

Federated Hermes Impact Opportunities

Quarterly Impact Report
Q2 2022

**Federated
Hermes**
Limited

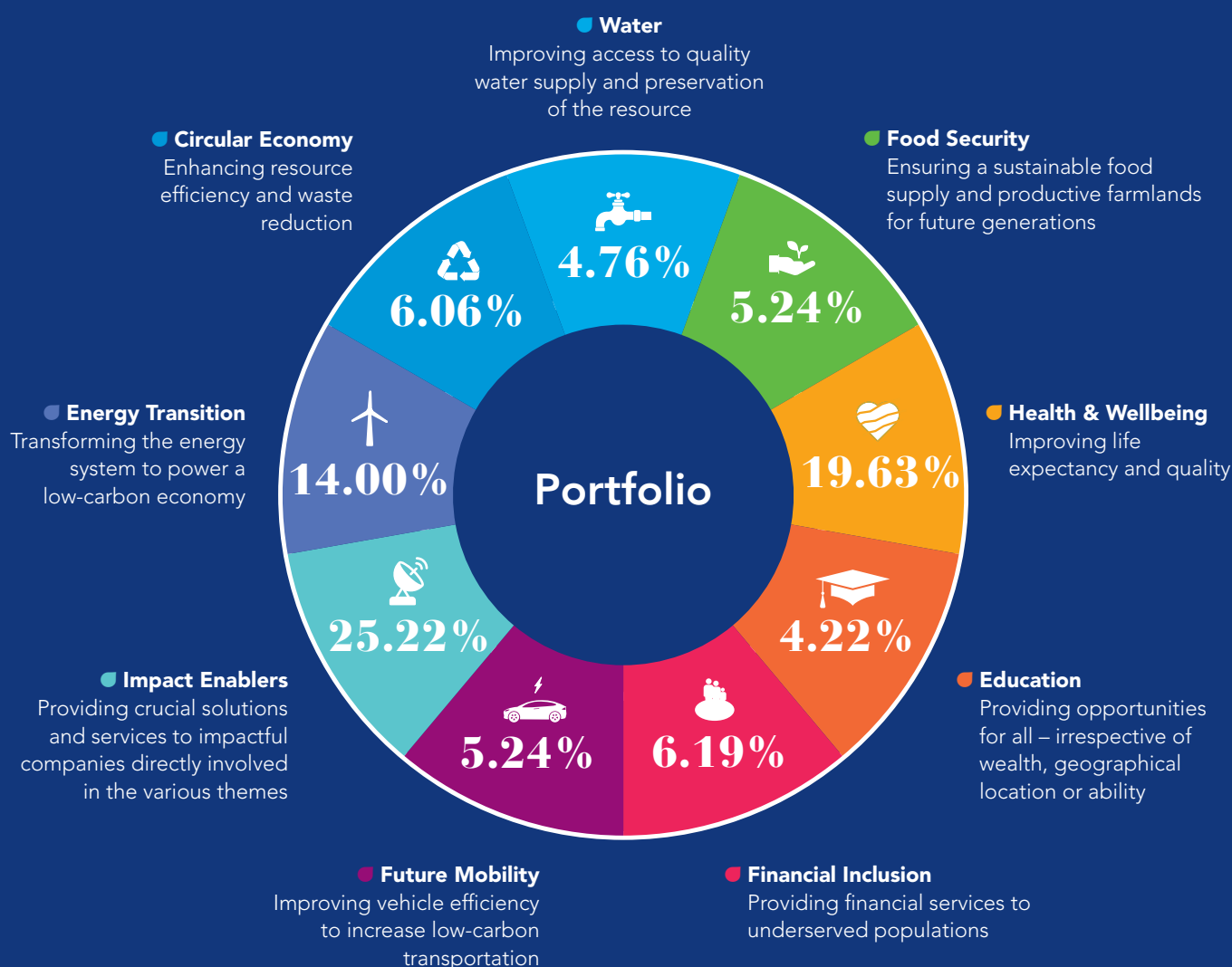


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The Federated Hermes Impact Opportunities strategy is a high-conviction global equity strategy with a bold objective. It aims to generate long-term outperformance by investing in companies succeeding in their core purpose: to generate value by creating 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 March 2022. NB: Excludes cash.

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THEMATIC FOCUS:

Build better: The hidden climate opportunity in bricks and mortar

Fast reading:

- While the transportation and industrials sectors get the most attention when it comes to cutting carbon emissions, buildings and the built environment offer the greatest and most cost-effective reduction opportunities.
- Progress has been encouraging, with building codes and technological innovation helping to lead the way towards a lower carbon footprint – but more needs to be done.

