Investment Advisory Committee: Summary minutes

Attendees:

Seb Beloe (Head of Sustainability Research)
Tim Dieppe (Fund Manager)
Ted Franks (Associate Fund Manager)
Hyewon Kong (Senior Analyst)
Ty Lee (Senior Analyst)
Geoff Hall (Chair)
Tristan Hilgarth (Adviser)
David Lloyd-Owen (Adviser)
Ebba Schmidt (Adviser)

Apologies:
Ben Goldsmith (Internal Adviser)
Nick Robins (Adviser)

Should renewable raw materials be considered to be better from an environmental point of view than fossil hydrocarbons in plastics?

Are bioplastics sustainable?

From an environmental perspective, is it always preferable to make plastics from renewable raw materials or from fossil hydrocarbons? This was the question posed to us by the Investment Advisory Committee meeting in October 2013.

The quick answer is probably 'no, not always', because a lot depends on the manner in which the materials have been produced. Having said that, bioplastics, that is plastics that have been derived from renewable biomass sources do have important fundamental advantages. As a group, bioplastics have lower toxicity, lower impacts on climate change, produce less waste and are typically more biodegradable[1]. In fact, the design principles of green chemistry state that renewable feedstocks should be used 'whenever technically and economically practicable'. So fundamentally, bioplastics do have strong advantages.

However, these advantages can be significantly reduced - and even reversed – by the processes used in producing bioplastics. The key impact is in the agricultural production of the biomass in the first place. Where agricultural processes have significant negative impacts (for example palm oil plantations on previously forested land), it can mean that traditional plastics perform better than bioplastics.

We reported these findings back to the Committee who recommended that a core part of our analysis of bioplastic companies should include an assessment of their sourcing strategies to ensure that they have a robust approach to this issue.

Investment Theme Reviews

We updated the committee on our recent theme reviews and the positioning of the fund in these areas.

90% of today's data has been created in the last 2 years, with 100 hours of YouTube videos being uploaded every minute.

Resource Efficiency: Data Centres

Use of data storage and communications continues to grow at an astonishing pace. 90% of today's data has been created in the last 2 years[2], with 100 hours of YouTube videos being uploaded every minute.[3] This in turn is driving enormous growth in the energy intensive infrastructure that supports it. On some forecasts the sector may be emitting more carbon dioxide than aviation by 2020[4].

External data centre providers are significantly more efficient than internal data centre operators and so we see some of the these businesses fitting our Resource Efficiency theme because of their existing performance and high levels of innovation to recycle heat energy and use renewable power sources.

[1] Sustainability Metrics: Life Cycle Assessment and Green Design in Polymers
[2] www.ScienceDaily.com.
[3] www.youtube.com
[4] McKinsey

Continued high levels of growth are expected as a growing proportion of traffic shifts to cloud computing and penetration of smartphone usage continues.

We are currently invested in **Telecity** – one of the leading European independent data centre operators, operating premium data centres with high levels of connectivity and efficiency.

Committee members broadly supported our approach and encouraged us to explore the related theme of cyber security and the potential that this might also offer the fund.

2.5bn people lack basic sanitation and 70% of industrial waste in developing countries is dumped untreated into water courses.

Water: Water Treatment

4.1bn people lack safe sanitation and 70% of industrial waste in developing countries is dumped untreated into water courses[5]. While the problems are well understood, the mispricing of water has meant, in our view, that countries and businesses have not invested in effective water resource management. There is evidence that this is beginning to change as the scale of the problem of water scarcity and water contamination begins to undermine economic growth in key regions of the world.

For example, water scarcity is now limiting power production in South East Asia and China. New government initiatives are forcing businesses and municipalities to treat and recycle water, and new regulations are driving investment in new water treatment capacity. We are particularly interested in niche and industrial markets where margins are higher and in the Asia-Pacific region where significant further growth is forecast.

The challenge in the sector is finding companies with significant exposure to these trends as most water treatment technologies are dominated by very large companies for whom water treatment is just a small part of their overall activity.

