

Federated Hermes Sustainable Global Equity

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One-year review: June 2023

**Federated
Hermes** 
Limited

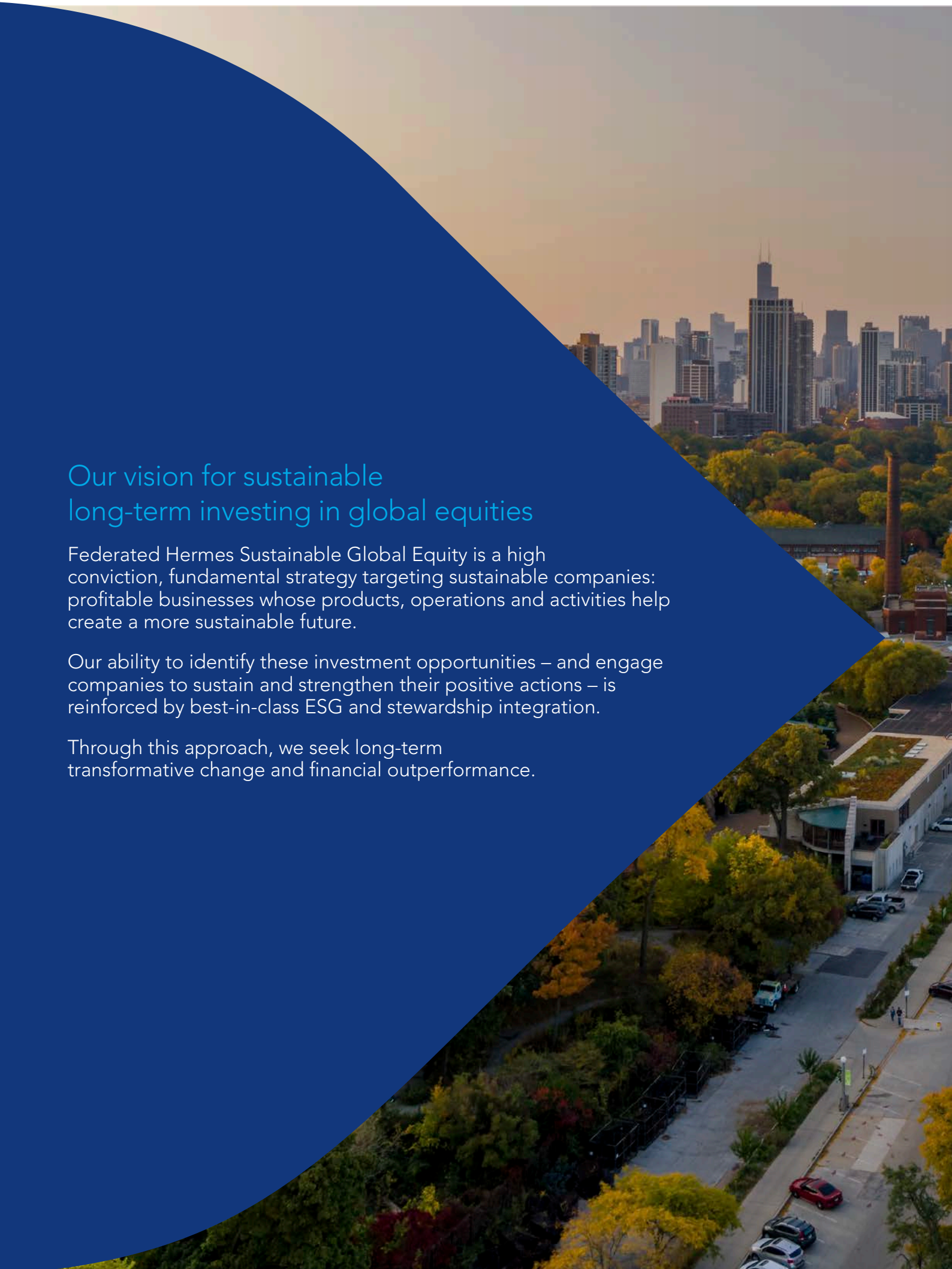
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For professional investors only

Our vision for sustainable long-term investing in global equities

Federated Hermes Sustainable Global Equity is a high conviction, fundamental strategy targeting sustainable companies: profitable businesses whose products, operations and activities help create a more sustainable future.

Our ability to identify these investment opportunities – and engage companies to sustain and strengthen their positive actions – is reinforced by best-in-class ESG and stewardship integration.

Through this approach, we seek long-term transformative change and financial outperformance.



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SECTION 1

Strategy philosophy

Exposure to sustainability themes

All portfolio holdings fit into one or more of our four investible themes, each of which consists of several sub-themes.

Environmental preservation

Sub themes include:

- Energy transition
- Biodiversity
- Future mobility
- Decarbonisation
- Electrification

Portfolio weighting: **23%**

Health and wellbeing

Sub themes include:

- Life sciences
- Pharmaceutical innovation
- Healthy and active lifestyles
- Medical equipment

Portfolio weighting: **22%**

Efficient production and resource usage

Sub themes include:

- Circular economy
- Better and faster decision-making
- Water preservation
- Supply chain efficiency
- Green materials

Portfolio weighting: **28%**

Social inclusion

Sub themes include:

- Democratising access to goods and services
- Financial inclusion
- Access to education
- Digitalisation

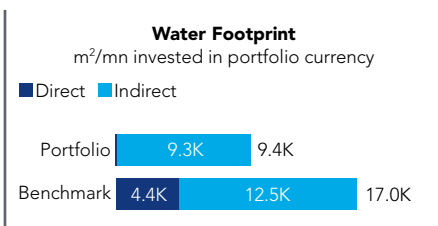
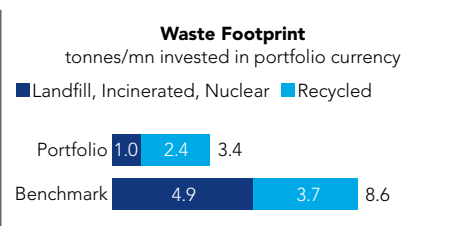
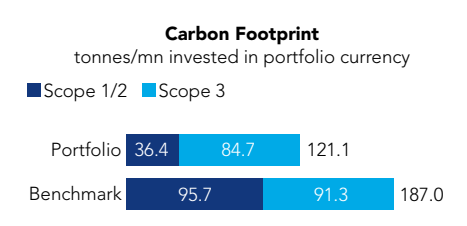
Portfolio weighting: **25%**

Source: Federated Hermes, as at 30 June 2023. The sub-themes listed above are not an exhaustive list. The portfolio weightings are subject to change.

Environmental footprint

The strategy aims to have a smaller environmental footprint than the benchmark, the MSCI All-Country World Index. As at 30 June 2023, the portfolio’s carbon, waste and water footprints measured as follows:

	Portfolio (tonnes per US\$m invested)	Benchmark (tonnes per US\$m invested)
CO₂ footprint (scope 1, 2 & 3)	121.1	187
	Portfolio (m ³ per US\$m invested)	Benchmark (m ³ per US\$m invested)
Waste footprint	3.4	8.6
Water footprint	9.4K	17K



Source: TruCost, Federated Hermes, as at 30 June 2023.

