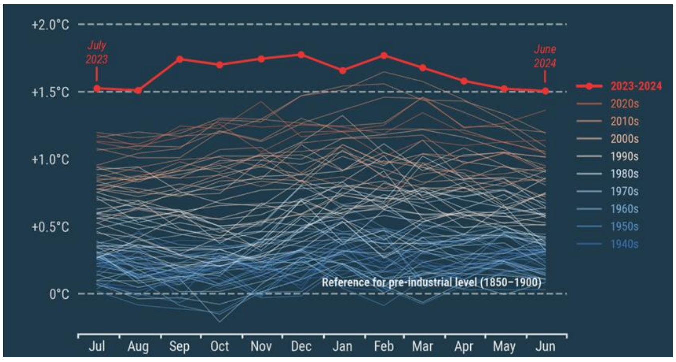
AiM Inheritance Tax Service Sustainability Spotlight

A soggy year for ESG

2024 has been a mixed year for the UK climate. Storm Lilian, named on 22 August, was the 12th named this storm season, the furthest through the list since the naming convention began back in 2015. On average, it's been slightly wetter and cooler across the UK, though there have been some regional anomalies. For example, in the South-East, you might think it has been slightly dryer and warmer… and feel the exact opposite here in the North-West! This is a good example of why the term 'climate change' is now preferred to 'global warming'. Regional weather fluctuations are more common each year.

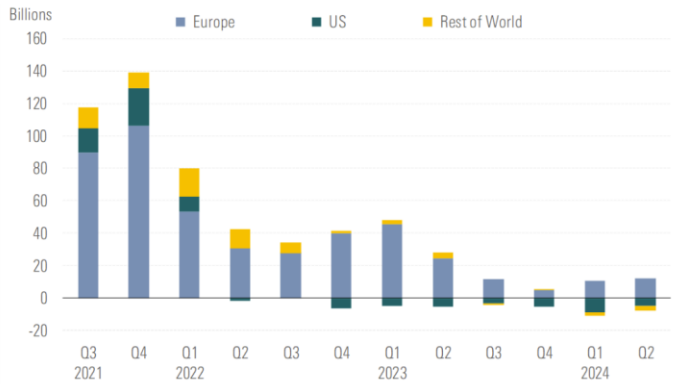
Looking at the global picture however, since our last ESG spotlight, where we noted that July 2023 was the hottest month on record, every month since to June 2024 has also set a record for highest global surface temperature per Copernicus data. August 2024 saw temperatures 1.51°C above pre-industrial levels, ahead of the 1.5°C target set by the United Nations. While this might not seem significant over a 100+ year period, historical data suggests such a temperature change would typically occur over thousands of years.



From an investment perspective, Barclays data showed that in 2024, clients withdrew a net $40bn from ESG equity funds globally, the first year that flows have trended negative. Many funds have been hit by poor performance from sectors such as clean energy, claims of greenwashing and have faced significant push-back in the US where ESG has become a polarising topic.

It has been a key talking point in the upcoming US election, which has only created further uncertainty and negative investor sentiment. Republicans would seem to be aiming to either prevent or reverse government agency regulations around climate change. Taking the recent SEC climate change disclosure requirements as an example, these requirements had to be stayed by the agency less than a month after they were published. This gives a template for how, even if Republicans don't get into office, they can still stall ESG regulation and continue to wane on sentiment.

Looking beyond just equity funds, the flows from global ESG funds tell a different story. Morningstar data shows reduced, but continued positive inflows (see below) into sustainable funds globally in 2024, largely driven by high demand in Europe for passive investments and green bonds. Per the Climate Bonds Initiative, the first quarter of 2024 was the most prolific on record for green bond flows, bringing in $272.7bn. Demand for responsible investments across Europe is still high, despite poor equity performance.



In the UK, this demand is further demonstrated by data recently provided from the 2022 Financial Lives Survey. 4 in 5 UK investors believe corporates have a responsibility to conduct business with a view to the environment, and 3 in 4 either have or are planning to make responsible investments in the future, though are unwilling to accept paying a premium to achieve this. Investors **want to do good** with their money, but not if it **impacts performance**.

We believe the current economics of decarbonisation are misaligned with the reductions required by the United Nations. More punitive measures, such as carbon taxation or pricing, are necessary to tip the scales in favour of low carbon alternatives. As temperatures continue to rise, we anticipate a long-term transition towards decarbonisation, with those businesses taking action now to reduce emissions, in an economic way, being the least exposed and best positioned to thrive.

