



Federated Hermes Impact Opportunities Fund

Quarterly Impact Report
Q1 2021

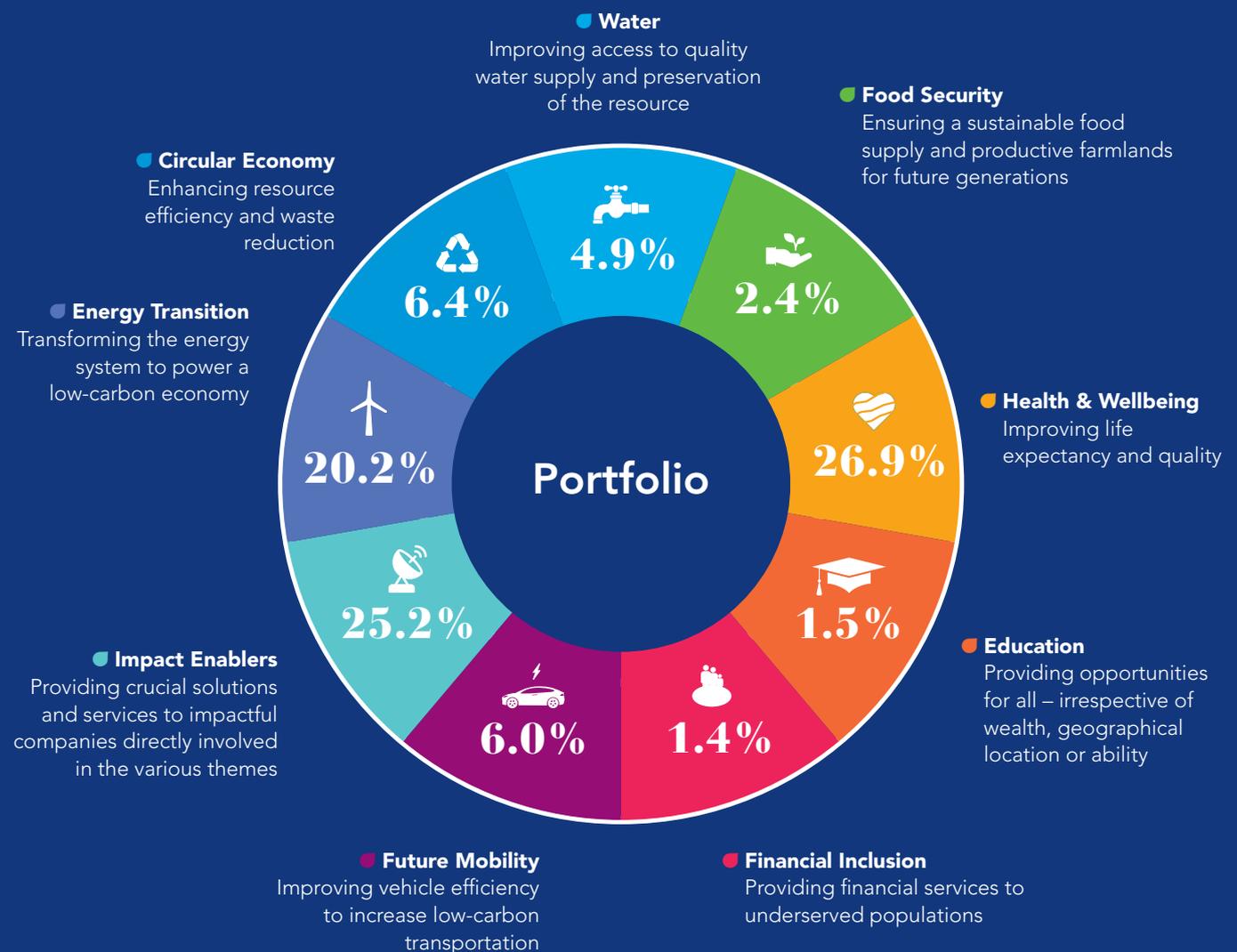
**Federated
Hermes** 
International

www.hermes-investment.com
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The Federated Hermes Impact Opportunities Fund is a high-conviction global equity strategy with a bold objective. It aims to generate long-term outperformance by investing in companies succeeding in their core purpose: to generate value by creating positive and sustainable change that addresses the underserved needs of society and the environment. In this way, it focuses on tomorrow's leading companies, today.

