Taskforce on Climate-related Financial Disclosures Report 2022

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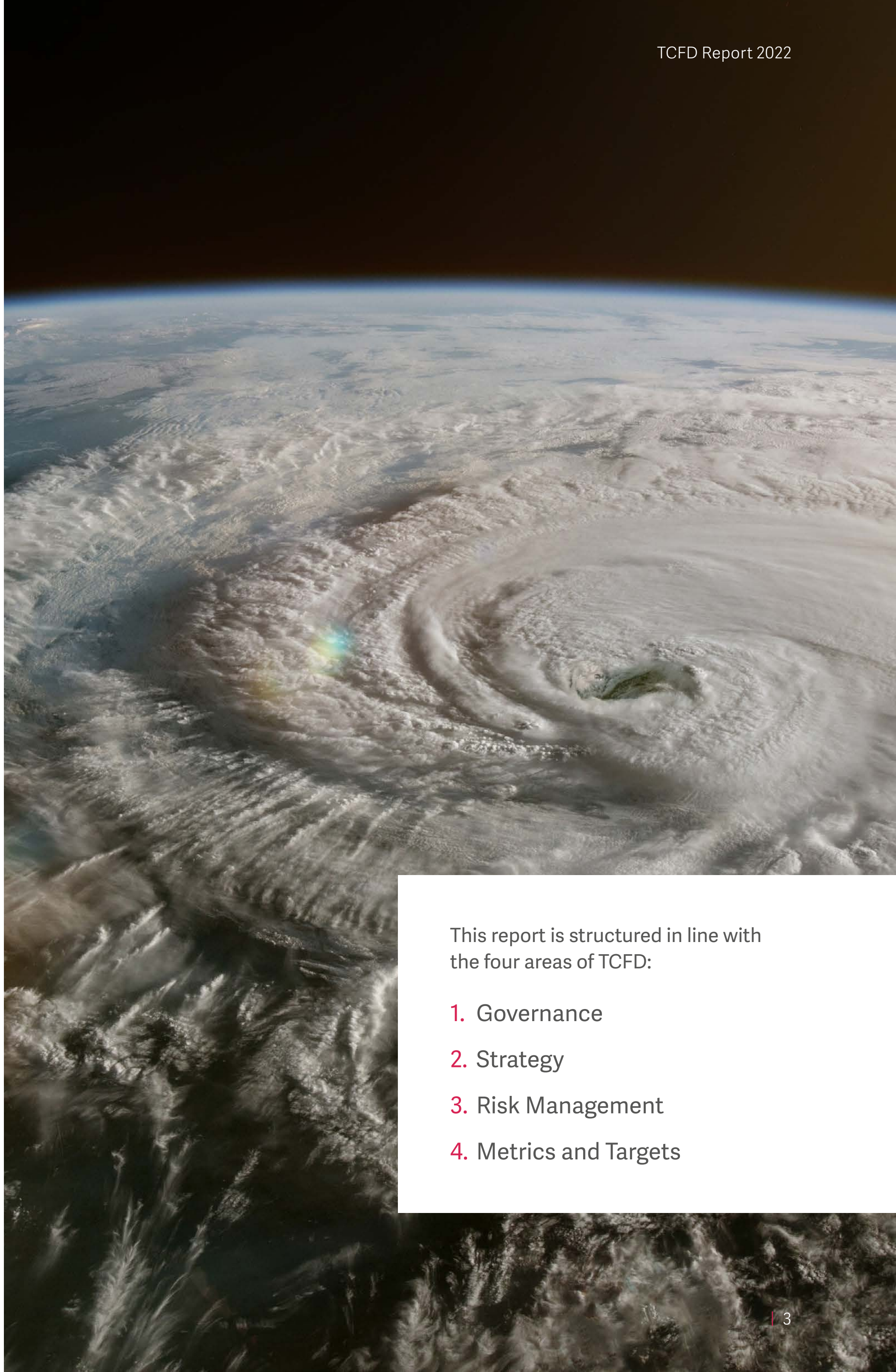
Hg recognises the major challenges that the world is facing due to climate change. Slowing the rate of global warming over the next ten years is crucial for the future of our planet. There is more carbon dioxide in our atmosphere today than at any time in human history[1], average wildlife populations have dropped by 60% in just over 40 years[2] and scientists warn of "severe, widespread and irreversible" climate change effects unless emissions reach net zero by 2030[3]. Without radical action, our lives – including our resources, economies and businesses – are going to be profoundly impacted.