Engagement themes

The team’s engagement efforts covered 96% of the strategy’s AUM. The breakdown by theme was as follows:



Source: Federated Hermes, as at 30 June 2023.

The team’s engagement efforts over the last 12 months covered

96% of the strategy’s AUM.



Portfolio positioning

As at 30 June 2023, the portfolio’s top 10 active positions were as follows:

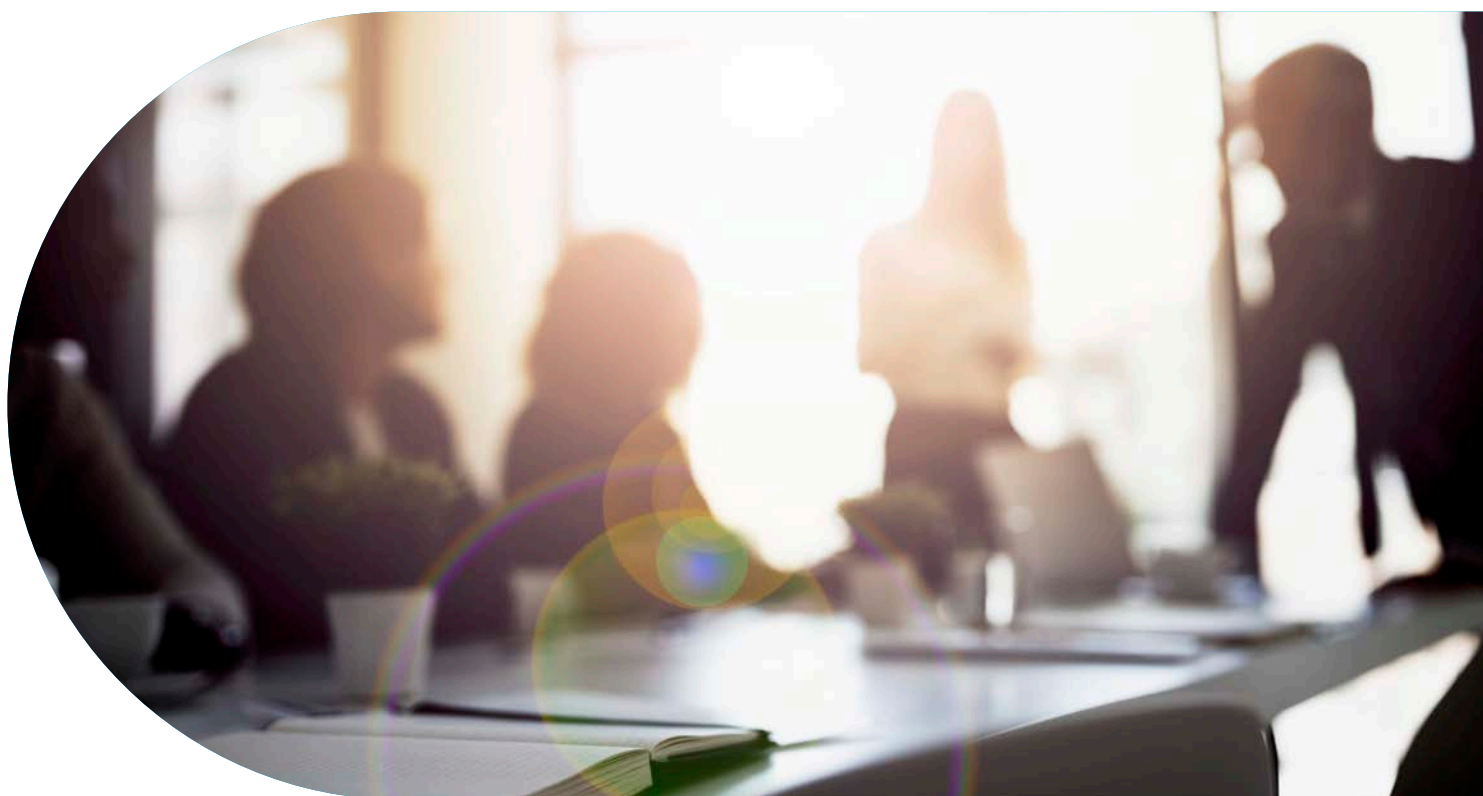
Holding	Portfolio weight (%)*
Microsoft	6.70
Nvidia	4.44
Novo-Nordisk	4.22
Mastercard	3.63
Thermo Fisher	3.55
Costco Wholesale	3.20
PTC	3.19
Deere & Co	3.14
Republic Services	3.12
RELX	3.04

Source: Federated Hermes, as at 30 June 2023.

*The portfolio weight is calculated as the strategy weight minus the benchmark weight.

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The above does not represent all of the securities held in the portfolio and it should not be assumed that the above securities were or will be profitable.



Impact performance, 2022

Total company level impact of stocks held, 2022

46 mil Total Scope 1 and 2 emissions / Metric Tonnes 

225 mil Metric Tonnes of CO₂e avoided 


46 k MT food waste avoided 

342 mil m³ volume of water saved 

104 mil MT Conventional material production avoided 

56 mil Total patients treated/served / unit(s) 