Exposure by impact theme

A thematic approach: our holdings fit into one or more of nine impact themes that are aligned with the SDGs.



Source: Federated Hermes, as at 31 December 2020. Note: as at 31 December 2020, 3.4% of our exposure was not directly related to any of our nine impact themes, while 1.8% was held as cash.

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THEMATIC FOCUS:

Introducing the Federated Hermes Impact Database

In our view, it is imperative that all investee companies generate a positive impact that can be measured quantitatively, as well as qualitatively. As such, we invested considerable time and resource in the second half of 2020 to create our proprietary Impact Database, which enables us to quantify the impact of companies held within our portfolio. The Database also provides a clear framework for us to assess companies on our watchlist.

Why?

After looking at the tools available in the market to analyse impact data, we did not believe that any one provider had the depth of understanding and granularity we required at a company level. Indeed, the majority of pre-existing tools used aggregate modelling and artificial intelligence (AI) insights that, while impressive, at times yielded inaccurate and incomplete results for individual companies.

Building the Impact Database¹

In building our database, we have used traditional equity research methods, in combination with impact modelling techniques. As well as leveraging our expertise as impact investors at the international business of Federated Hermes, we used an external consultant to help aggregate data from company, sector and impact industry reports.

The Impact Database process:



Most relevant metrics chosen to assess a company's impact depending on industry, products and operations.



20

carefully chosen impact metrics, which have been grouped into



11

relevant themes are used to capture the impact of all the companies in which we invest.

'Operations-based' metrics may be chosen to assess company impact.

Reporting our portfolio's impact

We have carefully chosen 20 impact metrics, which have been grouped into 11 relevant themes. They are used to capture the impact of all the companies in which we invest.

Some themes may include solutions and operations-based metrics, such as Climate Change which looks at both operations metrics for carbon emissions and solutions metrics for emissions avoided; whereas Gender Equality currently only contains operations based metrics. Nevertheless, all portfolio companies are assessed using at least one solutions-based metric and one operations-based metric.

Assessing the impact of companies at such a granular level with quantifiable outcomes allows us to achieve two important objectives. First, it allows us as investors to trace and account for each investment, providing a means through which we can monitor a company and ensure its impact intentionality as a business. Secondly, it provides our clients with a quantifiable indication of how their capital allocation is helping achieve positive impact, as aligned to the 17 UN Sustainable Development Goals. The end result means we are able to report to our clients on the overall impact of our portfolio, as well as the impact of individual holdings.

What is the difference between solutions-based and operations-based metrics?



Operations-based metrics relate to a company's operations.

Examples include impact data like scope 1 and scope 2 carbon emissions, waste produced in operations, or share of women in management positions.



Solutions-based metrics relate to the specific outcomes a company is looking to provide.

For example, the impact of a company looking to decarbonise heavy-duty motive might be measured by looking at the carbon emissions avoided through use of the company's technology (CO₂ MT).

Operations-based metrics are generally relevant for all companies held and are often dependent on some level of company disclosure. Solution-based metrics differ; every company is unique and a thorough understanding of business models is therefore required to accurately appraise impact.

'Solutions-based' metrics may be chosen to assess company impact.



Company-specific impact appraisal

¹ As it stands, the database calculates the impact our portfolio had in the calendar year 2019. We are in the process of rolling this analysis forward to calculate impact for the calendar year 2020, as each of our investee companies start to publish their annual earnings and sustainability reports. We expect to be able to report to clients on the 2020 impact of our portfolio by the end of June.

The impact of our portfolio

Total company level impact of stocks held, 2019 highlights

Using our proprietary Federated Hermes Impact Database, we are able to present our impact data on an aggregated, cross-company basis. Put simply, it depicts our estimation of the total impact that the companies in which we are invested have delivered in 2019. As aforementioned, our database draws on data from company, sector and impact industry reports. Once each of our investee companies publish their annual earnings and sustainability reports, we will be able to update our figures to reflect 2020.