In this context, governments, industries, and companies are being urged to take steps to prepare, reduce risks, and take advantage of any opportunities that might arise from climate change. Hg is acting too, and we take our responsibility to be part of the change seriously.

We believe that by understanding and managing the emerging risks and opportunities that arise from climate change we can enhance our investment decisions. We are measuring our carbon footprint and working with our portfolio companies to increase their understanding of, and resilience to, climate change. By seeking a controlling stake in most of our investments, we can make an active contribution in supporting portfolio companies to promote positive environmental and social change.

In this second voluntary TCFD report, we expect to contribute to the disclosure of clear, comparable, and consistent information about the risks and opportunities presented by climate change. We hope to continue sharing our learnings and challenges with our peers and stakeholders, so that we can collectively achieve the goal of limiting global warming to 1.5 degrees Celsius, compared to pre-industrial levels.



This report is structured in line with the four areas of TCFD:

1. Governance
2. Strategy
3. Risk Management
4. Metrics and Targets

[1] The National Oceanic and Atmospheric Administration (NOAA)
[2] World Wide Fund for Nature (WWF)
[3] Intergovernmental Panel on Climate Change (IPCC)

Governance

Hg's ESG team leads the implementation of the ESG strategy and Hg's Audit and Risk Committee, reporting to our Board. It reviews climate change issues on a regular basis.

Hg has established Board oversight for our ESG approach and activities. In particular, the Hg Board reviews our Responsible Investment policy, firm-level carbon emissions report, carbon offsetting initiative and our commitment to the Science Based Targets initiative. Climate change forms part of Hg's quarterly risk management process which is conducted by our Audit and Risk Committee reporting to Hg's Board.

We believe it is important to have dedicated in-house ESG expertise with deep knowledge on ESG topics, including climate change. As such, Hg's ESG team reviews and monitors climate-related issues and collaborates with the deal teams and legal teams to provide expertise during the investment process. Hg's Chief Sustainability Officer, who is leading our ESG team, reports to our Head of Portfolio Value Creation and works closely with our Head of Portfolio Value Creation and CFO to define our ESG strategy, including our approach to climate change and actions for implementation.

We recognise that it is crucial to collaborate on climate change to drive change globally, and in particular across the private equity ("PE") industry, where many portfolio companies are not large and mature enough to meet the thresholds for mandatory carbon reporting. In 2020, Hg became a launch member of the UK network of Initiative Climat International (iCI), a global organisation with over 200 PE firms that join forces to advance the industry's commitment to tackling climate change. The group works together to define a variety of tools, methodologies, and standards to enable climate change action, whether that is on how to measure and report on carbon emissions across their funds, or how to set credible carbon reduction targets. As part of this, Hg worked with a number of other PE firms in the NetZero iCI working group, the World Resources Institute (WRI) and the Science Based Targets initiative (SBTi) to develop a guidance document for how PE firms can set and commit to science-based targets with the ultimate goal to be Net Zero by 2050. Hg is also part of the Carbon Footprint working group and the European iCI Operating Committee.

In November 2021, Hg became one of the first seven PE firms globally to get approved Science Based Targets, setting an example for the rest of the PE industry. The Science Base Target initiative (SBTi) is one of the most rigorous frameworks on how to set emissions reduction targets grounded in climate science which will keep global temperature increases within 1.5°C compared to pre-industrial temperature levels.

As part of our commitment to drive change across the investment industry, we have also joined to the NetZero Asset Managers (NZAM) initiative, an international network of over 270 asset managers with a combined AUM of $61.3 trillion committed to supporting the goal of net zero greenhouse gas emissions by 2050 or sooner. To support the acceleration of climate change action across governments we also signed the 2021 Global Investor Statement to Governments on the Climate Crisis.

Sharing knowledge and collaborating with our peers is fundamental to advance on climate action. We report publicly on our progress via our TCFD report, annual RI report and UNPRI submission.

Strategy

Understanding and managing climate-related risks and opportunities based on TCFD's recommendations is a fundamental part of our ESG Strategy.

Hg recognises that identifying climate-related risks and opportunities is fundamental in a sustainable transition to a low-carbon economy. Thus, we have identified different elements that shape our climate change strategy:

Scope

Geography

Hg primarily seeks controlling equity buyout investments in businesses headquartered predominately in Northern Europe and North America. In our risk assessment, we consider geographical location as one of the criteria for identifying and mitigating climate-related risks and opportunities.