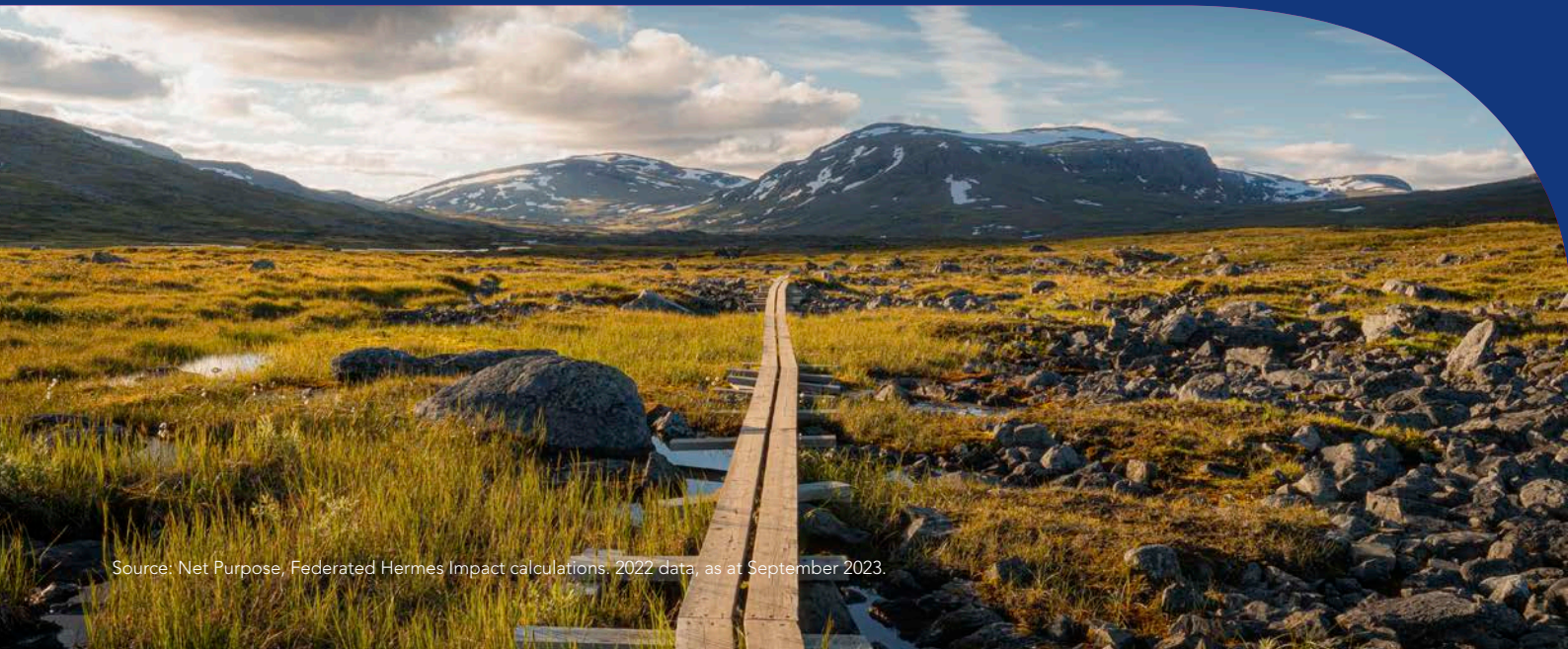
56 mil Life Sciences R&D enabled, USD\$ 

12 mil clients provided new access to financial services / unit(s) 

9 mil Renewable electricity produced / MWh 

117 mil Jobs supported – indirect / unit(s)

21 bil Clean distance travel enabled / KM 



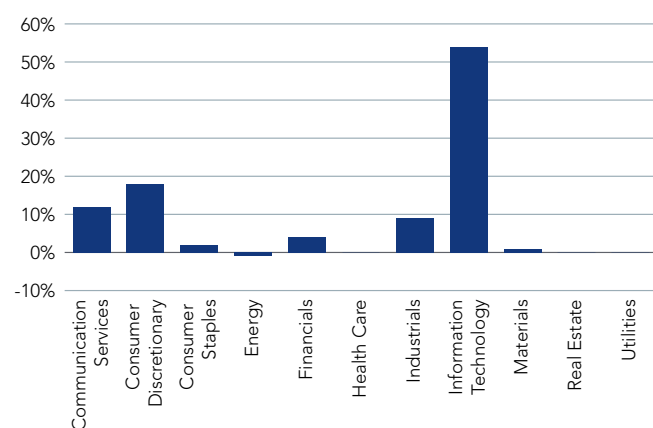
SECTION 2

Market performance

In contrast to the first half of 2022 (which saw the worst H1 return for developed markets in 50 years), easing inflationary pressures in the final quarter of 2022 fuelled a strong rally in both equities and bonds. This momentum continued into the start of 2023 thanks to the reopening of the Chinese economy and enthusiasm around Artificial Intelligence (AI).

One of the defining characteristics of the first half of 2023 was the narrow market breadth, as the majority of returns were driven by a small number of tech-focused mega cap stocks. Almost 90% of returns from the MSCI All Country World Index (ACWI) were generated by just three sectors – Information Technology, Communication Services and Consumer Discretionary, as shown in Figure 1 below. Similarly, over 75% of the return of the S&P 500 can be attributed to just 10 stocks.¹

Figure 1: Proportion of MSCI ACWI returns by sector, H1 2023



Source: Federated Hermes, as at 30 June 2023.

Past performance is not a reliable indicator of future performance.

Outside of the AI-generated excitement, investors remained cautious. Inflationary pressures proved to be more persistent than anticipated and central banks maintained their hawkish tone as strong economic data continued through the first half of 2023.

The overall performance of equities has confounded the sceptics, and risk appetite has picked up, as evident in market broadening in June including cyclicals and smaller cap companies. Information Technology and Industrials were the best performing sectors while Real Estate and Utilities were the worst. Real Estate was the only sector to end the period in negative territory. Large cap outperformed small cap and growth outperformed value.

Performance review²

The Strategy outperformed its benchmark, the MSCI All Country World Index, by 9.53%.³ The excess return was driven primarily by strong stock selection and supported by a healthy contribution from sector allocation. Our selection and overweight in Information Technology and Industrials and selection in Health Care and Financials was particularly supportive and offset the detraction from our selection in Consumer Discretionary and overweight in Health Care.

Nvidia, a semiconductor company specialising in AI, was the best performing stock over the period. The company's shares hit record highs in H1 2023, as forecast sales were 53% higher than analyst' estimates. The jump was propelled by an increased demand for AI processors, which are needed in data centres that run accelerated computing such as ChatGPT. Novo Nordisk, a pharmaceutical company, benefited from an accelerating uptake of its diabetes and obesity treatments. More recently, the supply constraints of its obesity drug, Wegovy, have eased, and the international launches of the drug have boosted sentiment. The company received FDA approval for its oral diabetic treatment, Semaglutide, in Q1 2023. Mexican financial institution, Grupo Financiero Banorte, also enjoyed strong performance over the period on the back of rising net interest margins and healthy asset quality. The Mexican economy remains in rude health and is a beneficiary of near-shoring of supply chains.

Apple, Thermo Fisher Scientific and AIA were the largest individual detractors from performance over the period. Not owning Apple detracted from performance as investor sentiment improved following a jump in service revenue, an easing of production problems and as China rebounded following the removal of lockdown restrictions. Thermo Fisher Scientific, a life science and healthcare diagnostics company, declined after posting a fall in Q1 Covid-19 testing revenue. The share price fell despite management affirming its commitment to long-term organic growth revenue guidance of 7-9% and adjusted EPS growth in the mid-teens. Insurance company, AIA, started the period strongly however, shares declined on the news of bank failures which included First Republic Bank as well as the rescue deal for Credit Suisse.

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¹ Federated Hermes, as at 30 June 2023.

² Management fees are not included and will have the effect of reducing performance.

³ Source: Federated Hermes as at 30 June 2023. Performance shown is the Federated Hermes Int'l Sustainable Global Equity Strategy Hedged to US\$ Strategy. In US\$, gross of fees. Inception date: 30 June 2021. Benchmark: MSCI All Country World IMI Index hedged to US\$. **Past performance is not a reliable indicator of future returns.**