38.9m MT
of CO₂ avoided, with only
6.0m MT released



80.7m MWH
of clean energy generated



867k tons
of waste recycled (through product solutions) plus a further



379k through recycling programs in operations

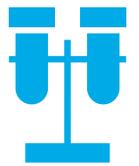
Average female manager and board representation of
28.8%
and
28.5%
respectively



1.3bn m³
of water saved vs
176m consumed



14.8k
life sciences lab budgets fully exhausted



20.0m
people given financial access



204m
patients treated and
4.7m
lives extended



1.9m MT
of food waste avoided

\$2.9m
SDG enabling R&D funded (excluding Healthcare)



93.8k
students educated



2.5k
hectares of forest protected



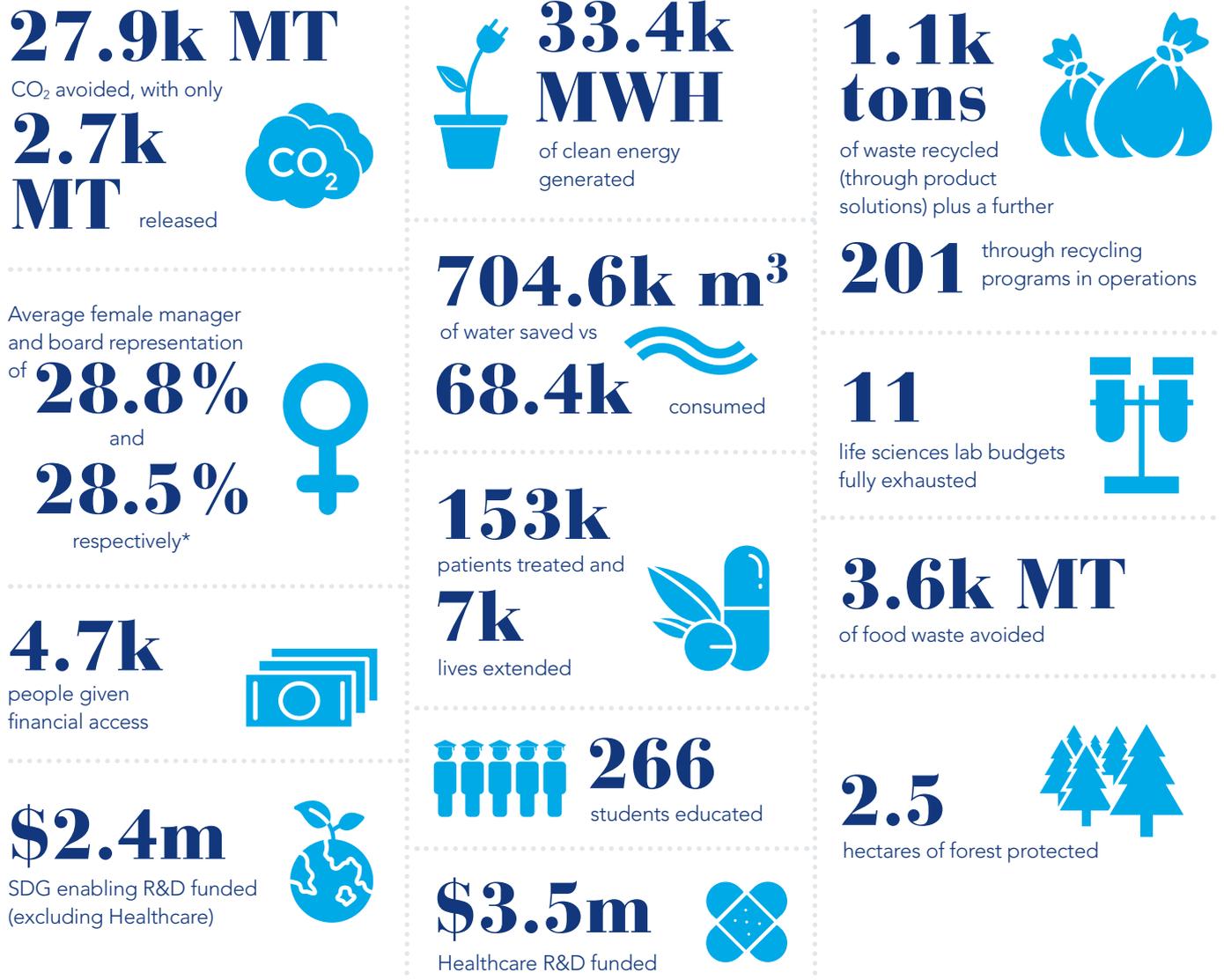
\$5.7bn
Healthcare R&D funded



Source: Federated Hermes, as at 31 December 2019. Note: The Impact Opportunities portfolio has been harmonised for calendar year impact.

