

Strengthening Portfolio Companies through ESG

How Ares Management is scaling energy projects across its private equity portfolio.

“EDF Climate Corps has helped illustrate that reducing your environmental footprint and providing meaningful dollar savings can occur simultaneously without compromising important considerations such as the customer experience or required returns on invested capital.”

*Caroline Zouloumian,
Managing Director, Head of
ESG at Ares*

Doing Well by Doing Good

In late 2012, [Ares Management, L.P. \(Ares\)](#), a publicly traded, leading global alternative asset manager, hired Caroline Zouloumian to lead the development of a firm-wide environmental, social and governance (ESG) program tailored to each of Ares’ three investment groups: Private Equity, Credit and Real Estate.

Within its Private Equity Group (PEG), Ares had a history of successfully investing in leading companies with attractive growth profiles, in part, due to its long-standing strategy of collaboratively creating value with portfolio company management. Zouloumian knew that ESG value-creation initiatives could fit into this framework; however, certain challenges would need to be overcome. These challenges included the need for topical expertise, the lack of procedural precedent for undertaking these types of projects and the complexities associated with having diverse industries, growth trajectories and competing priorities across Ares’ portfolio of companies.

Outsourcing to consultants was an option but would require a significant financial commitment and could be viewed as non-collaborative or disruptive to existing operations. Having explored several alternatives, Zouloumian vetted and ultimately chose EDF Climate Corps, a summer fellowship program that embeds trained, custom-matched graduate students inside leading organizations to accelerate clean energy projects and strategy.

Smart & Final, a warehouse grocery chain that operates more than 250 stores, became the first portfolio company to host an [EDF Climate Corps](#) fellow. After proving to be successful, Zouloumian has since introduced and guided several other PEG portfolio companies through the EDF Climate Corps program, including Floor & Decor, a retailer in the hard surface flooring market, and Guitar Center, the world’s largest instrument retailer.

Smart & Final 2013: Ensuring an Initial Win

In the summer of 2013, EDF matched [Michael Sciortino](#) to Smart & Final. Sciortino's main task for the summer was to analyze a pilot LED retrofit for refrigerator display case lighting at 37 stores and expand the analysis to determine the advisability of a company-wide rollout.

The stakes were high. Success would create a positive feedback loop that would encourage other Ares portfolio companies to participate in ESG initiatives. To ensure success, Zouloumian remained involved in the collaboration from the initial sign-up process and throughout the summer, providing the fellow with weekly check-ins and guidance.

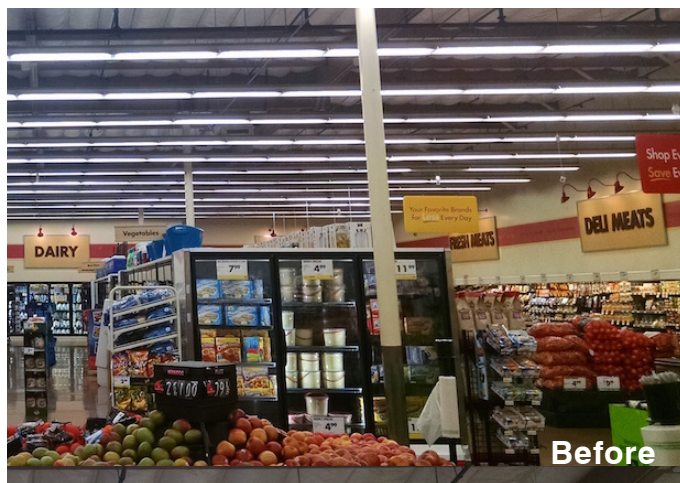
At the time, although Smart & Final was installing LED fixtures in refrigerator display cases as part of new store builds and remodels, the majority of its existing stores were still using fluorescent lamps. While the initial cost of the LEDs was higher than that of existing lighting, the LED lamps were three to four times more efficient. In addition, many utilities were offering rebates for the LED installs, which would further reduce capital costs.

After gathering the relevant data and analyzing the associated financial costs and benefits, Sciortino found that for an initial 37-store rollout, the annual savings would be approximately \$150,000, representing a 35 percent first-year return on investment (ROI). Over the lifetime of the LEDs, given Smart & Final's store operating hours, the cumulative nominal savings would be over \$1 million. A retrofit of an additional 117 stores would yield annual savings of \$500,000+ with similar ROIs.

At the end of his summer fellowship, Sciortino presented his final recommendations to relevant stakeholders from Smart & Final and Ares. The project was approved and implemented at the initial 37 stores by the end of 2013. The remaining stores are being retrofit during scheduled remodels. Smart & Final has since successfully implemented LED retrofits for sales floor lighting as well, building upon its successful experience with refrigerator display case lighting retrofits.

Floor & Decor 2014 and 2015: A Scalable Solution

The following summer, Floor & Decor, another Ares PEG portfolio company, decided to host an EDF Climate Corps fellow of their own. In 2014, with similar weekly guidance from Zouloumian, Tatyana Brown analyzed the potential of retrofitting sales floor lighting with LEDs at six existing Floor & Decor stores.



Store lighting at a Smart & Final location before and after an LED retrofit.

Floor & Decor ultimately installed LED lighting in a total of 37 stores, 33 new stores and four existing stores.

Brown also identified and evaluated the financial returns of purchasing increased efficiency HVAC units for all new stores as well as ways to reduce the amount of heated/cooled air that escapes through service doors during operations for both existing and new stores. On a combined basis, Brown's analysis of these projects uncovered over \$650,000 in annual energy cost savings at an initial capital cost of approximately \$1 million, resulting in a sub-two-year payback with a 60+ percent initial ROI. Floor & Decor has since used high-efficiency HVAC units in all new stores and has made numerous HVAC replacements in existing stores.