SECTION 3

Activity highlights

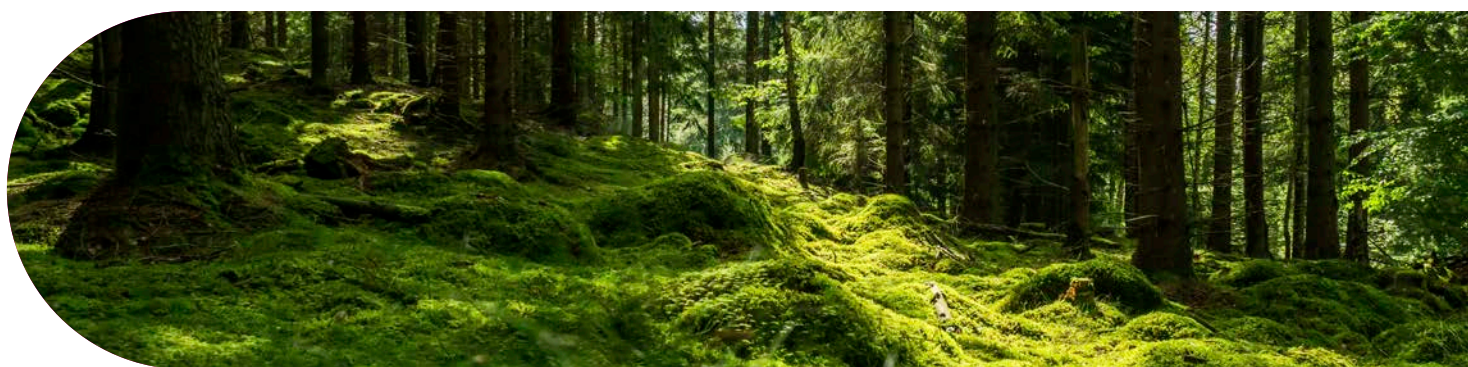
A high conviction, fundamental strategy targeting sustainable companies: profitable businesses whose products, operations and activities help create a more sustainable future. Market movements in 2022 provided opportunities to purchase a number of new holdings at attractive valuations, including ICICI Bank and Republic Services.

Trading – Purchases

ICICI Bank	The bank is a leading franchise in India and is winning market share, while benefiting from an attractive macro-economic backdrop. It has strong financial inclusion credentials, most notably through the expansion of its digital product portfolio in a country with low financial access. It is also accelerating lending in its micro, small and medium-sized enterprise business.
Fuyao Glass Industry Group	The company is the primary supplier of auto glass to the electric vehicle industry. Fuyao has strong market leadership, and continues to take share as EV adoption increases.
Republic Services Group	Republic Services is the number two player in the North American waste management industry, a market characterised by through-cycle resilience and improved pricing power. The company's investments in integrated plastics recycling facilities and waste-to-energy present future growth opportunities, while the recent acquisition of US Ecology in hazardous waste supports future pricing power.
American Tower	As the industry-leading US Tower REIT, American Tower offers consistent, long-term contracts with embedded inflation protection, low variable costs, high operating leverage, and an attractive cash flow profile. The company's well-diversified asset base offers exposure to high-growth emerging markets alongside the domestic business.
HCA Healthcare	As the largest for-profit hospital operator in the US, caring for more Medicaid inpatients than any other health system in the country, HCA plays a vital role in providing high quality, affordable health care. As populations age and grow in its key markets, we expect HCA to benefit from higher volumes and acuity mix.
Datadog	The company is a leading monitoring and security platform for cloud-based infrastructure and applications. It has proven unit economics and a strong competitive advantage. As the cloud spending environment becomes more benign, we expect Datadog's consumption-driven model to benefit.

Trading – Sales

Natura	Buffeted by macro headwinds at the same time as trying to integrate the acquisition of Avon. Missed synergy targets and a series of management changes followed.
Verisk	A series of lacklustre earnings updates led to a reappraisal of the company's overall quality. Given the steep valuation, we saw better risk/reward elsewhere.
Itron	A lacklustre meeting in late 2022 led to unanswered questions around the company's capital allocation priorities. Given the overweight in tech within the broader portfolio, we closed the remaining 0.5% position given better opportunities elsewhere.
Baxter	Conviction had been waning after a series of disappointments which point to more structural concerns with the business, rather than temporary or Covid-19/ lockdown-related issues.
Sunnova	Higher interest rates pose a challenge for the company, and while we expect continued strong demand, it is less clear how that will flow through to profitability.
Ocado	Rising interest rates have led to balance sheet pressure on Ocado's capital intensive Solutions business. This has coincided with a dearth of new license agreements.



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THEMATIC FOCUS

AI: How artificial intelligence can help address UN SDGs

Excitement around recent developments in artificial intelligence (AI) has sent associated tech stocks soaring, but there is a much broader, longer-term story. Over a multi-year time frame, we see AI not only benefiting general productivity in most sectors in the market, but also supporting progress towards the United Nations Sustainable Development Goals (UN SDGs).

While the concept of artificial intelligence has been around for decades, the last nine months has seen the buzz around AI reach fever pitch. Interest spiked with the launch of Open AI's generative AI-based chatbot, ChatGPT, in November 2022. Since then, discussion of the range of potential use cases for generative AI have been a recurring theme in the media (see Figure 2 below).

What is generative AI?

Generative AI is a form of machine learning that employs neural networks to identify the patterns and structures within existing data. It then uses this information to generate new and original content such as text, code, images or video.

For decades, the key focus of interest in AI research was on whether successive innovations in AI represented a genuine form of 'intelligence'. More recently, this has given way to rising concerns around the potential threat to society presented by misdirected or 'rogue' AI.

Fast reading

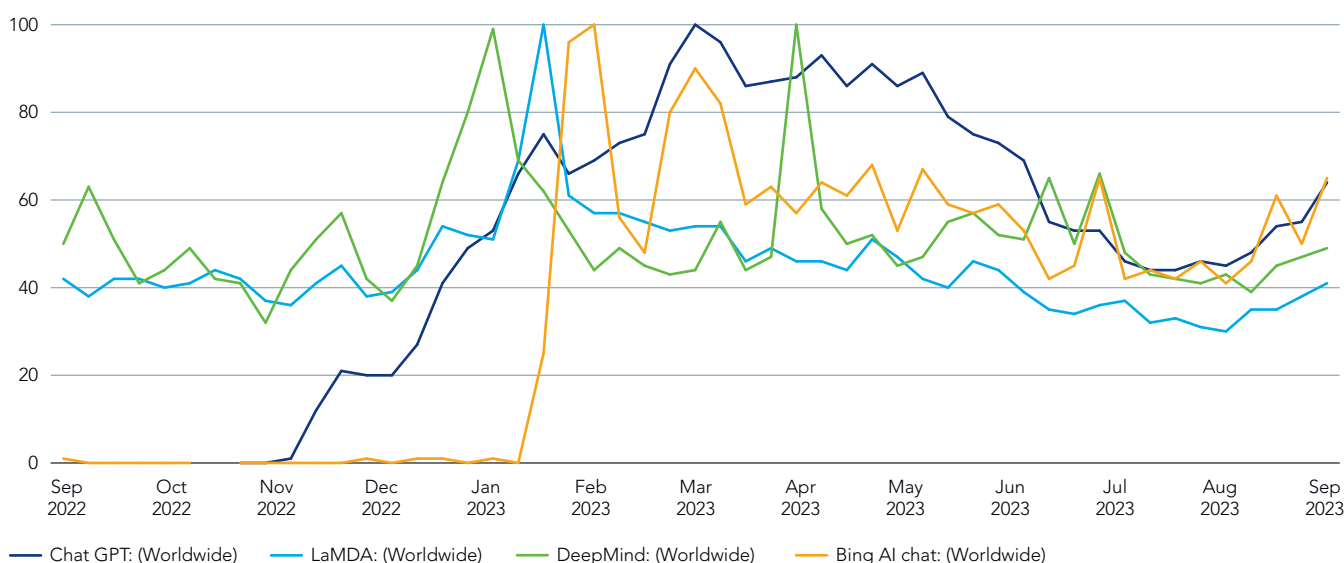
- Recent developments in generative AI have sparked considerable excitement about its potential impact across almost every sector of the global economy. As well as driving productivity, generative AI can act as a significant enabler of a more sustainable future.
- We see generative AI benefiting three key company types: 'foundation' businesses essential to building generative AI systems; 'utilities' that provide core services such as models for training AI; and 'fixtures and fittings' firms that use AI in practical applications.