When we think of solutions to climate change we tend to think of the headline acts: electric vehicles, the energy storage revolution, smart cities, the rise of renewables. These are the topics that seem to enjoy the biggest audience when it comes to decarbonisation.

But away from the main stage, there's another act that has a big part to play. It's not often that we think of buildings and the built environment as being the 'rock stars' of climate change mitigation – but that's exactly what they are.

To understand why, consider the following from the International Energy Agency (IEA). Buildings, according to the IEA, represent nearly 40% of global energy-related carbon-dioxide emissions. That's considerably more than the entire transport sector (which accounts for some 23% of emissions) and more even than industry (accounting for 32%).

But there's more. Not only do buildings account for a significant portion of CO₂ emissions, they also offer some of the most cost-effective opportunities to mitigate them.

The European Commission has identified roughly 75% of the EU building stock as being energy inefficient. So, in Europe alone, that equates to a lot of wasted energy – all of which could be addressed by renovating existing building stock and building better when it comes to new construction.

Indeed, the Intergovernmental Panel on Climate Change (IPCC) suggests that of all the emissions reductions possible through 2030, buildings are by far the largest source of low-cost opportunities. Taken together they could be equal to all the opportunities in agriculture, industry, energy supply and forestry combined.

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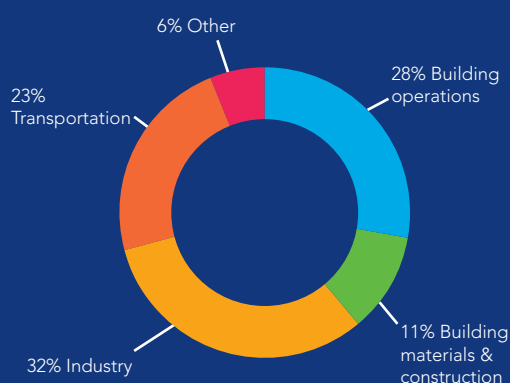
This is doubly important given the longevity of building stock. With an average useful lifespan of between 40 to 100 years, what happens to buildings today can still be relevant and meaningful for decades to come.

Building better: Fast facts

- By 2060, the world is projected to add 2.4 trillion square feet of buildings – more than double the current global building stock. Given population trends, this will largely occur in India, Africa and parts of Asia.
- This pace of development equates to adding another New York City to the planet every 34 days for the next 40 years.

Source: The American Institute of Architects



Global CO₂ emissions by sector

Source: Global Alliance for Buildings and Construction, 2018 Global Status Report, IEA

Global energy efficiency investments and total spending on buildings, 2018

US\$4.5tn

Total spending
on buildings
construction and
renovation



US\$139bn

Energy efficient
spending in
buildings

Note: HVAC = heating, ventilation and air conditioning. Source: Adapted from IEA (2019d), Energy Efficiency 2019.

Brick by (low carbon) brick

So, where are we today on our road to a world where buildings account for a lower carbon footprint?

In many ways, progress has been encouraging. The European Commission estimates that since the first measures were introduced under national building codes, the energy consumption in new buildings has halved, relative to typical buildings from the 1980s.

Meanwhile, more countries each year are putting building energy codes in place, green building certification is rising, and investment in energy efficiency increased to more than \$180bn in 2020 from \$129bn in 2015, when the Paris Agreement was adopted, according to data from the UN's Environment Programme¹.

In Europe, the EU Green Deal sets out an ambition to increase investment in renovated, energy efficient buildings. In the UK, likewise, the government is currently forming a new policy that all homes and businesses will have to meet rigorous energy efficiency standards to lower energy consumption and bills, helping to protect the environment.