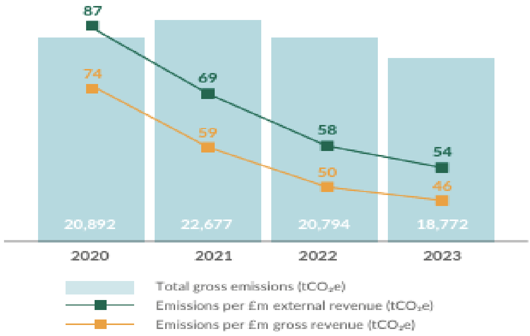
Our aim is to promote acceptance of what we see as the important ESG issues and address long-term drivers we feel can deliver long-term performance benefits to our investors. In line with this, we have decided to simplify our ESG approach. We dedicate more focus to what we view as the key areas of ESG as our understanding has improved. We are still in the process of applying this new approach to all portfolio companies, however the trends we are seeing from those completed so far are encouraging, with scores generally having improved across all areas. We will provide more detail when scoring is completed across the portfolio.

Epwin

Epwin is the leading, UK-based manufacturer of energy efficient and low maintenance building products, holding significant market share and strong sustainability credentials in the Repair, Maintenance and Improvement ("RMI"), new build and social housing sectors. Founded over 50 years ago, the Business is comprised of two divisions: Extrusion and Moulding (E&M) and Fabrication and Distribution (F&D). E&M is one of the UK's largest manufacturers of extruded window profile, cellular roofline, cladding, rainwater, drainage, decking systems and GRP building components. F&D includes the Group's national network of plastic distribution outlets and window stores.

Their products, such as PVC and aluminium window systems, decking systems, and GRP building components, contribute to building and maintaining sustainable cities and communities. For example, their PVC windows achieve some of the highest energy ratings on the market, resulting in improved heat retention, lower energy usage, and annual carbon savings for homeowners. Buildings and product use contribute 20.2% of the UK's total greenhouse gas emissions, making it the second-largest contributing sector according to 2023 government data. Enhancing the energy performance of UK homes is a national priority and by 2030, landlords must ensure properties meet at least a band C Energy Performance Certificate (EPC) rating. The latest government data shows that 59% of homes in England currently fall below a D rating. Epwins windows, with efficiency ratings from A to A++, play a crucial role in the UK's carbon transition.

They are also committed to reducing their own carbon footprint, having reported a reduction in their energy intensity ratio (carbon emissions per £m revenue) by 8% in 2023 compared to 2022. This improvement was driven by actions such as using newer and more efficient vehicles, optimizing routes, and improving vehicle loading. This focus on operational efficiency not only reduces emissions, but also helps the company save on fuel costs and improve overall logistics. Since 2020, this intensity ratio has come down by 38% (see right) showing a strong and continued focus on improving their carbon emissions efficiency.



Epwin also places a strong emphasis on responsible sourcing, operational efficiency, and waste reduction. Their recycling program offers customers a collection service for PVC-U frames and factory off-cuts, which are then taken to regional recycling hubs. This program not only helps reduce waste, but also encourages customers to participate in their sustainability efforts. Since 2009, the company has been recycling waste bar length into RCM (recycled composite material) as part of its manufacturing process.

They have invested in co-extrusion tooling to increase the proportion of recycled PVC used in their products, minimising the use of virgin materials and promoting a circular economy. The 2022 acquisition of Poly-Pure significantly increased their capacity to recycle post-consumer waste, allowing more PVC building materials, like old window frames, to be reprocessed and reused, reducing the need for new raw materials and lowering the environmental impact of their operations. 84% of 2023 group revenues were derived from recyclable products. These long-standing commitments to recycling and decarbonisation position them strongly in the climate and waste transition.

Jack Pedley
Assistant Fund Manager

Jack joined Stellar in January 2023 to support Stephen English and Phil Kirwan with the management of the Stellar AIM IHT Service. He has a background as a Chartered Accountant from Grant Thornton and previously helped manage equity derivative products at Bank of America. Jack holds the ACA and ACSI designations as well as the CFA Certificate in ESG Investing. As a keen Evertonian, he finds himself on an unending search for improvement!