However, the emergence of generative AI as a practical tool is rapidly changing the narrative. Whether 'machine intelligence' is really intelligent is becoming something of a moot point – more important is the technology's huge implications for the global economy, and for society generally.

Generative AI's ability to analyse and interpret vast quantities of data makes it suitable for a wide range of tasks.

Generative AI's ability to analyse and interpret vast quantities of data makes it suitable for a wide range of tasks (see Figure 3 below). Given its potential, fears around the threat AI might represent to society are now competing with considerable excitement around the benefits generative AI can offer.

Figure 2: Google Trends – mentions of generative AI, September 2022 – September 2023



Source: Google trends as at September 2023. Numbers on the y axis represent search interest relative to the highest point on the chart for the given region and time. A value of 100 is the peak popularity for the term. A value of 50 means that the term is half as popular. A score of 0 means there was not enough data for this term. ChatGPT is owned by OpenAI, in which Microsoft has a potential 49% stake. Google acquired DeepMind in 2014. LaMDA is a conversational language model developed entirely in-house at Google. Bing AI, also known as Bing Chat, is an artificial intelligence (AI) chatbot developed by Microsoft on a foundation model developed by ChatGPT and released in 2023. **This information does not constitute a solicitation or offer to any person to buy or sell any related securities or financial instruments.**

Figure 3: Generative AI Capabilities

Capability	Example
Perception (visual, textual or tactile)	Face recognition
Decision-making	Medical diagnosis systems
Prediction	Weather forecasting
Knowledge extraction and pattern recognition	Identifying fake news circles on social media
Interactive communication	Chatbots
Logical reasoning	Developing scientific theories

At Federated Hermes, we are highly aware of the potential negative implications of AI and have been engaging with companies on understanding and managing the business and wider societal impacts for several years. We published our Investors' Expectations on Responsible Artificial Intelligence and Data Governance back in 2019, which sets out six clear principles for companies' use of AI. However, we also recognise the enormous positive potential of AI, and it is this aspect we will chiefly focus on here.

The business case for AI

By making smart technology smarter, generative AI will act as a significant enabler. The resulting productivity effect – in which new technology enhances workers' efficiency and/or creates new jobs – will be felt throughout the global economy.

By making smart technology smarter, AI will act as a significant enabler. The resulting productivity effect will be felt throughout the global economy.

In our view, there are three types of companies that will be the key beneficiaries of generative AI. A useful analogy to explain these is that of building a house, for which you need strong foundations, utilities such as water and electricity, and fixtures and fittings.

- **AI 'foundations':** Provided by semiconductor companies such as Nvidia, whose products are essential to building a generative AI system.
- **AI 'utilities':** Core generative AI services provided by hyperscale companies like Microsoft, such as access to proprietary or third-party foundational models for training and inference.
- **AI 'fixtures and fittings':** Practical applications being developed by software companies like Adobe, that are typically based on or require hyperscale generative AI services/functionality.

Over a multi-year time frame, we see AI benefiting most sectors if employed effectively – as well as creating the potential for entirely new industries. Its potential positive impact on productivity is comparable to (but potentially far greater than) the impact of the introduction of computing into the industrial and commercial sphere. However, generative AI's potential doesn't stop there; it can also play a significant role in creating a more sustainable future.

The sustainability case for AI

Generative AI's ability to streamline workflows makes it a potentially powerful enabler in the drive for a more sustainable future. In fact, research published in the academic journal Nature Communications⁴ found that AI could enable the accomplishment of 134 of the 169 targets across the 17 UN Sustainable Development Goals (SDGs). While the range of use cases is too wide to go into in detail, it's worth highlighting some of the more significant applications for AI in this context.

AI could enable the accomplishment of 134 of the

169 targets across the 17 UN Sustainable Development Goals (SDGs).

1. Environmental outcomes

From highly detailed monitoring and analysis to modelling, predicting and managing issues, generative AI has significant potential to improve environmental outcomes:



SDG 6 – Clean Water & Sanitation: Enhanced water quality monitoring and contamination detection; supply and demand prediction and management; catchment management and flood response.



SDG 7 – Affordable and Clean Energy: Supporting research and development in renewable technology; enabling smart grids to increase the usability of variable renewable power e.g., wind and solar; predicting and managing power demand and supply.



SDG 14 – Life Below Water: Reducing the amount of plastic waste that ends up in oceans; supporting clean-up of the marine environment; analysing underwater visual data; tracking and monitoring fish stocks and fishing activity.



SDG 15 – Life on Land: Improving climate modelling; tracking and forecasting emissions; tracking deforestation, desertification and degradation; monitoring distribution and abundance of natural species.

⁴ 'The role of artificial intelligence in achieving the Sustainable Development Goals'. Published in Nature Communications, as at 13 January 2020. <https://www.nature.com/articles/s41467-019-14108-y>

2. Social outcomes

Generative AI has the power to improve social outcomes by supporting decision-making and delivering more equitable services:



SDG 1 – No Poverty: Improving access to technology and education to aid social mobility; assisting decision-making; enlarging data coverage; delivering greater agricultural efficiency.



SDG 4 – Quality Education: Improved reach and accessibility; tailored learning to maximise achievement; mapping education to future employment needs.



SDG9 – Industry, Innovation and Infrastructure: Enabling efficient and sustainable manufacturing; monitoring and optimising traffic, waste collection and other public services; predicting, detecting and managing disasters.



SDG 11 – Sustainable Cities and Communities: Supporting urban planning decisions for more liveable cities; delivering more efficient and equitable transport systems; supporting public safety and crime prevention; enabling more efficient waste management.

The threat

Generative AI will be disruptive in the truest sense, with negative as well as positive consequences. It's worth noting that as well as highlighting the opportunity offered by AI, the research published in Nature Communications flagged the need for regulatory insight and oversight for AI-based technologies, to ensure transparency, safety, and ethical standards.

AI's advancement pulls the counterintuitive reality of Jevons Paradox⁵ into focus; from a societal perspective, significant improvements in efficiency will also almost inevitably lead to job losses in the short term, although this may be countered by new employment opportunities in newly created sectors over the long term.

The opportunity

The immediate beneficiaries of the generative AI revolution will be the foundation companies described above. Nvidia, which is a dominant force in AI hardware and software, is the most obvious example (see case study, page 12).

Utility style companies such as Microsoft (see case study, page 13) and fixture and fittings style firms such as Adobe (case study, page 14) are already experiencing heightened investor interest, but will monetise generative AI more gradually over time.

Over the longer term it will be about which companies position themselves most effectively to benefit from the power of generative AI in their specific sectors.

