


The case for water and waste investing

The global agenda for water and waste

In 2015, the United Nations launched its 17 Sustainable Development Goals (UNSDGs) as a blueprint for a more sustainable future. Along with heightened awareness of the risks presented by climate change,[1] the UNSDGs elevated the importance of ESG issues within the global and economic agenda. Water and waste are now a direct focus for five of these goals.

Sustainable water and waste practices also support many of the other goals. According to a UN World Water Development Report: 'Water is the ultimate connector in the global commitments towards a sustainable future: the 2030 Agenda for Sustainable Development and its goals are highly dependent on improved water management.'[2]

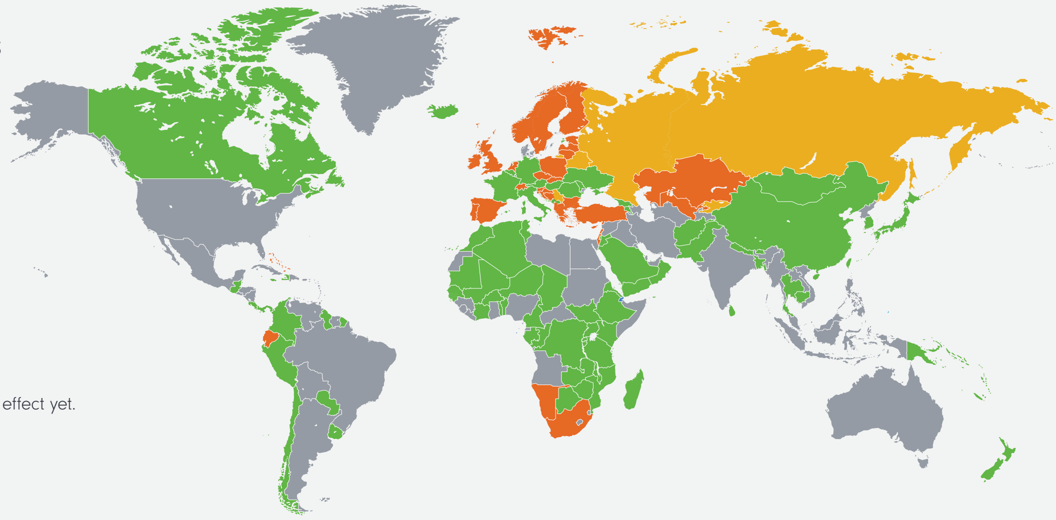
Essential services for a sustainable world

With continuing growth in our world population, improving water and waste management is becoming a vital issue for governments and businesses to address. Water scarcity has become a globalised phenomenon and studies have shown that the global aggregated water supply gap will increase to 40% by 2030,[3] due to a growing global need for food, goods, energy and health. Water scarcity and extreme weather events require efficient water management – and waste reduction and waste as a resource thinking is required to fight climate change. Our global population is growing at rate of around 1% per annum and a growing middle class accounts for around one-third of total GDP according to the UN, which places more demand related to farming, mining, oil power, etc. Urbanisation pressures increase the need for clean water and better ability to manage the waste created and an ageing developed world infrastructure requires improvements, along with new projects for emerging markets.

> " Today, humanity uses the equivalent of 1.75 Earths to provide the resources we use and to absorb our waste. This means it now takes the Earth one year and eight months to regenerate what we use in a year. "

Source: Global Footprint Network, https://www.footprintnetwork.org/our-work/ecological-footprint/

Paying with plastic: More than 90 countries have restrictions on single use plastics



As emerging markets grow, so do wealth and consumption habits, which increase the demand for water-intensive goods and increase the amount of waste generated. As our ageing population increases, this places higher health standards and regulation should be increased value for new services and technology.

As standards of living surge and drive consumption, these rapidly evolving industries have the potential to make a significant impact on public health, economic prosperity and environmental protection. There is an opportunity for investors to harness growth in demand for these services and contribute to their capacity for sustainable resource management for the benefit of both people and the planet.

Policy reforms foster opportunity

This global focus on policies that support responsible and efficient use of resources and materials is giving rise to greater regulatory scrutiny of water consumption and waste disposal practices.

Major public and private spending is expected to support a wider range of technologies, products and services that enable more efficient management of water and waste. This complexity in the value chain for both sectors gives rise to investment opportunities in companies where innovation is driving sustainability and growth.

