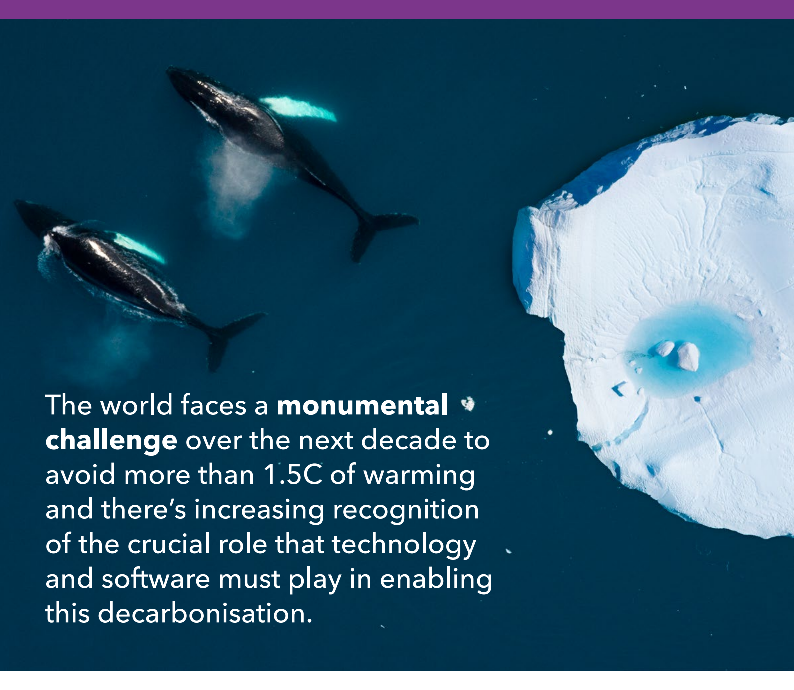
Investing in Winners

Climate Accounting Software



The world faces a **monumental challenge** over the next decade to avoid more than 1.5C of warming and there's increasing recognition of the crucial role that technology and software must play in enabling this decarbonisation.

Climate Accounting Software exists to help companies measure and reduce their carbon emissions in a streamlined and automated way.

Climate Accounting Software tackles a fundamental challenge: how to identify, assemble, and synthetise the data required to estimate a company's carbon footprint. A group of emerging providers have made great headway in solving this challenge but there is still a long way to go.

Adoption tailwinds are strong: sustainability is on top of most large businesses' agenda, with internal and external stakeholders expecting enhanced scrutiny on environmental impact. The ability to accurately measure emissions, analytically plan their reduction, and credibly measure and report on progress becomes a strategic requirement.

It is already clear that the best Climate Accounting Software players are going to be very successful businesses. Venture investors have been active in the space for some time (we tracked over $400m of VC investment in climate accounting last year). The category is growing and maturing; and we believe that progressive PE investors are right to be thinking about it carefully as an investment theme in the months and years ahead.

> In this note we have sought to identify the drivers of success for the best Climate Accounting Software businesses – and hence to help pick winners from the dozens of players that exist in the US and Europe.

Defining Climate Accounting Software

Climate Accounting Software helps companies to track, manage, report and offset their carbon emissions.

These solutions tend to be deployed at a corporate / company-wide level, rather than a site or product level, providing a way for companies to understand and manage their GHG emissions holistically. Though some solutions support the monitoring and management of ESG metrics more broadly, climate is usually the focus, with tons of CO_2e being the primary metric tracked.

CLIMATE ACCOUNTING SOFTWARE OVERVIEW

Track	Manage	Report	Offset
• Creates centralised hub of ESG-related data through manual data imports and integrations with key data systems (including transactional ERP systems). • Uses this data to calculate a company's full carbon footprint to understand the size and composition of their emissions.	• Dashboard to understand the key sources of emissions and these trends over time. • Benchmark emission performance vs similar companies in other industries. • Set targets and run scenarios to understand likely development of emission profile based on certain actions.	• Tools to help companies report emissions both internally and externally and comply with key regulations in an auditable, recognised and standardised way. • Data can be connected to sustainability reporting workflows to increase reporting speed and accuracy.	• Automatically connect customers with decarbonisation and offsetting programmes, either via trusted partners or by providing marketplaces of carbon negative projects to invest in.