Impact achieved by capital deployed

As well as producing company-level impact, our database allows us to report on the impact of our Fund's assets under management. Put simply, we scale the metrics to demonstrate the impact accomplished through the capital we deploy – approximately \$450m as at 31 December 2020 – on behalf of our clients, thereby reflecting our ownership of each company held in our Fund. As discussed previously, the data used represents company, sector and impact industry reports from 2019 while we await the publication of 2020 reports.



*This metric is based on an average, and therefore does not change when scaled.

Source: Federated Hermes, as at 31 December 2019. Note: The Impact Opportunities portfolio has been harmonised for calendar year impact.





CASE STUDY

Itron

Itron is a Global leader in energy efficiency technology, offering innovative products to optimise energy and water resource management.

Impact theme: Energy Transition



Compared to a traditional grid, an active grid – which leverages the Internet of Things (IoT) to better match supply with demand and monitor inefficiencies/outages – can reduce electricity usage by 12%.² The active grid will increasingly draw focus through the energy transition, as demand for electricity rises due to vehicle and home electrification.

Our holding, Itron, is a leader in this market. The company provides hardware and software solutions that are critical to smart and active grid management, with a product offering that is focused on improving resource efficiency.

Powering energy efficiency through the smart/active grid

Itron derives 100% of its income from resource management hardware and software deployed in energy (60%), water (20%) and gas (20%). The company has three key product areas, which together accounted for 66% of its revenue base in 2019:³

- **Smart/Active Meters (40%):** Itron manufactures both smart and active meters: the former use a one-way communication model; the latter use two-way communication, meaning the operator is able to both monitor and communicate with the end-point meter.
- **On-Grid Hardware (11%):** The company's offering includes automated distribution equipment and monitoring kits.
- **Software and Analytics (15%):** Itron is focused on management software, which is sold into the utilities sector to optimise grid operations.

In the US, Itron holds a 50% market leading share in communicating meters, and a 30% market leading share in on-grid hardware and management software. With respect to the company's future prospects, Itron's continued spend on research and development is encouraging.

The real economic and environmental cost of grid inefficiency

Inefficiency across the grid is a costly affair, both economically and environmentally.

Faulty equipment wastes around 5% of electricity generated in the US⁴, while out-of-service end points that are left connected are similarly troublesome. Itron identified that for one client, inactive metering was wasting around 456GW of electricity annually, which is equivalent to the yearly electricity consumption of 54,000 homes⁵.

The grid is also not particularly resilient, despite representing vital infrastructure for millions of people. It is vulnerable in the event of natural disasters, which are becoming more prevalent thanks to climate change.

By allowing operators to identify faults more efficiently, the equipment produced by Itron directly improves recovery times and, in turn, saves energy. In 2019, Itron's solutions meant 3.5m metric tonnes of CO₂ emissions were avoided.⁶

2019 impact measurement highlights for Itron:

3.5m MT

of CO₂ avoided, with

1.7k MT

emitted



301 MT

of waste recycled with

416 MT

of waste generated



22%

female board representation with

43%



female management representation

Funding of **\$202m**

to SDG enabling research and development (R&D)



92.6k m³

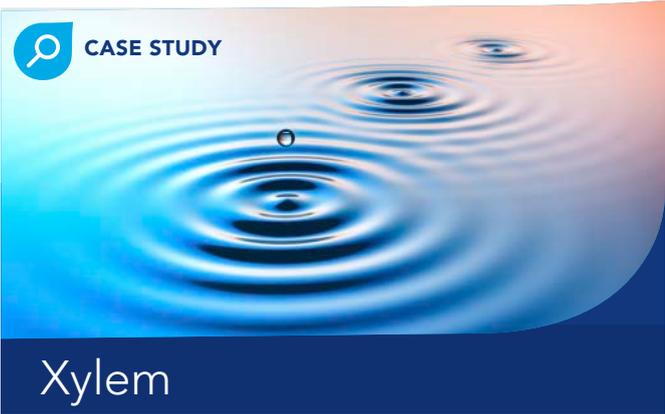
of water saved with

11.4k m³ used



Source: Federated Hermes, as at 31 December 2019

CASE STUDY



Xylem

Xylem is one of the biggest water technology companies in the world, providing a full suite of solutions across the water cycle – from smart water infrastructure analytics to water treatment.