Over the longer term it will be about watching to see which companies position themselves most effectively to benefit from the power of generative AI in their specific sectors. We are monitoring this aspect closely.

⁵ Jevons Paradox: An economic phenomenon which states that, in the long term, an increase in efficiency in resource use will generate an increase in resource consumption rather than a decrease.

 CASE STUDY

Nvidia

Nvidia Corporation is an American multinational computing platform company. Its products include graphics cards, chips and APIs for supercomputers, cloud computing, workstations, mobile phones and autos. Significantly, it is a dominant supplier of hardware and software that is tailored for artificial intelligence applications.



Nvidia has enjoyed a raised profile recently due to its position as the leading player in the market for AI hardware and software. However, the firm's history goes back 30 years, and it has been a publicly traded company since 1999.

Although its initial commercial success was built around supplying graphics cards for the video gaming market, from the start Nvidia has invested heavily in research and development to solve a range of massive computational problems. This has enabled it to expand its offering over time to include hardware and software solutions for diverse industries and applications, including robotics, autonomous driving and healthcare.

During 2023 the business has become a major beneficiary of two platform transitions: accelerated computing and generative AI. According to Nvidia, there is roughly US\$1tn of data centre spend in terms of general-purpose computing that is transitioning at a faster pace.

Nvidia's commitment to ongoing innovation make it a true impact enabler in AI and cloud computing, a field in which it has a strong presence.

Why we're invested

Nvidia's commitment to ongoing innovation make it a true impact enabler in AI and cloud computing, fields in which it has a strong presence.

- **Driving sustainability:** Through AI, the company can contribute significantly to delivering on the UN Sustainable Development Goals (SDGs).
- **Reducing emissions:** The firm's cloud computing offering can help SMEs reduce their carbon footprint by up to 80% compared to on-premises IT infrastructure.⁶
- **Underappreciated potential:** Its potential to drive productivity gains and facilitate the shift to autonomous vehicles is yet to be fully appreciated by the market.
- **Product quality:** Nvidia's graphics processing units (GPUs) are up to 30 times more efficient than the competition.⁷



- **Environmental performance:** The firm ranks positively on carbon intensity versus its peers, while its energy, water use, and hazardous waste intensity are also best in class.
- **Strong social and governance:** Nvidia invests heavily in its people, is working to improve diversity, and has an independent board.

⁶ World Leader in Artificial Intelligence Computing | NVIDIA.

⁷ Ibid.

 CASE STUDY

Microsoft

Microsoft Corporation is an American multinational technology platform company founded in 1975. Best known for its Windows operating system, the firm's products and services also include cloud computing, productivity software, videogame consoles, social networking and computer hardware.



Over the last decade, Microsoft has positively evolved from being a global software monopolist to its current position as a global diversified tech platform. The company's CEO and CFO are widely acknowledged as one of the best management duos in the corporate world; their transformation of the company is reflected in its improved execution in technology platform shifts such as cloud computing and generative AI. Microsoft is an example of solid corporate governance, with a high proportion of independent directors and strong female representation relative to the wider tech sector.

In January 2023, Microsoft announced a new multibillion-dollar, multi-year deal with OpenAI, the developer of the ChatGPT chatbot (which is a case study for generative AI), as well as its underlying foundational models and other AI services.

Microsoft's commitment to reaching 'true net zero' by 2050, by extracting all the carbon emitted since the company's founding in 1975, is ground-breaking.

Why we're invested

Microsoft's productivity software and cloud computing businesses have large total addressable markets and continue to provide secular growth opportunities, while it is also well-positioned for the AI revolution.

- **Strong core business:** The company's legacy Windows business is a mature cash cow which enjoys a deep moat, high barriers to entry and high switching costs; the breadth and depth of its technology platform and its tenured enterprise relationships provide resilience.

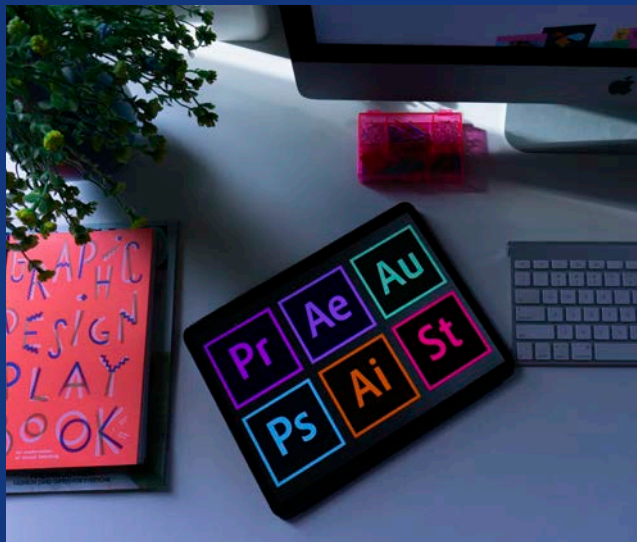


- **AI positioning:** Its focus on both on new generative AI services and on integrating AI into existing software applications can drive efficiency gains across a wide range of sectors and themes, opening the business to new revenue streams.
- **Financial robustness:** The business has a strong balance sheet, is highly cash generative, and has a strong track record in terms of capital allocation.
- **Sustainability:** Microsoft's use of renewable energy compensates for the high energy usage of its cloud computing business; its carbon intensity is already low versus peers, while its commitment to reaching 'true net zero' by 2050, including the extraction of all carbon emitted since the company's founding in 1975, is ground-breaking.

 CASE STUDY

Adobe

Adobe Inc. is an American multinational software company founded in 1982. It specialises in applications for the creation and publication of a wide range of content, including graphics, photography, illustration, animation, video, multimedia, motion pictures and print.



If Adobe itself is less of a household name than Microsoft or Apple, the names of its products and solutions, including Photoshop and the PDF file format, will be familiar to almost anyone.

The company's keen historical focus on content creation has enabled it to gain a near monopoly across audio visual formats. More recently it has branched out into digital marketing software and become a global leader in customer experience management.

As well as increasing productivity and enhancing innovation, Adobe's generative AI-powered tools promise to democratise creativity.

Why we're invested

Adobe enjoys global influence across almost every genre of content creation, while its forward-looking approach means it has already harnessed and integrated the power of AI into its solutions.

- The company's enviable market position creates a deep and durable moat and high profitability; its SaaS (software-as-a-service) business model delivers more than 90% recurring revenue.



- As well as increasing productivity and enhancing innovation, Adobe's Sensei GenAI machine learning-based productivity tool and Firefly generative AI-powered content creation tool promise to democratise creativity by lowering the barriers for content creation.
- Carbon, waste and water intensity are low relative to peers and the wider IT sector; by 2025 Adobe aims to power 100% of its operations with renewable electricity.
- The company also scores well on most social themes, investing in initiatives that enhance transparency and embeds data protection into its products and services.

THEMATIC FOCUS

Building a circular economy

Improving waste management and developing a circular economy aligns with a number of the United Nations Sustainable Development Goals (UN SDGs). Success will require action on multiple fronts. Two key facets will be minimising the environmental impact of waste, and embedding recycling and reuse deeper into waste processing and the design of products and packaging.