How much carbon do I emit? | How are my emissions relative to my peers? | Am I on track hit my emissions targets? | How do I report my emissions to stakeholders? | What actions can I take to decarbonise / offset my emissions?

Market **attractiveness**

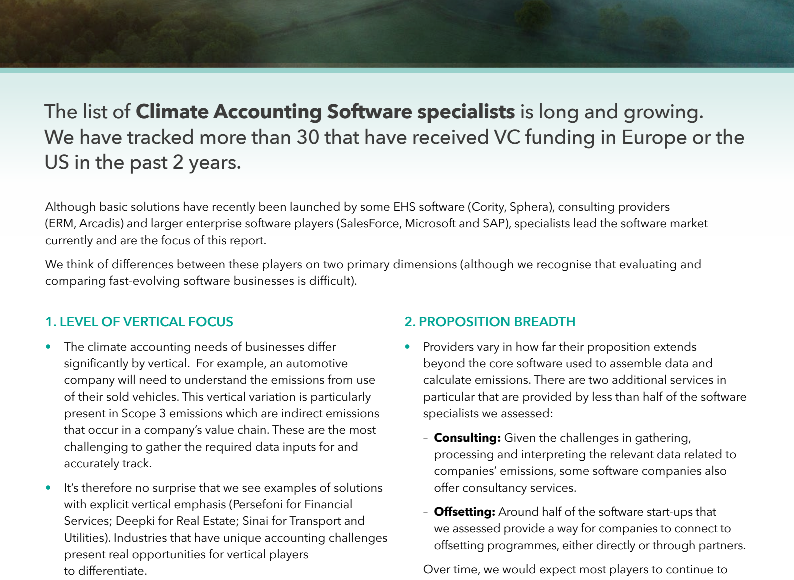
For progressive PE investors, there are clear reasons to get excited about this category.

SIGNIFICANT WHITESPACE AND STRONG ADOPTION TAILWINDS

- Faced with the enormous and urgent challenge of mitigating climate change, pressure from internal and external leaders has led many businesses to adopt this software already. However, significant headroom remains and regulatory and customer pressures are leading to a broadening of market demand for climate accounting software:
  - **Regulatory Triggers:** In the US, the SEC recently proposed a rule that would mandate companies to include scope 3 emissions in all their climate disclosures.
  - **Customer Triggers:** As larger companies try to understand the scope 3 emissions through their supply chain, they are putting pressure on their suppliers to track and manage their own emissions, creating a snowball effect on adoption.

ATTRACTIVE SOFTWARE FUNDAMENTALS

- This software drives **significant ROI** when replacing manual methods, and can be mission-critical in making carbon accounting feasible at scale.
- **High natural stickiness** results from successfully navigating the complexities of data integration.
- These solutions can act as platforms which provide natural **cross-sell opportunities** to actively help companies reduce their emissions.
- **Strong potential network effects** where these platforms link to multiple 3rd parties across a value chain.



Introducing **the Field**

The list of **Climate Accounting Software specialists** is long and growing. We have tracked more than 30 that have received VC funding in Europe or the US in the past 2 years.

Although basic solutions have recently been launched by some EHS software (Cority, Sphera), consulting providers (ERM, Arcadis) and larger enterprise software players (SalesForce, Microsoft and SAP), specialists lead the software market currently and are the focus of this report.

We think of differences between these players on two primary dimensions (although we recognise that evaluating and comparing fast-evolving software businesses is difficult).