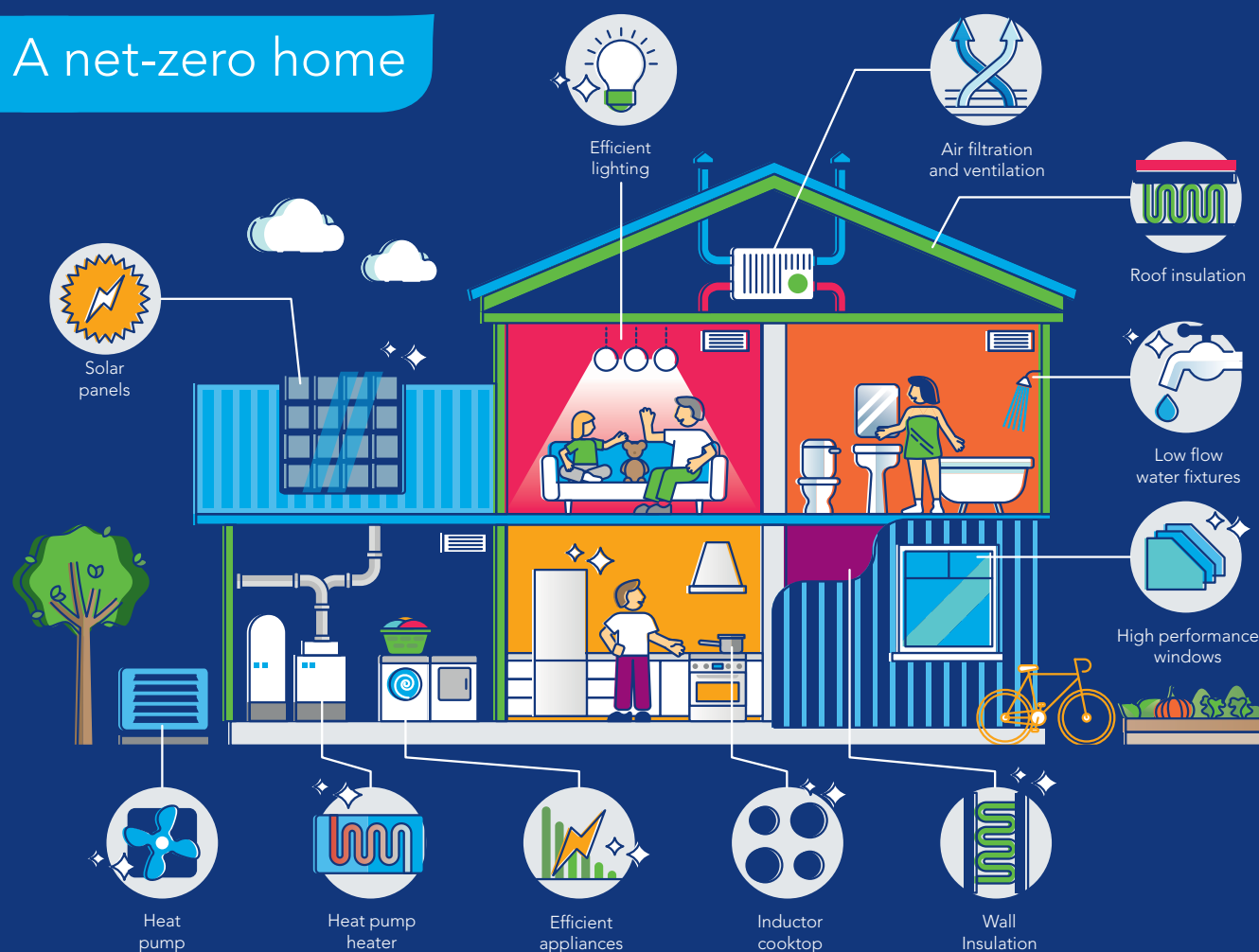
Even so, clearly, much more needs to be done. UN data suggests two thirds of countries worldwide still have no mandatory building energy codes. And, while there has been a boost in energy-efficiency investment, this has come predominantly from only a few European countries.

In Europe, the EU Green Deal sets out an ambition to increase investment in renovated, energy efficient buildings.

More worrying is the evidence that the headwinds are growing. The UN estimates that without meaningful change, emissions from buildings could double by 2050, rather than drop. This is due to a combination of factors: a slowdown in energy efficiency gains (from 3% annual improvement to 1.3%), coupled with a growing global population and the associated need for floor space around the world.

¹ United Nations: '2021 Global Status Report for Buildings and Construction', 19 October 2021

A net-zero home



Turning the tide in water preservation

Beyond decarbonisation, buildings offer various opportunities for resource efficiency.

In the US, the average family uses more than 300 gallons of water each day at home. Roughly 70% of this use occurs indoors. Of this, 24% is attributed to toilet use, 20% shower use and 19% taps².

Water scarcity is a growing issue in many regions, including in the US where a number of communities are beginning to face supply challenges – a US Government Accountability Office report from 2014³ noted that 40 out of 50 state water managers expected water shortages in some portion of their states over the next decade. To state the obvious, the less water we are able to use in the home, the less strain put on reservoirs and the more water available in lakes, rivers and streams.

The challenge, then, is to identify the right companies that are not only committed to providing solutions to the question of water wastage but which are also well-managed businesses with potential to provide a return for investors.

In the US, the average family uses more than

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Investable solutions

The Impact Opportunities team believes there is significant need for companies delivering solutions to decarbonise and those helping to provide a more circular economy.

Technology also offers an opportunity to reduce emissions of building operations:

- Smart metering technology can now not only let you know how much energy you are using, but also speak to the grid, allowing users a greater understanding of supply.
- More efficient cooling and heating systems such as heat exchange pumps can save energy inputs.
- Light bulb technology has shown significant improvement in reducing electricity needs.