Fast reading

- Waste management and the circular economy align with UN SDGs including SDG9 – Industry, Innovation and Infrastructure and SDG11 – Sustainable Cities and Communities. Key to success will be both reducing waste and minimising its environmental impact.
- Innovation and investment at both ends of the system are driving more positive outcomes: improved packaging design and better recycling facilities are boosting reuse and recycling, while better landfill management reduces emissions and can generate renewable energy.

Another key investable theme that links to several of the United Nations Sustainable Development Goals (SDGs) is better waste management. This is targeted by SDG9 – Industry, Innovation and Infrastructure and SDG11 – Sustainable Cities and Communities.

According to the World Bank, 2.01 billion tonnes of municipal solid waste are generated annually around the world, a third of which is openly dumped or burned.⁸ Despite widespread media coverage and public concern about issues like the quantity of plastic ending up in our oceans, this figure is rising at double the rate of population growth – the World Bank estimates overall municipal solid waste could hit 3.4 billion tonnes by 2050 unless urgent action is taken.⁹

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2.01

billion tonnes of municipal solid waste are generated annually around the world, a third of which is openly dumped or burned.¹⁰



While reuse, remanufacture or repair are preferable where possible, addressing the issue will require a multi-pronged approach. This includes incentivising reduced usage at a commercial and consumer level, encouraging and facilitating recycling, and improving waste treatment.

Minimising the environmental impact of waste: energy from landfill gas

A number of waste management companies such as Republic Services (see Case Study 4 below) are opting to decarbonise their operations by utilising the natural gas by-products of landfill sites to generate renewable energy.

While carbon dioxide from fossil fuels and industry is the biggest cause of the greenhouse effect, methane is also a significant contributor, accounting for 16% of global greenhouse gas emissions.¹¹ What's more, methane has around 80 times more heat trapping potential than carbon dioxide over the first 20 years after its release into the atmosphere, making it far more significant as a climate change agent than pure percentages suggest.¹²

Fortunately, however, methane breaks down far more quickly than carbon dioxide, which can linger in the atmosphere for centuries. As a result, the UN Environment Programme has described addressing methane emissions as 'the strongest lever we have to slow climate change over the next 25 years'.¹³

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25

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^{8,9,10}https://datatopics.worldbank.org/what-a-waste/trends_in_solid_waste_management.html

¹¹'Global Greenhouse Gas Emissions Data'. Published by the United States Environmental Protection Agency, accessed 27 August 2023. <https://www.epa.gov/ghgemissions/global-greenhouse-gas-emissions-data>

¹²'Ask MIT Climate: Why do we compare methane to carbon dioxide over a 100-year timeframe? Are we underrating the importance of methane emissions?' Published by MIT Climate Portal, updated 6 July 2023. <https://climate.mit.edu/ask-mit/why-do-we-compare-methane-carbon-dioxide-over-100-year-timeframe-are-we-underrating>

^{13,14}'Press Release: Global Assessment: Urgent steps must be taken to reduce methane emissions this decade'. Published by the UN Environment Programme, 6 May 2021. <https://www.unep.org/news-and-stories/press-release/global-assessment-urgent-steps-must-be-taken-reduce-methane>

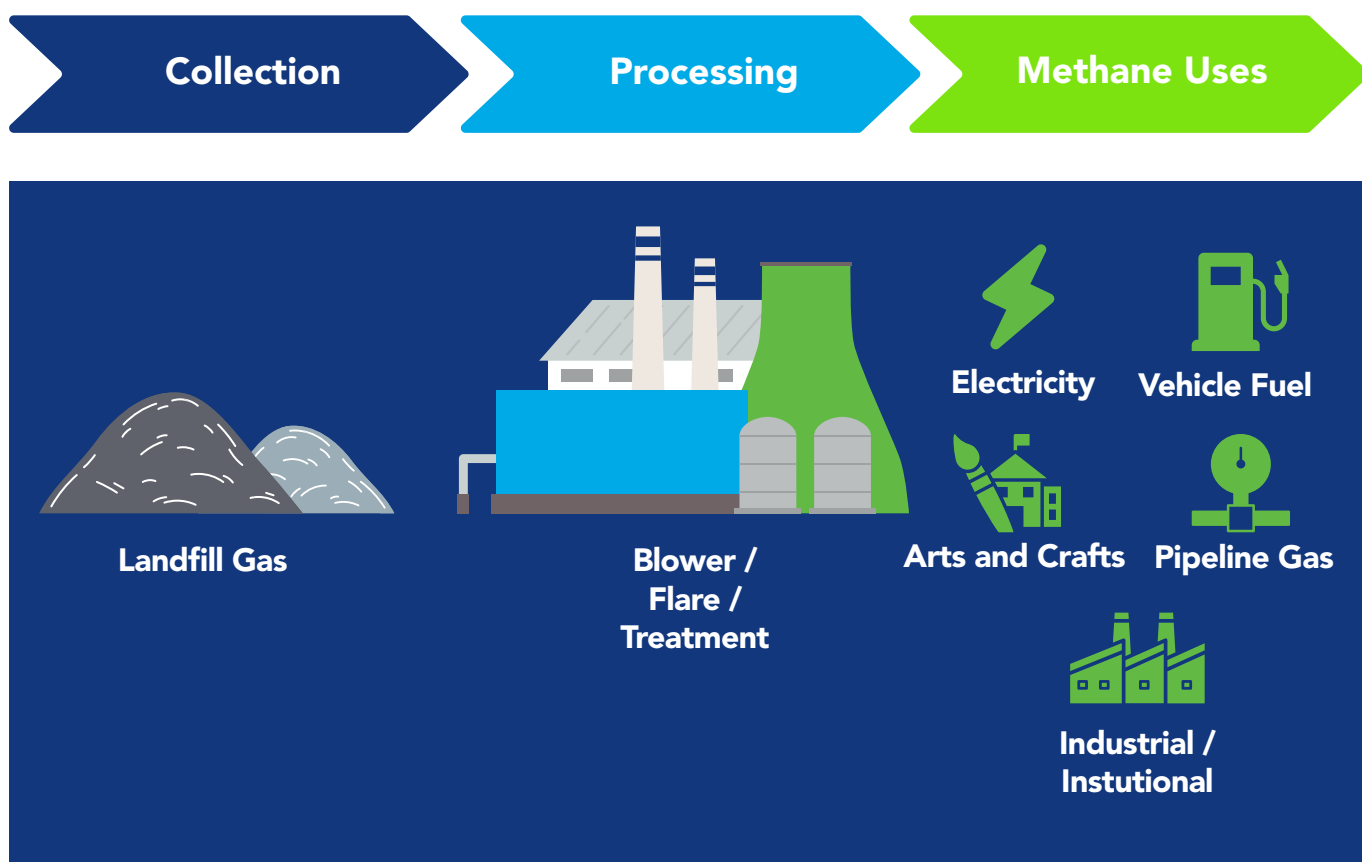
The landfill gas (LFG) emitted when solid waste biodegrades contains roughly equal proportions of methane and carbon dioxide, along with small amounts of other gases. LFG makes waste the fourth largest source of emissions after combusting fuels, agriculture and industrial processes.¹⁵

While dangerous to the environment, LFG is potentially useful. It can be used directly to generate heat and/or electricity, or processed to produce methane for use as a fuel or in the production of plastics, fertiliser, anti-freeze and fabrics (see Figure 4).