1. LEVEL OF VERTICAL FOCUS

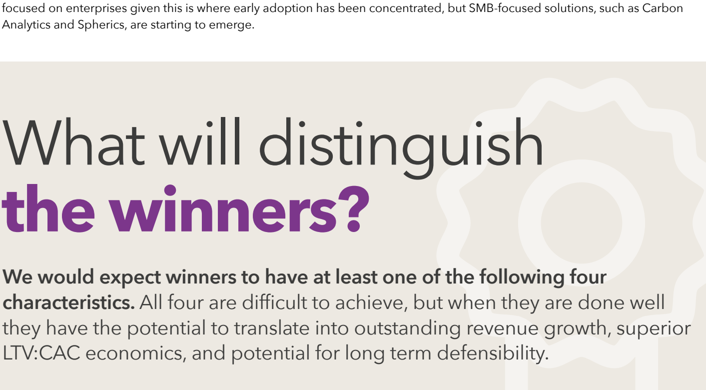
- The climate accounting needs of businesses differ significantly by vertical. For example, an automotive company will need to understand the emissions from use of their sold vehicles. This vertical variation is particularly present in Scope 3 emissions which are indirect emissions that occur in a company's value chain. These are the most challenging to gather the required data inputs for and accurately track.
- It's therefore no surprise that we see examples of solutions with explicit vertical emphasis (Persefoni for Financial Services; Deepki for Real Estate; Sinai for Transport and Utilities). Industries that have unique accounting challenges present real opportunities for vertical players to differentiate.
- Horizontal players can win by focusing on early adopters in a vertical-agnostic way, reaching scale and category leadership more quickly. Or potentially, by exploiting the power of integrations with giant software ecosystems like SAP, Salesforce or Microsoft Dynamics.

2. PROPOSITION BREADTH

- Providers vary in how far their proposition extends beyond the core software used to assemble data and calculate emissions. There are two additional services in particular that are provided by less than half of the software specialists we assessed:
  - **Consulting:** Given the challenges in gathering, processing and interpreting the relevant data related to companies' emissions, some software companies also offer consultancy services.
  - **Offsetting:** Around half of the software start-ups that we assessed provide a way for companies to connect to offsetting programmes, either directly or through partners.

Over time, we would expect most players to continue to broaden their proposition, with narrower propositions only succeeding for more complex process steps, such as regulatory reporting or energy data monitoring.

CLIMATE ACCOUNTING COMPETITOR MAPPING



In the long-run, customer size will emerge as an important 3rd dimension. In more mature software segments, such as ERP, company size tends to be an important driver of competitive positioning. The initial wave of carbon accounting start-ups have focused on enterprises given this is where early adoption has been concentrated, but SMB-focused solutions, such as Carbon Analytics and Spherics, are starting to emerge.

What will distinguish **the winners?**

We would expect winners to have at least one of the following four characteristics. All four are difficult to achieve, but when they are done well they have the potential to translate into outstanding revenue growth, superior LTV:CAC economics, and potential for long term defensibility.

1 PARTNERSHIP-LED GTM ADVANTAGE

- Channel partnerships are a winning formula for many software providers. They unlock large client bases, establish trust through referrals, and provide material leverage from large, established sales teams.
- These benefits are even more pronounced in this nascent category, where trust needs to be established by small and unknown vendors, and the value proposition of climate accounting itself depends on deep data connectivity with a broader enterprise cloud.
- In particular, existing applications such as ERP or supply chain management systems are a critical source for the raw data required by carbon accounting software. This makes integration and wide interoperability with these providers a critical buying criteria for Climate Accounting Software. Establishing closer partnerships with these existing applicaitons, whether through custom integrations or collaborative sales support, can therefore provide significant differentiation.

> Consumer goods companies, solving the challenge of tracking their suppliers' emissions is critical to developing a holistic view of their emissions.

2 BEST FOR A MAJOR 'VERTICAL'

- For example, for consumer goods companies, solving the challenge of tracking their suppliers' emissions is critical to developing a holistic view of their emissions. Doing so requires specific capabilities and features from their Climate Accounting Software provider, benefitting specialists who have previously solved for this specific challenge.
- Demonstrated traction within verticals gives providers an attractive set of logos and case studies to use to target similar customers. This is important as it gives prospective customers confidence that the provider knows how to solve similar challenges to those that they face.

