KEYNOTE INTERVIEW

Finding value through an ESG lens

Being systematic on the 'S' in ESG will help firms identify opportunities and build resilience, says Blue Wolf Capital's Adam Blumenthal

New York-based Blue Wolf Capital, which has a portfolio made up largely of healthcare services and industrial companies, found itself on the frontline of the covid-19 pandemic in the early months of 2020.

Adam Blumenthal, founder and managing partner, tells *Private Equity International* that the firm's long-term focus on environmental, social and governance factors was fundamental to its ability to cope with the pressures brought by covid-19.

Meanwhile, Blue Wolf's attention to the 'S' in ESG is at the heart of its strategy to unlock value as it prepares for life after the pandemic.

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Q How has Blue Wolf been affected by covid-19 and how has it responded to the pandemic?

Due to the healthcare services aspect of our investment portfolio, we were aware of the likely impact of covid-19 very early. That insight meant we were able to educate our employees and put in place support across the portfolio to maintain safe workplaces and behaviours at our companies.

Through our longstanding Safety, Health and Environmental programme, we already had infrastructure in place that allowed us to not only roll out best practices but also to encourage broad cross-portfolio engagement of resources – which was necessary, because all our portfolio companies continued operating throughout the pandemic. All of them were deemed essential. We had to keep going and remain safely operational, despite the disruption.

Whether it was on the healthcare or the industrials side of the portfolio, we witnessed the heroism of frontline workers as they met the needs of society in the pandemic. We have a group of outpatient healthcare facilities that operate in areas of New York that were at the centre of the pandemic. Everyone around the world saw what was happening in Brooklyn. We had urgent care centres there, and people kept coming into work every day in the midst of covid-19, and had their workload increase.

The only good news is that now we have a year of experience on how you manage in a pandemic at a high-performance level, while keeping people safe and meeting society's needs. We are far better prepared to do that today than we were a year ago.

Q Blue Wolf has been focusing on ESG for many years; how did that contribute to the resiliency of its portfolio when covid-19 arrived?

We have always had a focus, portfolio-wide, on managing human capital and on employee health and safety. We think that engagement with our employees is an important driver of business success, and we have formal governance systems to ensure our portfolio companies are doing that – that is getting onto the 'G' in ESG. You need a governance process. Without the 'G', it just does not happen. You need to know what you are doing and measure it through board committees.

We have used the 'G' features of ESG to put in place supports for the 'S'. Having emphasised employee health and safety at the board and C-suite level for many years, when the crisis hit we did not have any questions about what our priorities would be or need to invent any new tools. If there are no questions about priorities and if you have the tools, it is easy for people to do the right thing.

We were able to track covid-19 infection rates across the portfolio and we found that less than 5 percent of our employees who contracted covid-19 were infected at work. We were able to demonstrate that if you are focused on providing people with a safe place to work and with the tools and the education to work safely, then it can be done. We are extremely proud of our work to make that happen.

Q The pandemic has highlighted inequalities in the US healthcare system. What is Blue Wolf doing to address these?

The American healthcare system is well known for its inefficiency. Although the US has some of the best healthcare in the world at the highest level, on average it provides lower-quality outcomes at a higher cost than in many other developed nations. Closing that gap is a driver of value.

Blue Wolf's approach to healthcare can be summarised by something called the Triple Aim – having better health, at a lower cost, with a higher level of patient satisfaction. We believe that the way to tell if you are creating value in American healthcare is whether your strategy is delivering on the Triple Aim. That has led us to embrace distributed home and community-based services that improve population health.

An example of this is portfolio company FOX Rehabilitation, which provides home-based physical therapies to a geriatric population. We have been putting physical therapists – with adequate PPE and testing – into the homes of 80 or 90-year-olds during lockdown. We help keep these people healthy, even though their mobility is restrained. We have great partnerships with assisted living facilities and senior citizen advocacy groups, because we can deliver the care where it is not happening otherwise.