Morgan Stanley's Institute for Sustainable Investing[4] has been polling investors since 2015 on their thoughts and attitudes around ESG. When asked about which areas of ESG investors were most passionate about, climate change and plastic reduction topped their list. Sustainable investing is expected to continue to accelerate and attract more assets as investors increasingly recognise the value of ESG data, driving the full integration of sustainable investing into mainstream investing.

Sustainable waste solutions will provide benefits to society and investors

Sustainable waste solutions (i.e. solutions that reduce, reuse or recycle waste) have the potential to provide greater structural changes for environmentally friendly waste practices in society. For investors, sustainable waste solutions are in the early stages of market penetration, and where operating in markets with supportive environmental regulation have the potential to force adoption of these solutions. This is expected to present long-term, structural growth opportunities.

A secure water supply is an economic imperative as well as a goal for a sustainable future. Many industries rely on water for production, from agriculture to energy, from mining to semiconductor manufacturing. With the expected acceleration in demand for water for human consumption and industrial production, it's clear that companies and governments are both facing a future where access to water is high on their agenda.

Technology for water-wise operations

Only 0.5% of the water on our planet is available as fresh water.[5] Solving the equation of growing demand for this finite supply is creating a flourishing water industry that supports less wasteful distribution and use of water as well as water treatment and recycling. Water infrastructure and technology companies are supplying everything from filter membranes to pumps and equipment and software to track data and analytics for water usage and quality. For both businesses and consumers, there is an economic incentive to seek out sustainable solutions to reduce water consumption.

Case study: Energy Recovery

An innovative company in the water sector is Energy Recovery. Energy Recovery produces pumps that reduce energy consumption of desalination. This helps to make desalination plants more economic, scalable and environmentally friendly (Energy Recovery's flagship product helped customers save c. $2.6 billion in energy costs and avoid c.12.5 million metric tons of CO_2).[6] Improved economies of scale are expected to help to increase adoption of desalinisation where there are no other economic alternatives. This in turn helps to improve the clean water supply. The company also applies this pump technology to the following industries:

Industrial wastewater treatment – Its products help to make treatment of wastewater from industrial processes cheaper, increasing the potential for industrial wastewater penetration to go up and for the quality of water sources in industrial areas to increase.

Commercial refrigeration systems (such as those used in supermarkets) – Conventional refrigeration systems use superpolluting hydrofluorocarbons (HFC). Instead, regulations are expected that require CO_2 as a replacement for HFC, as CO_2 is one of the most sustainable and safe natural refrigerants. However, the cost of CO_2 refrigeration systems is expensive, making it hard for retailers to switch. But with Energy Recovery technology (which significantly reduces the energy consumption of the systems), CO_2 refrigeration become more economic.

On the sustainability side, the company has strong characteristics across all E, S and G attributes. On the environmental side, its products are heavily aligned to clean technologies. The company has a strong anti-corruption framework in place. The company employs an above-average focus on innovation capacity, which translates into a high-quality product offering. The company's governance is aligned with shareholder interests and promotes independent oversight.

Case study: Biffa

A key environmental issue today is the 'plastic planet', where plastic waste is both polluting our oceans and plastic production is contributing to high CO_2 emissions. We are therefore very excited about Biffa, an integrated waste management company operating exclusively in the UK, with leading plastic recycling and food waste reduction initiatives.

Central to the stock's investment thesis is Biffa's dominant and leading position in the industrial and commercial waste collection segment, along with new waste recycling and recovery opportunities, particularly within plastic recycling. Biffa plans to quadruple its plastic recycling capacity by 2030, providing significant growth tailwinds. Furthermore, the company has recently acquired Company Shop, the UK's biggest food retailer that distributes surplus food stock.

Company Shop buys products that would go to waste from retailers and food producers, and then sells the products at very cheap prices to people on low-income support. This will act to further reduce landfill in the UK, provide social benefits to UK communities, and provide Biffa with enhanced waste management solutions for customers (i.e. clients can reduce waste volumes and cost by earning a small income, by diverting excess stock to Company Shop).