3 IMPLEMENTATION AND DATA INPUT

- The lowest friction solution to adopt and run as a consequence of strengths in **Implementation and Data Input** – delivered with a high quality service 'wrapper' to the software.
  - Data is the largest challenge of successful carbon accounting. The required data is regularly not standardised, not digitised or even non-existent within organisations, which can lead to long implementation timelines and significant pain points for companies. Showcasing capabilities that solve for these challenges through hands-on sales and implementation support can truly differentiate software providers.

4 PROVEN LAND AND EXPAND CAPABILITY

- Once a provider has been implemented within a company, significant opportunities open up to sell new decarbonisation and offsetting tools and services. However, clearly winning new accounts and monetising new product development through cross-sell is by no means trivial. Demonstrating this ability not only provides more certainty over continued cross-sell of existing product features, but also more confidence in future product development ultimately translating into revenue.
- These additional services and capabilities are key to long-run defensibility, given the core emissions calculation and tracking features are relatively standardised.

CHARACTERISTICS OF WINNING COMPANIES

	Partnership-led GTM advantage	Best for "vertical"	Strength in implementation and data input	Proven land and expand
Definition	• Partnerships with consultancies or ISVs that provide differentiated access to or ability to win customers	• Demonstrated traction within specific verticals supported by hard product differentiation aimed at that industry	• Proven capabilities to solve implementation challenges regarding data identification, gathering and inputting	• Demonstrated ability to land accounts and then cross-sell new product development to them
Characteristics	• Deep, unique partnerships with multiple consultancies or ISVs with large embedded customer bases • Significant number of sales leads through partnerships	• High relative market share within target verticals • Features developed that cater to the specific needs and requirements of that vertical	• Mix of software and services provided during implementation, with dedicated support FTEs • Strong customer references regarding implementation and support	• Product development in decarbonisation and offsetting tools • Successful and growing cross-sell and monetisation of these tools to existing customers
Example providers	PERSEFONI ClimatePartner CLEARTRACE • Persefoni partners with a number of consulting and tech integrators, such as Bain, CGI, Workiva, SCSK and Novata	PERSEFONI ClimateView Normative • Climate View is focused on local governments and cities and has specific features designed for these customers, such as collaboration tools for multiple city stakeholders to engage with each other, scenario and simulation city emission models and community feedback tools	planA Ecochain • For more complex businesses, PlanA offers project-based work to provide a service-wrapper to facilitate the data integration challenges	SINAI CLEARTRACE Watershed • ClearTrace partnered with EDF to ensure that JP Morgan Chase's electricity consumption is matched with EDF's renewable energy generation on a real-time basis

Closing **Reflections**

Climate Accounting Software is going to play a critical role in driving sustainability initiatives in progressive organisations across the world, and in turn supporting the decarbonisation of economies.

For investors, there are clear reasons to get excited about a market opportunity of this scale. The key to success at this relatively early stage is to understand the likely drivers of future success, and to filter carefully to find the very best opportunities to back.

ABBREVIATIONS AND GLOSSARY

- **CO_2e:** Carbon dioxide equivalent is a term for describing different greenhouse gases in a common unit. For any type of greenhouse gas, CO_2e represents the amount of CO_2 which would have the equivalent impact on global warming.
- **E2E:** End-to-end, indicating the provision of features and services that span the different stages of the climate accounting process.
- **ESG:** Environment, Social and Governance.
- **EHS Software:** Environmental, Health and Safety software focuses on the compliance and mandatory reporting elements of environment, health and safety legislation.
- **ISV:** Independent Software Vendor.
- **GHG:** Greenhouse Gas.
- **KPC:** Key Purchase Criteria.
- **Scope 1:** Direct emissions from company-owned and controlled resources, such as the production of in industrial manufacturing.
- **Scope 2:** Indirect emissions from the generation of purchased energy, such as the production of energy that a company buys to heat or cool its buildings.
- **Scope 3:** All indirect emissions that occur in the value chain including both upstream (from your suppliers) and downstream (from your customers) activities, such as employee travel and emissions from suppliers in the production process.

To share your experience or start your strategy shake-up, or continue the discussion, please get in touch

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