Sectors

Hg specialises in the software and services sector, which generally has lower financial risks related to climate change compared to other sectors that rely on energy-intensive manufacturing processes or sourcing raw materials with complex supply chains. Software and services are generally considered lower-risk, less carbon-intensive, sectors, with the exception of software companies with sizeable data centres.

Climate risk scenarios

We assess our portfolio companies' climate-related risks based on a 2-degree scenario aligned with the Paris Agreement and a 4-degree scenario aligned with the World Bank's study on the risks of a 4-degree warmer world. We seek to understand how resilient our portfolio companies are, by identifying how adequate their policies and processes are to face potential transition and physical risks.

Timeframe

As a private equity firm, our typical hold period is between 3-5 years, but it can sometimes go beyond that. We recognise that climate change has a longer-term impact than our investment timeline. Our climate change risk assessment covers risks and opportunities at the portfolio level until 2030, which is the timeframe that most externally recognised climate risk frameworks currently align to.

Potential impact

We consider the impact of climate change on our portfolio companies' operations and strategies and assess risks from an operational and a supply chain perspective, including any data centres. We prioritise managing those risks that can have the greatest impact in our investment and ESG strategies but also work on improving the climate resilience of investments across our broad portfolio. We will report on climate change risks to investors in our annual client ESG reports.

Firm level strategy

At the firm level, we have made significant progress in measuring and managing our carbon footprint in the past years. Since 2018, we have worked with an external party to be certified as a carbon-neutral company and offset our emissions through projects contributing to delivering on the Sustainable Development Goals. In 2022, we achieved firm-level carbon-neutral status for the fourth consecutive year.

To help reduce our footprint, we have a number of firm-wide initiatives, including energy reduction projects and procuring renewable energy. Our footprint also takes homeworking into account, though currently most of our carbon reduction initiatives are relating to the office environment as we acknowledge that directing similar initiatives in a private, residential context is more complex.

Acre Amazonian Rainforest project

Once again in 2020/21 Hg was certified as a carbon neutral by offsetting our carbon emissions through the Acre Amazonian Rainforest project which prevents deforestation and promotes sustainable economic livelihoods in the Brazilian Amazon. This is an externally verified natural climate solutions project focusing on forest conservation (REDD+) in line with the CCB, VCS standards.

With the support of carbon finance, the project supports local communities to create models of economic development, to prevent deforestation and protect the ecosystem. The project aims to deliver on seven of the 17 Sustainable Development Goals:

1 NO POVERTY

2 ZERO HUNGER

3 GOOD HEALTH AND WELL-BEING

15 LIFE ON LAND

More information on Acre Amazonian Rainforest project: https://www.naturalcapitalpartners.com/projects/project/acre-amazonian-rainforest-conservation.

Risk Management

At Hg, climate change is covered across the investment process – from screening to ownership.

Throughout the investment process we focus on two main categories of climate-related risks:

- **Transition risks,** arising from the shift to a lower-carbon economy, which include policy and legal risks, technology risks, market risks, and reputational risks.
- **Physical risks,** arising from a changing climate, which include acute risks (such as extreme weather-related events), and chronic risks (such as sea-level rise).

Our climate change risk assessment, conducted as part of portfolio company onboarding, highlights if and where these risks occur and considers how resilient each portfolio company is in managing any potential risks.

The investment process

Climate change risk is considered across our investment process, from screening to active ownership:

Screening

Hg's exclusion list clearly states that we do not invest in companies in sectors that are considered high-risk from a climate risk perspective. Our focus is on software and services companies. Our investment strategy and exclusion list prevents us from investing in companies that are principally engaged in the manufacture and trade of coal, burning of fossil fuels or in the extraction of geological materials.

Due diligence

Our ESG team leads the pre-investment ESG due diligence (DD) in close collaboration with our legal and investment teams. This covers six key metrics related to climate change: (i) climate change risk management; (ii) business continuity plans; (iii) carbon footprinting; (iv) energy audits; (v) renewable energy consumption; and (vi) carbon reduction targets. Due to the sectors in which Hg operates, it is rare that we come across any climate change risks that would prevent us from investing in a business.