Impact theme: Water

It is estimated that around three in 10 people worldwide currently lack access to safe drinking water, with six in 10 having no access to safely managed sanitation services.⁷

And while demand for fresh water is rising due to population growth, industrial expansion and increased agricultural development, availability is declining. Experts have warned of a ‘water crisis’ by 2040.⁸

A large part of the problem here is the resilience of water infrastructure. While in developed markets inadequate funding means aging pipes are beginning to leak, in emerging markets water systems remain underdeveloped.

Then there is the issue of wastewater. Lack of treatment creates dangerous water pollution, while transporting and treating water using inefficient, outdated equipment results, globally, in more than 86m metric tons of electricity-related emissions – the equivalent of 9.7bn tons of gasoline.

Our holding, Xylem, generates a far-reaching impact by offering unique and innovative solutions that encompass all stages of the water cycle.

‘Let’s solve water’: innovation and emerging markets water infrastructure

We see Xylem’s product range, which is focused entirely on water technologies, as addressing a number of issues aligned to the UN SDGs.

Two things really stand out about Xylem’s proposition. First, the company is a clear leader in water management technology, bringing innovation to market since acquiring smart-metering company, Sensus, in 2016. See, for example, Xylem’s offering in sensors and data analytics, which allows users to identify leaks more quickly and optimise water use. Xylem also created the world’s first large-scale ultraviolet/ chlorine process, which is being used to turn wastewater to drinking water in Los Angeles.

Secondly, the company are helping to build new water infrastructure in emerging markets – which accounted for 21% of Xylem’s sales in 2020 – through local partnerships with the likes of universities and non-governmental organisations (NGOs).

Xylem’s impact therefore goes beyond the utilities and industrial sectors, which together accounted for 85% of the company’s sales in 2020. We see Xylem as having the ability to empower communities and transform the lives of millions.

Leading by example

Reducing the environmental impact of products such as pumps and mixers is a key area of focus for Xylem.

But Xylem have also set goals to improve the environmental impacts of their own operations. For the five-year period to 2019, the company achieved a 20% reduction in water use intensity and a 28% reduction in greenhouse gas emissions⁹. Targets for 2025 include reaching 100% renewable energy and 100% process water recycling at major facilities.

In addition, Xylem’s Carbon Disclosure Project (CDP) scores have improved from 2017, when the company was awarded a ‘C’ for Climate Change Disclosure and a ‘B’ for Water Security Disclosure. Xylem now scores an ‘A-’ in both areas, respectively¹⁰.

2019 impact measurement highlights for Xylem:

40.0k MT
of CO₂ avoided with
10.3k MT
emitted



22.2k MT
of waste recycled with
33.9 MT
of waste generated



18%
female board
representation
with **24%**
female management
representation



Funding of **\$191m**
to SDG enabling research
and development (R&D)



520m m³
of water saved with
37.2k m³
used



Source: Federated Hermes, as at 31 December 2019

Endnotes:

² As reported by the American Council for an Energy-Efficient Economy

³ Please note, we argue that Itron's 'Device Solutions' division – which accounted for 34% of 2019 sales – had minimal to no discernible impact. This is because it supplies non-communicating meters, which play no role in the smart or active grid, and therefore have very limited implications for resource efficiency. It is worth noting that this division is in decline, having accounted for +45% of revenues in 2017, a trend which looks set to continue.

⁴ See <https://www.eia.gov/tools/faqs/faq.php?id=105&t=3>

⁵ Source: Commonwealth Edison (ComEd), performance metrics 2018.

⁶ Source: Federated Hermes, as at 31 December 2019. Note: The Impact Opportunities portfolio has been harmonised for calendar year impact.

⁷ (Xylem Sustainability Report 2019).

⁸ See: <http://safcei.org/wp-content/uploads/2015/06/Anglican-Water-Rio+20-.pdf>.

⁹ See: https://www.business-standard.com/article/international/water-crisis-looms-large-in-pakistan-may-face-absolute-scarcity-by-2040-121032200050_1.html

¹⁰ See: <https://www.xylem.com/siteassets/sustainability/2019/xylem-2019-sustainability-report.pdf>.

¹¹ See: <https://www.cdp.net/en/responses/36718>

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