LFG can also be upgraded to renewable natural gas (RNG), which has a higher calorific content and can be used as a direct replacement for natural gas from fossil fuel sources.

A recent research note from Goldman Sachs estimated a free cash flow tailwind for the environmental services sector of up to 21% over the next 5-8 years, based on announced landfill gas projects.¹⁶ The economics of RNG are particularly compelling – costs are higher than for conventional gas, but the value of carbon reduction credits more than compensates for this, while demand should more than match supply.

Figure 4: Landfill gas can be processed to produce methane for multiple uses



Source: United States Environmental Protection Agency (EPA), as at July 2023.



¹⁵ 'Greenhouse gas emissions from waste'. Published by Eurostat (an official website of the European Union), 23 January 2020. <https://ec.europa.eu/eurostat/web/products-eurostat-news/-/ddn-20200123-1>

¹⁶ Goldman Sachs, Energy, Sustainability & Environmental Services, 'Is landfill gas an economically & environmentally attractive solution?', as at August 2022.

Figure 5: The lifecycle of RNG and how it generates revenue for waste companies

Source: Jefferies, Equity Research, as at 2 April 2023.

Research by Jefferies puts margins for US RNG at 60-70% in 2026, thus adding significantly to waste companies' future earnings before interest, taxes, depreciation and amortisation (EBITDA).¹⁷

The most significant RNG development so far is a joint venture between RNG producer Archaea Energy (now BP) and US waste player Republic Services (see the case study, page 18).

Embedding recycling and reuse: improving packaging recyclability

While reducing the environmental impact of landfill waste is a highly positive step, the ultimate aim should be to minimise the amount of waste material reaching landfill in the first place. To achieve this, recycling and reuse must be incentivised and facilitated to ensure the maximum amount of waste material goes back into the value chain to be used again. At the same time, products must be made as recyclable and reusable as possible.

AI can help firms analyse the environmental impact from raw-material extraction through processing, manufacturing, distribution and use to reuse, recycling or disposal.

Leaders in the field are driving innovations in product and packaging design that reduce waste, improve recyclability and reusability, and boost their overall sustainability credentials – and those of the companies that use their products.

Modelling the lifecycle of a potential product system can enable companies to assess its overall environmental impact. With the help of AI and big data, firms can analyse the impact at every stage, from raw-material extraction through processing, manufacturing, distribution, use and maintenance, then onwards to reuse, recycling or disposal.

Aptar, a key player in delivery solutions, is a significant innovator in this respect (see case study, page 19).

¹⁷ Jefferies, Equity Research as at 2 April 2023.

 CASE STUDY

Republic Services

Republic Services is an American waste and environmental services company offering collection, transfer, recycling and disposal of domestic, commercial, industrial and hazardous waste. Its 16% market share makes it the second largest company in its sector in the US by revenue.



Republic Services is one of a handful of major players in the US solid and hazardous waste management sector. As well as owning 239 transfer stations and 198 active landfills, the firm owns 71 recycling processing centres for cardboard, newsprint, aluminium, glass and other materials.

In 2022 the company launched a joint venture with Archaea Energy (now BP) to commercialise the conversion of gas from its landfill sites into pipeline-quality renewable natural gas (RNG). Comprising 39 different projects across 19 states, it is the biggest RNG portfolio in the US to date. The aim is to increase the beneficial reuse of biogas at Republic Services' landfill sites by 50% by 2030 (versus a 2017 baseline).

Republic are also investing in a network of Polymer Centres, which will be the first vertically integrated plastics recycling facilities in the US. They will make Republic the first single company to manage the full plastic waste stream from kerbside collection to the delivery of quality, recycled content for consumer packaging.

The first centre is due to open in Las Vegas this year, with a second in the Midwest due in 2024 and more to follow. The company estimates each facility will produce over 100 million pounds of recycled plastics annually, helping support FMCG: Fast-Moving Consumer Goods company voluntary commitments and legislative mandates.

Why we're invested

Republic Services is a key player in an attractive market, and are well-positioned relative to peers from a sustainability standpoint, given their investment in polymer recycling.

- **Sustainability:** The firm's investment in the collection of landfill gas is the biggest commitment so far in the US waste management sector.
- **Circularity:** Republic targets increasing the recovery and circularity of key materials by 40% on a combined basis by 2030 (versus a 2017 baseline) – this will expand the volume of materials diverted from landfill and entering the circular economy.
- **Favourable market dynamics:** Waste management is characterised by a quasi-oligopolistic structure and high barriers to entry.
- **Defensive positioning:** Because the waste sector mainly comprises essential services contracted on a long-term basis, it is less vulnerable to late-cycle dynamics.
- **Strong margins:** Waste sector margins have improved over the past decade – and should continue to owing to further industry consolidation and greater pricing power.

The company's

16%

market share makes it the second largest company in its sector in the US by revenue.

 CASE STUDY

Aptar

AptarGroup Inc., is a US-headquartered manufacturer of dispensing packaging and active material science solutions with operations in 18 countries. It has a particular specialism in packaging and dispensing solutions for the pharmaceutical sector.



Having started out as a manufacturer of spray valves and pumps for consumer household products, Aptar later developed a niche specialism in devices such as nasal sprays and metered-dose inhalers.

Over the past 10 years or so, a series of judicious acquisitions have enabled the company to diversify into a range of other specialist packaging solutions, including elastomer primary packaging components, airless packaging, materials science and active packaging, and makeup packaging.

Aptar's business model has a strong sustainability focus, as evidence by it being named to Barron's list of the Top 100 Most Sustainable US Companies for the past four years running.

Aptar is firmly on the front foot with respect to all aspects of ESG, both in terms of disclosure and action.

Why we're invested

Aptar has a leading market position in the packaging industry serving a diverse set of customers who value their innovative solutions and ability to produce at scale.

- While lower use and greater reuse will impact the size of the packaging market in the long-term, as a sustainability innovator with niche specialisms in the evergreen food and beverages, pharmaceutical and beauty sectors, Aptar is well-positioned to thrive.
- The firm is integrating Life Cycle Assessments into product design to evaluate environmental impacts and analyse materials being used for circularity and recyclability.
- Its innovative products are meaningfully driving positive outcomes – these include tethered closures (designed to remain attached and pass through the recycling stream), fully recyclable mono-material pumps, and highly recyclable metal-free nasal sprays.
- The company is firmly on the front foot with respect to all aspects of ESG, both in terms of disclosure and action; it is a signatory to the New Plastics Economy Global Commitment to address plastic pollution at source, and a member of both the World Business Council for Sustainable Development¹⁸ and the Circular Economy 100 Network.¹⁹
- Further evidence of Aptar's green credentials include 'Landfill Free' initiatives at all operational sites and 90% of electricity consumption coming from renewable sources.

¹⁸ For more information visit <https://www.wbcsd.org>.

¹⁹ For more information visit <https://ellenmacarthurfoundation.org>.

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