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Focusing on environmental returns

Q: Provide a bit of background to the Fund, when was it actually founded and why?

Bruce: Impact is a boutique specialising in the environmental sector. It was actually founded as long ago as 1994, initially as a financial advisory business, and then I think we realised that the real opportunity lay in fund management so a colleague of mine, Ian Simm, set up the asset management in 1998. And really since then we've grown a portfolio of different fund offerings within the environmental sector, really to take advantage of the huge growth that we're seeing in new energy, in the water sector and in the whole recycling and waste space.

Q: You describe yourself as a boutique, are you a small company?

Bruce: Yes, we're 23 people now. We've got 14 dedicated investment professionals who do nothing else apart from look for investment ideas in the environmental sector. Both, as well as in the listed sector, we're also looking at venture capital. We're looking at private equity investments as well. So we've got a large critical mass sized group all looking at environmental investment opportunities.

Q: Environmentally related investments are an enticing prospect now, purely because of the anticipated growths we

expect, due to legislation, changes in public opinion. How exactly has it developed?

Bruce: Yes, I think it's been driven by three sort of key things. The environmental markets tend to be focused on three sectors; energy, water and waste. Those are the sectors where you get the big impacts on the environment. And they're also the sectors that historically have really been state owned, quite sleepy, not a lot of innovation, very little happening. But really following liberalisation that you got in the '90s, really across the globe, a lot of privatisation, coupled with a whole load of legislation related to things like climate change and water pollution and recycling, etc.

And then the third key driver would be the fact that the cost of many of these new technologies, the renewables, the water treatment, recycling, have come down dramatically, at a time obviously when oil prices, commodity prices and landfill tax, etc, have all been rising. And this has transformed the economics, and this is really what drives the growth opportunity, and we are calling environmental markets in our new fund, looking for the environmental leaders in these markets.

Q: It's curious to say it's sort of still driving things, but I thought alternative energy investments, or any sort of alternative energy business was actually expensive, aren't the products expensive?

Bruce: Well that was the point. I mean I think, historically, when we first started doing this, there was definitely niche applications, certain users, costs were way ahead of conventional fossil fuel. But mainly due to economies of scale and the fact that the conventional methods have got more expensive, they're now increasingly competitive.

Q: So you've identified these kind of companies. Just what's the objective of the Fund?

Bruce: Yes, I think that the point is that these are now high growth emerging markets, whether you're talking about renewables, you're talking about energy efficiency, or new water treatment technologies, water sensing, etc, or recycling, these are markets that are growing rapidly. And this fund is all about giving investors exposure to the long term winners or the leaders, as we're calling it in these markets.

Q: So talk to us about the investment process.

Bruce: Yes, I think I mean the key thing that we need to do is identify those businesses that are active in the markets and are being successful in the markets. So Simon and myself and our team are scouring the globe, if you like, for those companies. And that really was what creates the investment universe. And then after that we're using the expertise within Impact. We've all typically got long experience in the sector to identify those that are going to be most successful, those with the most attractive valuation, for inclusion in the portfolio.

Q: So what sort of portfolio selection does that actually translate into?

Bruce: All our key investment decisions are taken up on a bottom-up stock picking approach. So we select on a company by company basis rather than a top-down allocation across different sectors or geographies. But, clearly, when we put together the portfolio, we're monitoring to ensure that the investor has exposure to a broad range of opportunities. So the Fund is a global fund. It has reasonably exposure to Asia, North America and Europe, reasonable exposure to the opportunities in energy and in water and in waste, and broadly diversified across the environmental opportunity.

Q: What sort of themes are you seeing at the moment?

Simon: I think there are many sort of different tiers of themes, if you like. I think we're seeing obviously some of the drivers that Bruce has mentioned. We're seeing higher energy costs, oil touched \$100 a barrel this year, and we're seeing a raft of environmental legislation. We're seeing a movement away from dirty polluting technologies into cleaner more efficient technologies. All of these things are influencing our investment decisions. I think if you sort of take a more geographical approach, we're expecting the US election to come out far more favourably for the environmental sector, and that I think probably goes hand in hand with recent announcements in Europe on targets for renewable energy capacity in 2020, as well as CO2 emission targets and energy efficiency targets.

Sort of on a more micro level, we're seeing a lot of interesting activity around the metal recyclers, which are consolidating at the moment. There's a lot of corporate activity in the space. And I think

also recent news on the growth in the renewable energy markets, specifically wind in Europe, growing at 18% in 2007, has been a great filler for our fund.

Q: What exactly are the stocks in the portfolio?

Simon: Well I think that one of the unique things about this portfolio is that it's going to include both pure play environmental businesses, household names such as Vestas and Itron, as well as probably slightly more hidden opportunities in larger environmental leaders, or emerging businesses within larger groups that we think are actually going to outperform in terms of growth. I think one of the hot areas for us, at the moment, is scrap metal recycling, so we've been looking at Sims Group, which is an Australian scrap metal recycler, which is in the process of merging with a US business called Metal Management. We think that's going to offer a lot of outperformance, particularly through 2008, as scrap metal prices stay high.

Finally, another stock to mention is Praxair, which is a US industrial gases business, again, not traditionally associated with the environmental sector. But Praxair is a company that sells into the water and waste water business, it sells a lot of hydrogen into refineries for the desulphurisation of fuels, and also there's obviously the sort of the golden egg of CO2 sequestration on the horizon for these businesses.

Q: One final question, in terms of the management of the fund, how often do you revisit these companies, and how actively are you managing the portfolio?

Bruce: We don't expect the turnover on the portfolio to be tremendous. We're expecting something like 50%. So we're expecting to hold these stocks for four years. The key message is that we're investing in those companies that go on to be the leaders in these very attractive high growth markets. Having said that, obviously stock markets are volatile, we do have quite rigid target prices for some of these stocks, we are monitoring them on a quarterly basis as the earnings releases comes along, so there will be some top and tailing and some trading. But it won't be a fund that we aggressively trade, as I say, we're backing the long term leaders in this environmental space. ■