As a consequence, the fund's exposure is relatively modest at c.5% in water treatment. The fund owns **Ecolab** which is well-placed to benefit from growing demand for water treatment and conservation across several sectors. We also own several companies with exposure to the water treatment theme including **Danaher**, **Halma**, **Pall**, **Pentair** and **Suez Environnement** which all own water treatment businesses within larger corporate structures.

The committee also largely supported our analysis though suggested that another barrier to investable ideas in the theme comes from the very conservative attitude of the water industry who have typically been resistant to innovations.

Portfolio Holdings

The committee reviewed the holdings in the fund including three new additions to the portfolio.

BOER 博耳电力 BOER POWER

The committee reviewed the holdings in the fund including three new additions to the portfolio. We initiated a holding in **Boer Power** in our Resource Efficiency theme. **Boer Power** is the largest local high-end electrical distribution system and solution provider in China. The company is set to benefit from an increased focus on energy efficiency in China and we believe the company is undervalued given its high growth potential.

We also started a position in **Infinis Energy** in our Cleaner Energy theme at its Initial Public Offering after meeting the company's management team. **Infinis** is a leading UK renewable energy generator owning significant landfill gas power generation capacity and a portfolio of existing and planned onshore wind farms which it aims to develop over the coming years.

Finally, we also initiated a holding in **Canadian Solar** also in our Cleaner Energy theme. **Canadian Solar** is a top-tier Chinese solar module manufacturer. It sells its products internationally and also has a downstream project development business developing solar farms and selling these on to third party customers.

[5] Water Resources Group & US EPA
[6] Munich RE
[7] For example as presented by the Intergovernmental Panel on Climate Change
[8] For example in risk mapping by the World Economic Forum

Committee members were also interested to see that we had sold out of EnerNOC, a company that we had only bought a few months previously. The team indicated that it was rare to have such a short holding period, but in this case, it had become clear that the demand response technology and services offered by the company were subject to significantly more policy risk than we had first appreciated.

Engagement strategy 2014

We presented a draft engagement strategy to the committee seeking their input on the overall approach as well as ideas for particular areas to engage companies on.

The majority of our engagement takes place bilaterally with individual companies on specific issues.

Our approach is to view engagement with companies as an opportunity both to learn more about their management and operations and to seek to encourage them to take more responsible positions on long-term issues such as key environmental, social and governance risks. The majority of our engagement takes place bilaterally with individual companies on specific issues that appear either on the agenda at Annual General Meetings, or in response to developments that take place during the year.

In addition, we have also embarked on a series of proactive engagement initiatives that we undertake with groups of companies. The two examples of these that we undertook in 2012-2013 focused on business ethics across our portfolio and phasing out substances of very high concern (SVHCs) in the chemical industry.

The committee endorsed our approach to combine reactive bilateral engagement with individual portfolio companies with more proactive thematic based engagement.

Extreme Weather

Several companies in our portfolio have already seen significant financial impacts from extreme weather.

We also asked the committee for their thoughts on our proposal to engage portfolio companies on their exposure to extreme weather. The number of extreme meteorological, hydrological or climatological events has increased in recent decades[6]. Climate science also indicates that these trends are likely to continue[7]. The risks posed by extreme weather are already well-recognised by the business community[8] and several companies in our portfolio have already seen significant financial impacts from extreme weather.

Our work will focus on a short list of companies in the fund that have either directly or indirectly (e.g. through suppliers) experienced the impact of extreme weather. Our aim is to better understand both the extent of the risk – or opportunity – posed by extreme weather and how these businesses are managing the impacts. The committee were supportive of the initiative and encouraged us to focus in on the links between extreme weather and share price performance.

Investment Advisory Committee Members

Ben Goldsmith: Co-founder of WHEB Group

Nick Robins: Head of HSBC's Climate Change Centre of Excellence

Geoff Hall: Chairman of WHEB Asset Management. Former Chief Investment Officer at Allianz Insurance Plc

Ebba Schmidt: Investment Manager at the UK Pension Protection Fund (PPF)

Tristan Hillgarth: Former CEO Invesco Europe, and Head of Jupiter Private Clients

David Lloyd Owen: Waster and Water Industry Consultant