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² Water Research Foundation, Residential End Uses of Water, 2016

³ Freshwater: Supply Concerns Continue, and Uncertainties Complicate Planning (gao.gov)



CASE STUDY

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%⁴. 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 account for the majority of its revenue base.

Smart/active meters: 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: The company's offering includes automated distribution equipment and monitoring kits.

Software and Analytics: 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 US⁵, 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, equivalent to the yearly electricity consumption of 54,000 homes⁶.

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 avoided⁷.

2020 impact measurement highlights for Itron

CO₂ avoided =

2.6mT

Waste recycled =

261mT

Female Mgt =

43%

CO₂ emitted =

1.5mT

Waste generated =

361mT

Water saved =

67.5k m³

SDG enabled R&D Funding =

\$194m

Female board =

22%

Water used =

9.9k m³

Source: Net Purpose, Federated Hermes Impact calculations, as at 31 March 2022.

⁴ As reported by the American Council for an Energy-Efficient Economy

⁵ See [Frequently Asked Questions \(FAQs\) - U.S. Energy Information Administration \(EIA\)](#)

⁶ Source: Commonwealth Edison (ComEd), performance metrics 2018.

⁷ Source: Federated Hermes, as at 31 December 2019. Note: The Impact Opportunities portfolio has been harmonised for calendar year impact.



UK company, Kingspan, is a leader in high performance insulation. With five business divisions making up the complete building envelope⁸, the company seeks to reduce the carbon emissions associated with inefficient buildings.

Impact theme: Impact Enabler



Our impact and investment case is focused around Kingspan's innovations in insulation which we believe are incredibly important in helping to target the huge emissions deficit associated with inefficient buildings. The company has set stretching sustainability targets and is demonstrating strong progress. For example, through the use of recycled materials in its products, increasing use of renewable energy and its ocean clean up initiative.

2020 impact measurement highlights for Kingspan

CO2 avoided =

1.8mT

CO2 emitted =

5.0mT

Female board =

18%

Waste recycled =

28.6mT

Source: Net Purpose, Federated Hermes Impact calculations, as at 31 March 2022.

We met with the company ahead of investing and have spoken with management on a number of occasions since initiating the position. We also spoke with the company specifically on the Grenfell inquiry both in late 2020 and early 2021.

We had another call recently in November with the chairman and independent director on the question of governance. This conversation provided more reassurance that the company is taking the right measures in regards to safety and culture, and that it understands how seriously shareholders have viewed the matter.

Our impact and investment case is focused around Kingspan's innovations in insulation which we believe are incredibly important in helping to target the huge emissions deficit associated with inefficient buildings.

From an investment perspective we still see upside to fair value. There is increasing recognition of the energy savings possible within buildings, and the corresponding climate change mitigation benefits.

We see strong multi-year growth opportunities for Kingspan organically, and more room for further M&A activity given its strong balance sheet.

From an investment perspective we still see upside to fair value.

Fast facts

- Kingspan is a leader in helping to decarbonise buildings. The superior thermal properties of its products versus competitors can reduce total emissions from heating and cooling residential, commercial or industrial buildings.
- The company has set science based emissions reduction targets, and its recently revised 'planet passionate' commitments continues to set ambitious thresholds (50% supply-chain carbon reduction by 2030).
- Product design is a material advantage and the company compares well with peers. Both in thermal properties, as well as in lifespan (30-year life-span vs ~eight years for competitor products). It uses recycled ocean plastic as an input in its insulation materials, one of many aspects of product impact.

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⁸ These divisions are insulation, insulated panels, light and air, data and flooring, water and energy.

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Federated Hermes

Federated Hermes is a global leader in active, responsible investing.

Guided by our conviction that responsible investing is the best way to create long-term wealth, we provide specialised capabilities across equity, fixed income and private markets, multi-asset and liquidity management strategies, and world-leading stewardship.

Our goals are to help people invest and retire better, to help clients achieve better risk-adjusted returns, and to contribute to positive outcomes that benefit the wider world.

All activities previously carried out by Hermes Investment Management are now undertaken by Federated Hermes Limited (or one of its subsidiaries). We still offer the same distinct investment propositions and pioneering responsible investment and stewardship services for which we are renowned – in addition to important strategies from the entire group.

Our investment and stewardship capabilities:

- **Active equities:** global and regional
- **Fixed income:** across regions, sectors and the yield curve
- **Liquidity:** solutions driven by four decades of experience
- **Private markets:** real estate, infrastructure, private equity and debt
- **Stewardship:** corporate engagement, proxy voting, policy advocacy

For more information, visit www.hermes-investment.com or connect with us on social media:  