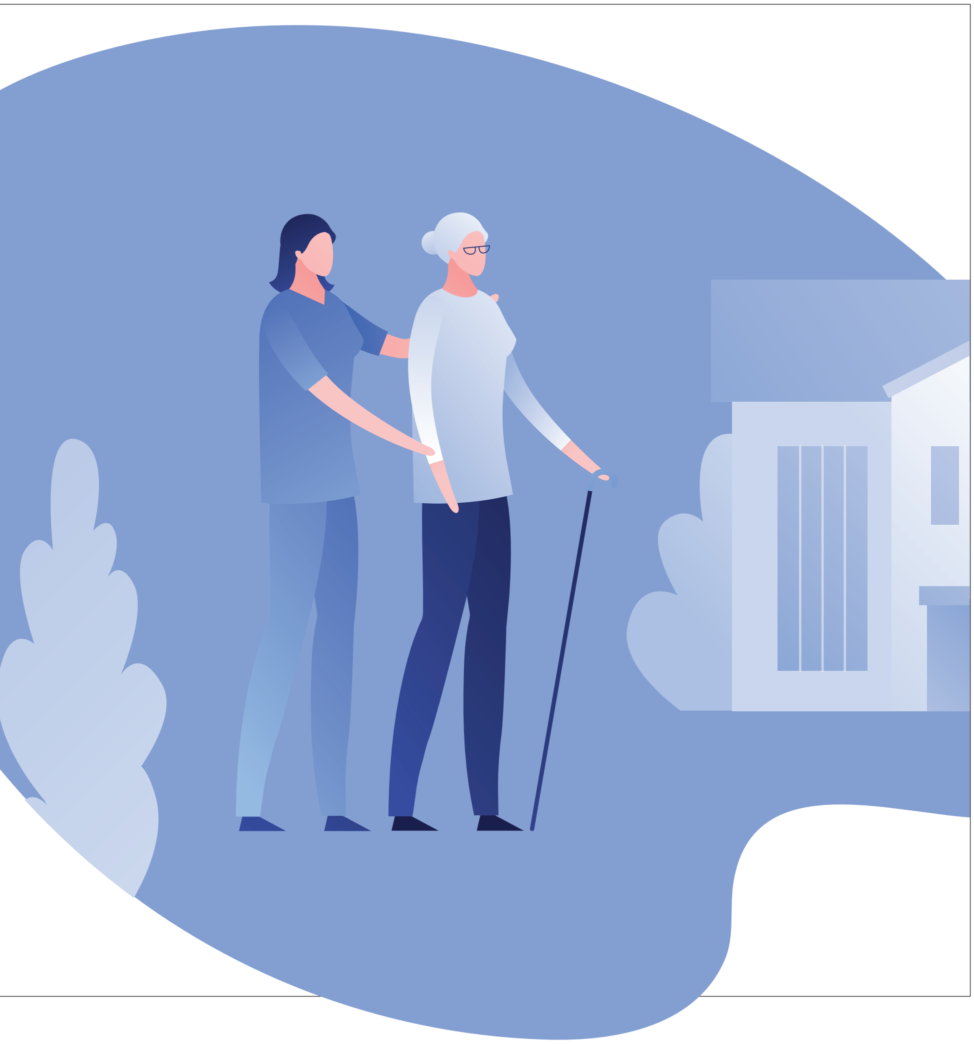
We think that the way to lose money in healthcare over the next decade is to provide high-cost luxury services. The way to generate value for society and for investors is to use the Triple Aim to provide quality outcomes at a lower cost, in the way that the rest of the world has proved it is possible to do. Since the pandemic, valuation multiples on home-based and community-based care have increased dramatically. Covid-19 has made it clear that they are a critical piece of creating value in the system.

Q 2020 exposed various social problems in the US. Can private equity investment help neglected communities while delivering returns?

With some of our industrial investments, we are the largest employer in small towns in America. We have operated sawmills in Dixie County, Florida, and Glenwood, Arkansas; paper mills in Madawaska, Maine. When we make an investment in a place like that, the advantage we have is that we are the only private equity company around. Because we are off the beaten path, typically, we can invest at valuations that are quite compelling.

We use ESG as a lens to find value creation opportunities. The fact that there is a lack of investment capital in these areas creates the opportunity to acquire attractive assets at low values. You get talented people, low-cost inputs and do not have a lot of competition.

However, it is not an anonymous world in Glenwood, Arkansas – your plant manager is going to have breakfast at the same café as the janitor. When you are operating in that environment, you need to be a community partner if you are going to be an employer of choice for the most talented people in the community. We view that as a business strategy as well as the way businesses need to behave.



> *"We have used the 'G' features of ESG to put in place supports for the 'S'"*

Q Does this approach extend to partnering with your workforces?

We have successfully invested in unionised companies since our inception as a firm. In a regulated environment, like healthcare, working collaboratively with unions is important. We approach our relationship with unions the same way we do with sources of financing or customers, and over 15 years, we have conducted ourselves so that we have a relationship of trust with unions. We negotiate hard for business success, but we tell people the truth and we recognise that unions and their workforces have a vested interest in the success of the company.

The result has been that we see investment opportunities that other people do not, because unions will call us and say: "Hey, we've got a problem at this company, is there a way you can buy this and fix it?" Usually we can't – but when we can, that is a really remarkable piece of off-market dealflow.

Q Will disruption to supply chains during covid-19 encourage investment in US manufacturing?

In our mind, it is about balance. American business followed a model of outsourcing to low-wage economies for many years that created structural risk within their supply chains. What is happening now is not a 180 degree turn from there, but companies are acknowledging the risks and investing to mitigate them. It is tragic that it took a pandemic for people to recognise that risk. We have been trying to mitigate it for many years. For example, we bought a building products company in 2016 and invested in domestic manufacturing to make sure we can always meet short-term demand. We want to have that kind of balanced, robust, resilient supply chain.

Q What are the main lessons from the past year? Can interest in ESG be sustained?

ESG is a lens for value creation – it forces you to see things that others don't, in ways that others don't. I believe the private equity community is serious about embracing this approach.

As an investor, you have to see problems that become evident today as opportunities to invest for the future. Certainly, the pandemic has highlighted problems in our society and economy, ranging from the vulnerability of our supply chains, to the quality of our public health infrastructure. At the same time, operating in the pandemic has made clear there is room for innovation to address those problems. The pandemic has taught many people how to operate in a safe and systematic way – that is an innovation that has been broadly accepted throughout our economy. ■