A year later, Floor & Decor elected to participate in the fellowship again, this time looking beyond the "low-hanging fruit". The 2015 fellow, Ahmed Ahmad, looked into potential savings from installing energy management systems (EMS) within existing stores. With a payback period of only one year, this proved to be a smart business investment. Due to the

Tips for Successful Energy Efficiency Projects

In reviewing their experiences, participants at Ares and its portfolio companies identified the following key items:

- **Crunch the Numbers.** Not all projects are created equal, so choose a project that has meaningful absolute dollar savings and ROIs to create positive future momentum.
- **Ensure buy-in.** Consult with relevant stakeholders – financial analysis may not be the only factor affecting decisions.
- **Make it easy.** Present the most compelling options even though multiple projects and scenarios have been analyzed.
- **Vendors matter.** Some will go the extra mile to ensure accuracy of projected savings and high service levels.
- **Roll up your sleeves and keep your eyes open.** A simple facility walk-through with an observant eye can help identify meaningful and potentially replicable projects.
- **Ask around and be open to suggestions.** Employees often have great project ideas, but may lack required resources.

project's level of sophistication, Ahmad collaborated with various EMS vendors to assist in determining both the quantitative and qualitative differences in available systems.

Since this initial analysis, Floor & Decor installed EMS in over 70 stores.

“After completing the RFP process and selecting a provider, we presented the project to the C-suite and expected to hear a response indicating a number of stores to pilot the project. We were pleased to hear that the executives wanted to know how quickly we could get the EMS units installed in every store.”

Michael Meek, Manager, Facilities Maintenance and Energy, Floor & Decor

Guitar Center 2015 and 2016: Generating More Wins

The third portfolio company to sign up for EDF Climate Corps was Guitar Center. In 2015, [Spencer Middleton](#) joined Guitar Center to help identify and evaluate cost-effective ways to reduce energy consumption in the company's 280+ retail store base.

By analyzing energy data from Guitar Center's facilities, Middleton identified several stores in California, representing both the most and least energy-intensive locations, for more detailed energy audits. California was chosen due to the large concentration of Guitar Center stores as well as the higher cost of energy and resulting cost-reduction opportunity compared to other states.

Through store visits and interviews with facilities' staff, Middleton determined that a LED retrofit of T8 florescent lighting would provide compelling returns. He estimated that an LED pilot retrofit of just one store in California could save \$14,000 annually at an implementation cost of about \$30,000, resulting in almost a two-year payback and nearly 50 percent first-year ROI. In 2016, Guitar Center completed the pilot LED retrofit in one of its California stores, with initial results exceeding projected savings. Seeing this success, LED

retrofits have since been completed for 12 additional California-based stores and more are planned for the future.

After success with Middleton's recommendations, the following year Guitar Center welcomed another fellow, [Linh Tran](#), into its operations to look for opportunities beyond lighting. After visiting store locations and conducting interviews with facilities staff and HVAC contractors, Tran identified opportunities to gain energy and financial savings by installing variable frequency drives (VFDs) and replacing older HVAC units. She found that installing VFDs in certain stores would yield a payback of less than two years and over 60% first-year ROI.

Guitar Center is exploring the implementation of HVAC-related projects through existing and other service-providers.

“Crunching the numbers and proving out the financial ROI for various projects was a great value-add, but, perhaps more important, our EDF Climate Corps fellows brought increased awareness of new ways to drive energy-efficiency related value within our organization.”

Darcy Higa, Director, Sourcing and Procurement, Guitar Center

Continuous Improvement: Challenges Ahead

For Zouloumian, the collaboration with portfolio companies and the weekly guidance calls with each of the fellows, including detailed review and assistance with final project deliverables, has become a standard and key practice for each fellowship. This three-pronged team effort between the company, the fellow and Ares helps capitalize on lessons learned from previous EDF Climate Corps summers and provides an opportunity to leverage Zouloumian's background as a former private equity investment professional. The result has been greenlit projects within Ares' portfolio companies for all five fellows. Taken together, the annual metric ton carbon reduction impact

and energy cost savings identified by the 2013 through 2016 engagements exceeds 8,000 and \$2.5 million respectively, with a weighted average 50+ percent first year ROI.

Despite the positive results of the EDF Climate Corps to date, Zouloumian is aware that continued success will depend on the ability to tackle projects that extend beyond the “low-hanging fruit.”

Challenge #1: Transitioning to Implementation

Entering the implementation phase can be a difficult task given already busy facilities managers who are usually tasked with moving projects forward. To help ease this process, Zouloumian finds it critical that greater emphasis be put on accumulating and sharing both qualified vendor resources and information between portfolio companies, resulting in a more streamlined implementation process.

Challenge #2: Beyond the Low-Hanging Fruit

As companies incorporate the easily quantifiable and less complex projects, opportunities to find greater savings will arise around more sophisticated energy improvement initiatives. Tackling these larger challenges will require similar partnerships and collaboration with knowledgeable stakeholders to ensure success.



Guitar Center's recent pilot LED retrofit showed initial results exceeding projected savings.

About Ares Management

Ares is a publicly traded, leading global alternative asset manager with approximately \$104 billion of assets under management as of June 30, 2017. The firm is headquartered in Los Angeles with offices across the United States, Europe, Asia and Australia. Its common units are traded on the New York Stock Exchange under the ticker symbol “ARES”.

About EDF Climate Corps

EDF Climate Corps embeds trained graduate students in organizations to help meet their energy goals by accelerating clean energy projects in their facilities. In just one summer, fellows get clean energy projects on the fast track to accomplishment – improving the organization's bottom line and environmental impact at the same time.