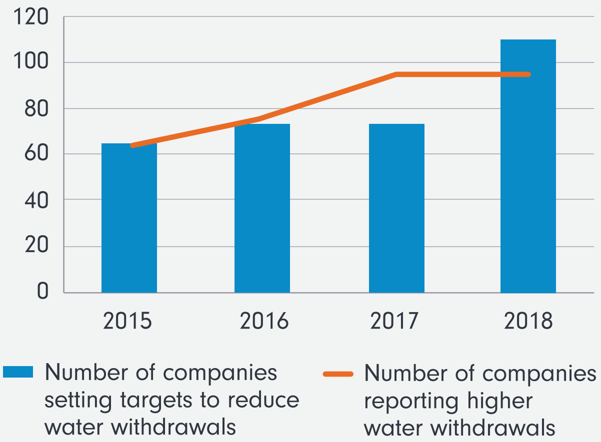
Furthermore, as market leaders of UK waste collection, Biffa is uniquely positioned to control its own recycling feedstock. This will generate higher quality input material and should generate a higher yield from its recycling business, along with high barriers to entry.

Upcoming regulation has the potential to rapidly accelerate customer adoption of Biffa's plastic recycling facilities, such as the introduction of the UK plastic tax in 2022 (a tax levied on manufacturers and importers of all packaging containing less than 30% recycled plastic) and Extended Producer Reforms (introduced to shift the full cost of collection, recycling and responsible end-of-life disposal of products on producers). With the introduction of these reforms, firms have no choice but to address and adopt plastic recycling efforts, which will provide meaningful opportunities for those with recycling capacity, of which Biffa has a leading position in the UK market.

On a sustainability basis, the company is a sustainability leader when it comes to recycling. The company has strong and credible GHG emission reduction targets and is the market leader in the UK for food-grade plastic recycling. Additional environmental goals include deployment of an electric truck fleet (cease using fossil fuel trucks by 2040) and 100% renewable electricity by 2050. From a social perspective, Biffa gives generously to the community (targeting £15 million by 2030 and £25 milion by 2030), and has ambitious targets for employee training, health and safety, along with gender diversity targets. On the governance side, the company offers a high-quality board and management team.

More companies are setting targets to reduce water withdrawals

Water withdrawals reported by cohort in 2018



Source: CDP, Treading Water, Corporate Response to Rising Water Challenges, 2018, https://www.cdp.net/en/research/global-reports/global-water-report-2018).

There are high levels of technological innovation in the water and waste sector, but also defensive utilities that can provide downside protection and stable, underappreciated growth.

The active advantage for risk and return

Fidelity specialises in active fund management. With one of the largest buy-side research teams in the world, we have the capacity to identify investment themes and ideas across different market cycles. Water and waste are under-researched sectors growing rapidly and the Fidelity active management approach offers advantages for exposure to these themes.

Our global network of investment professionals monitors around 300 companies across the water and waste value chains. We use in-house fundamental research to identify quality companies we believe are well positioned to generate growth and build a high-conviction, and diversified portfolio of 35 to 55 companies.

Velislava Dimitrova and Cornelia Furse are Lead and Co-Portfolio Manager, respectively. They have deep knowledge of the Water & Waste universe.

The Fidelity Sustainable Water & Waste Fund

The Fidelity Sustainable Water & Waste Fund is part of our sustainable fund range in Australia. We apply an exclusion framework and Environmental, Social and Governance (ESG) screening so that at least 70% of the portfolio is invested in companies exhibiting sustainable characteristics, and the remaining 30% are showing improving, or potential for improving, characteristics.

Our proprietary ESG ratings go beyond an analysis of governance to arrive at an assessment for each company compared with their peers. We also take into account a forward-looking assessment of ESG criteria and incorporate all these inputs into our final valuation.

Through a unique combination of water and waste investment opportunities, we believe this fund has the potential to offer strong diversification for global equities, as well as significant growth potential and a boost to the ESG profile of an investor's portfolio.

Like to know more?

If you'd like to know more about the Fidelity Sustainable Water & Waste Fund, visit our website, or call or email our client services team:

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1 World Economic Forum, Global Risks Report 2020, 'Severe threats to our climate account for all of the Global Risks Report's top long-term risks'. **2** The United Nations world water development report 2020: water and climate change, p.5. **3** McKinsey & Company, Water 2030 Global Water Supply and Demand model. **4** https://www.morganstanley.com/what-we-do/institute-for-sustainable-investing. **5** US Bureau of Reclamation, Water Facts – Worldwide Water Supply, 23 July 2020. **6** https://energyrecovery.com/about-us/

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