Onboarding

We take an active approach to manage ESG risks and opportunities during ownership. This starts with an ESG onboarding and maturity assessment against our Sustainable Business framework to identify areas for improvement, where Hg can support portfolio companies to realise their ambitions within and beyond our ESG framework. *Please see our RI policy for further details about our ESG assessment.*

As part of our engagement with portfolio companies on ESG, we conduct a climate change risk assessment covering transition risks and physical risks, under a 2-degree and a 4-degree scenario. Our climate change risk tool has been developed in conjunction with PwC's Sustainability & Climate Change team. It is specifically tailored to capture climate change risks presented by software and services companies and takes externally recognised methodologies and indices into account. The tool considers the sector and geographical location of each company, as well as its exposure to, and preparedness to address climate change risk. In addition, we work with our portfolio companies on an annual basis to calculate their carbon footprints. Our onboarding assessments and annual carbon footprint measurements allow us to prioritise our efforts on ESG during the investment period. The outputs from our assessments are shared with the Board members of each portfolio company.

Ownership

Our portfolio team works with the management of our businesses to focus on a set of operational levers which are key to their performance, including cybersecurity, data analytics, growth, legal, transformation, technology, ESG, and talent. Within ESG, we support our companies to enhance their practices around climate change data, risk mitigation strategies, procedures and reporting practices. Each company reports formally to Hg on climate-related issues at least annually. By providing both strategic and practical support to portfolio companies, as well as facilitating the active collaboration across our portfolio, we aim to help reduce risks and create maximum value for shareholders.

"PwC was delighted to work with Hg to develop a climate change risk screening tool helping them to identify key risks and opportunities in the sectors and geographies where Hg invests. Key considerations in the software and services sector are policy risks associated with energy consumption including carbon pricing mechanisms and regulation to improve energy efficiency. The tool helps bring these risks to life by providing context via impact pathways and resilience questionnaires."

- PwC

Metrics and Targets

We believe robust data is fundamental to better understand and manage climate-related risks and opportunities. We are constantly working on improving data quality both at the firm level, as well as for our portfolio companies.

Science Based Targets

As Hg is committed to driving action on climate change, we have set targets for the carbon footprints of Hg and our portfolio which is in line with SBTi's guidance for PE firms. The targets cover the portfolio companies where Hg has more than 25% ownership stake and at least one Board seat. Hg's long-term goal is to be NetZero by 2050 and our Science Based Targets (SBTs) – approved by the SBTi – set out the plan for how we will get there:

Hg's own Scope 1 and 2 emissions:
50% reduction by 2030 on a FY20 baseline[4]

Hg's Scope 3 financed emissions:
26% of our invested capital will be covered by SBTs by 2026

Hg's Scope 3 financed emissions:
50% of our invested capital will be covered by SBTs by 2030

Hg's Scope 3 financed emissions:
100% of our invested capital will be covered by SBTs by 2040

[4] Baseline set as our carbon footprint covering 2019/20 (1 April 2019 – 31 March 2020).

Firm-level carbon neutrality

In 2022, Hg was recertified as a carbon neutral company for the fourth year, as we continue to offset our firm-level carbon emissions. Together with an external consultancy, we assess our GHG emissions using the GHG Protocol Standard. Our scope includes relevant categories of the GHG Protocol, including metrics such as water, wastewater, energy, waste management, business travel, hotel stays, staff-commuting, and more recently home working and procured IT Equipment.

In our last financial year, we saw our carbon footprint increase five-fold, driven mainly by the return to work and business travel post-pandemic. At the same time, our business has grown. Our headcount increased by around 37% to 299 employees, and our Funds Under Management (FUM) grew by 33%. Our carbon footprint per employee consequently increased from 1.3 to 5.1 tCO2e / employee and our footprint per billion dollars of FUM increased by a multiple of 4 from 9.4 to 37.0 tCO2e. Our scope 1 and 2 emissions (31.5 tCO2e) decreased by a significant 73% this year, well below pre-pandemic levels, largely due to our move towards using renewable energy in our London office.

Despite our footprint being higher than last year we have still decreased our absolute footprint by 32% from our baseline year in 2019/20. Our footprint per employee has also decreased from 11.2 tCO2e in 2019/20 to 5.1 tCO2e in 2021/22. We are slowing heading in the right direction and decreasing our footprint, even though we are higher compared to pandemic levels.

By measuring, reducing and offsetting our carbon footprint, we aim to do our part in tackling the global climate emergency, whilst also supporting sustainable development in local communities. However, we recognise that offsetting is not the optimum solution, and we must work towards achieving reductions in our absolute emissions. As such, we are constantly working across our offices to reduce our energy consumption.

We have set firm-level targets for our scope 1 and 2 emissions, in line with the SBTi, to reduce absolute scope 1 and 2 GHG emissions 50% by 2030 from a 2019/20 base year. We aim to meet these targets and further reduce our footprint by decreasing our electricity and gas consumption and switching to renewable energy sources. Opposite is an overview of Hg's firm-level carbon footprint (excluding investments).

