some disruption, such as from energy prices and climate change, can be worldwide in nature. We believe the key to resilient procurement lies within management of this combination of local and global risks, with overarching policies that show commonality and specificity, and allow agility where events necessitate.

Kelvion

Claus von Hermann
Managing Partner

Kelvion operates in the industrial heat exchanger market. Headquartered in Bochum, Germany, the company has more than 20 manufacturing locations across the globe and c5,000 employees. The company provides solutions for critical applications in various end markets, including power generation; oil and gas; chemical industry; marine; climate and environment; as well as food and beverages.

Sustainability is increasingly important for the company. Its stated ambition is to design, manufacture and install heat exchangers with the lowest possible impact on the environment and human capital. To achieve this, the company's ESG Committee is setting the strategy; defining targets; assessing risks and opportunities; and is monitoring progress accordingly. Kelvion has increased its focus on its supply chain over the past two years, incorporating an emphasis on sustainable procurement covering supplier questionnaires, supplier codes of conduct, adherence to the modern slavery act, data collection enhancement, and digitalisation.

Kelvion is currently undergoing a compliance screening of its suppliers, covering 393 key suppliers across 25 countries. The intention is to fully align results with the German supply chain law, and later with the proposed EU legislation. Kelvion will also use the process iteratively, with learnings paving the way for new procurement processes.

WERNERCO™

Ruth Linz
Co-head of the Consumer team

WernerCo provides safe access solutions, including fall protection equipment and secure storage systems, operating as a collective of 10 different brands globally. It has manufacturing; warehousing; sales and distribution facilities; and offices in the United States, Mexico, Canada, Australia, China, Philippines, France, Germany, Hungary, and the United Kingdom.

The company sees procurement as a value creation driver, and actively seeks competitive advantage through supply chain management. It achieves this by focussing on four pillars: cost alignment, innovation, risk management (including ensuring continuous supply of materials through market disruption and supplier monitoring), and business intelligence. The company has set up rapid response teams to target issues where they arise. These teams focus on deviations, substitutions, supplier qualifications, and material qualifications across the business.

Driving supply chain resilience across our business

The pressures that companies face to responsibly manage risks in their supply chain are growing. The pandemic and the Ukraine crisis have shown how supply and distribution networks can be severely disrupted, see rapid price escalation or even cease.

Helmut Safar, Triton's Head of Global Procurement, spoke with Ashim Paun, Triton's Head of Sustainable Investing, about the importance of actively driving resilience in procurement and supply chain management.

Ashim Paun
Head of Sustainable Investing

Helmut Safar
Head of Global Procurement

AP: It seems apparent that this is a fast-growing area of focus for companies such as Triton. Where do you see the impetus originating from?

HS: Regulators, consumers and investors increasingly seek robust evidence that social and environmental risks in supply chains are actively managed. As consciousness around sustainability has grown, and frameworks such as the UN SDGs[1] have brought definition and targets, stakeholders demand that companies are responsible not only for their own operational footprint, but also for those along their supply chains. And so trading partners up and down value chains are compelled to make this a focus too.

One of our portfolio companies, the Norwegian office seating and furniture maker, Flokk, has a supplier evaluation process covering competitiveness, delivery performance, quality performance and on-site appraisals, which focus on environment and social responsibility. Suppliers to Flokk must meet compliance standards over time, with annual re-evaluations and selection from a population of suppliers driven by these factors.

AP: Triton is a growing company, with increasingly more employees and assets under management. Where do you see Triton's exposure to supply chain risks?

HS: The majority of Triton's own supply chain is with professional or business services suppliers. Indirect impacts sit with portfolio companies and are more diverse in nature.

For example, those PCs with larger energy footprints must now manage soaring electricity and fossil fuel input costs. Triton works with PCs to optimise procurement, and also encourages consideration of the economics of investments in energy efficiency solutions, where the 'payback time' has reduced against the higher commodity price backdrop.

AP: More efficient use of energy can also bring down a company's carbon footprint – how important is the environment in procurement?

HS: A focus on indirect emissions, (Scope 2) and also on supply chain emissions, (Scope 3), are other recent evolutions in sustainable procurement.

While regulation looks mainly at Scope 1 emissions (through directly burning fossil fuels), many stakeholders are focussing also on their supply chain carbon footprints.

An example of a PC now focussed on its Scope 2 and 3 emissions is Talis, a leading European provider of water flow solutions, headquartered in Southern Germany. Talis collects data from supply chain partners on their emissions and has engaged a consultancy to help assess its emission footprint. KPIs covering reduction of supply chain emissions are being built into procurement processes and decisions. The company is also offsetting some supplier emissions, namely those generated via sea freight from China and India.

AP: At Triton, we believe that more sustainable companies will be perceived as more valuable enterprises – de-risked and aligned with global standards and trends. Do supply chain management processes affect external perceptions of a company?

HS: Resilient procurement means less disruption risk in the supply chain and less chance of a scandal, due to human rights, safety flaws or environmental damage. This in turn means that revenues and profits are better protected – naturally, this creates more attractive and valuable businesses.

In addition, rating agencies are increasingly incorporating supply chain sustainability in their assessments, considering policies to address and meet requirements, action plans to implement policies and KPIs to measure progress.

AP: Supply chains can be complex, and transparency is key to building trust. As we look forward, what role will technological innovation play in driving greater sustainability?

HS: Whether it is production of gold, tungsten and other minerals in central Africa, or hardwoods from forested regions of the tropics, or grain commodities from sanctioned regimes, regulations will increasingly compel companies to track the origin of their supplied materials and goods.

Tracking can be complex, but technological solutions to this are advancing fast. New technologies, such as RFID (radio frequency identification), helps give confidence to our portfolio companies that their suppliers are acting responsibly and within laws. For some products and materials, sensor technologies and cameras can play a role in showing local conditions over periods of operation.

At Triton, we think technology will be key to the future of sustainable procurement. In addition to benefiting our operations, it may also throw up investment opportunities in this new frontier of industrial technology.

[1] United Nations Sustainable Development Goals: https://sdgs.un.org/goals

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