	2018/19	2019/20	2020/21	2021/22	% Change from baseline year (19/20)
Scope 1 – Direct emissions	51	38	19	5	-86%
Scope 2 – Indirect electricity emissions	195	119	94	26	-78%
Scope 3 – Other indirect emissions	1410	2093	178	1487	-29%
Total	1656	2249	291	1519	-32%
# of employees	161	201	218	299	+49%
tCO_2e / employee	10.3	11.2	1.3	5.1	-54%
FUM ($bn)	12.5	18.5	31.0	41.1	+122%
tCO_2e / $bn FUM	132.5	121.6	9.4	37.0	-70%

You can find further details in our 2020/21 carbon footprint report.

https://hgcapital.com/wp-content/uploads/2021/09/Hg-Carbon-Footprint-2020-2021-Report-Final.pdf

Updated link to come

Our investments

Since 2021, we have been using an online solution to collect and calculate scope 1, 2 and 3 carbon footprints across our portfolio companies. If a company has already calculated a carbon footprint by themselves, they report the final data to Hg, but if they have not done such calculation Hg helps the portfolio company to calculate a footprint based on their activity data, along with potential estimates, for the GHG scope 3 categories that are most relevant for technology and service businesses. This includes:

- Scope 1
  (diesel or petrol used for owned vehicles, kWh mains gas)
- Scope 2
  (kWh electricity consumed at offices or owned data centres, renewable electricity procured or produced, kWh from heating and cooling)
- Scope 3
  (emissions from business travel and hotel stays, emissions from cloud service providers, data centre usage, emissions from working from home and employee commuting, purchased IT equipment, waste and water consumption).

Hg's carbon reporting solution then calculates the carbon emissions of each of the above activities using emissions factors from relevant sources (Defra, AIB, etc).

Hg encourages portfolio companies to get their footprints externally validated as Hg does not independently audit the source data. The data in this report has not been audited and, due to the nature of the metrics, there may be some variation between actual and reported numbers. We have aligned to the PCAF data quality hierarchy and seek to continue to improve the quality of data collected, with a preference for activity data over estimates.

The emissions from the calendar year are shared with portfolio companies through a dashboard and normalised to enable them to benchmark their carbon footprint against other companies in the portfolio. To compare and benchmark carbon emissions across the portfolio, we have normalised emissions by number of employees and compared by fund and investment cluster to better account for the difference in company size and business operations. In the limited cases where activity data was unavailable (e.g., kWh for energy use from landlords) we have estimated the data using square footage or the number of employees, as recommended by the GHG protocol.

We conducted our second portfolio carbon footprint assessment in 2022, covering 2021 data. Below are estimates of the scope 1 and 2 emissions from our portfolio companies. Please note, the absolute emissions for portfolio companies were not audited by Hg or externally validated. Below emissions intensity metrics were calculated in line with TCFD recommendations for asset managers.[5] The emissions calculated below cover 60% of our investments, by value.

	2021	
	Scope 1	Scope 2
Absolute emissions (tCO2 e)	11,167	42,397
Financed emissions (tCO2 e)	4,173	19,914
Carbon intensity (tCO2 e / $m revenue)	0.5	2.3
Weighted average carbon intensity (tCO2 e / $m revenue)	0.9	3.2
Carbon footprint (tCO2 e / $m portfolio value)	3.9	0.8

[5] https://www.fsb.org/wp-content/uploads/P141021-4.pdf

For our second assessment in 2022, our focus was on improving data quality on scope 3 emissions, recognising that the highest source of a company's emissions is often scope 3. For software companies this largely resides in data centres which use large amounts of electricity to process and store data. As part of our partnerships with some of the world's largest cloud service providers, we are working with these players to raise awareness across our portfolio companies and provide tools to help them calculate the footprints that are arising from data centre usage.

In addition to supporting our portfolio companies to calculate their carbon footprints, we encourage them to focus on their emissions hotspots, identify opportunities for carbon reduction, as well as set interim and long-term targets. This active engagement approach helps to futureproof our portfolio companies against upcoming GHG reporting regulations and stakeholder expectations in both the public and private sector. We also anticipate potentially increasing profitability and benefits from cost savings through operational efficiency measures, as well as improving credibility and reputation among stakeholders.

We constantly try to improve in this space and are committed to provide an update towards our commitments at least annually to the public and our clients via our external RI reports.

If you have any questions about the content of this report, please contact **ESG@hgcapital.com**