

ENVIRONMENTAL STRATEGIES GROUP

Investment Update



MARKET UPDATE AND OUTLOOK

“Life is like a waterfall. It is always moving and there is always an uneven flow to it”. This quote from an anonymous author serves as a timely reminder about the fluid nature of markets when we consider activity within the environmental space so far this year.

Environmental solutions companies experienced record inflows at the start of the year, following on from a stellar year in 2020. But January has subsequently marked a peak for these flows, with assets in the environmental space declining by around 40% since then as investors assess several factors concerning the wider market.

Key among these concerns have been rising yields, higher inflation expectations, renewed tensions between the US and China and supply constraints augmented by rising commodities prices and a spike in freight costs. The combined force of these worries resulted in investor nervousness over the summer with markets de-risking in July and August.

Looking forward, we are excited by the possibilities presented by the fall in volume in the environmental space. **Firstly**, we think some of this decline can be attributed to the unwinding of three years of hedge fund net leverage into renewables. **Secondly**, the environmental universe is now trading at attractive valuation levels, particularly in comparison to other growth areas (as represented by the Nasdaq Index). **Thirdly**, the compound growth rate for environmentally-themed companies also compares favourably with these other growth areas. To us, this represents a valuation gap that is too big to ignore.

Finally, the forthcoming COP26 event in Glasgow will put efforts to combat climate change firmly back on the investment agenda. With these factors being joined by year-end portfolio re-positioning, we believe the stars will be aligned for an interesting year-end for the environmental space – a time when we saw the biggest increases in share price performance last year. In our view, our positions in green hydrogen and US residential solar should see a strong acceleration in performance in the coming months.

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PERFORMANCE AND PORTFOLIO UPDATE

BNP Paribas Energy Transition

The Fund declined -2.3% in August, underperforming the MSCI ACWI (EUR) Index by -5.3% and the broader environmental space during a period of low liquidity.



Source: Bloomberg, August 2021

Past performance or achievement is not indicative of current or future performance. BNP Paribas Energy Transition calendar performance over the past five-year period (I, Capitalisation) (%): 2020: 167.30, 2019: 5.51%, 2018: 18.54, 2017: 13.04, 2016: 35.97. All figures net of fees (in EUR). 2014-2019: During this period, the fund had a different investment policy and benchmark.

Top contributors

Chinese manufacturer BYD was among the portfolio's key contributors this month, benefitting from investors switching away from China's consumer-exposed sectors, following regulatory changes, and into environmental areas where government support is stronger. SolarEdge performed well, on the back of a strong set of results and a robust outlook for next year, and British manufacturer ITM Power outperformed after it opened the world's largest electrolyser factory.

Bottom detractors

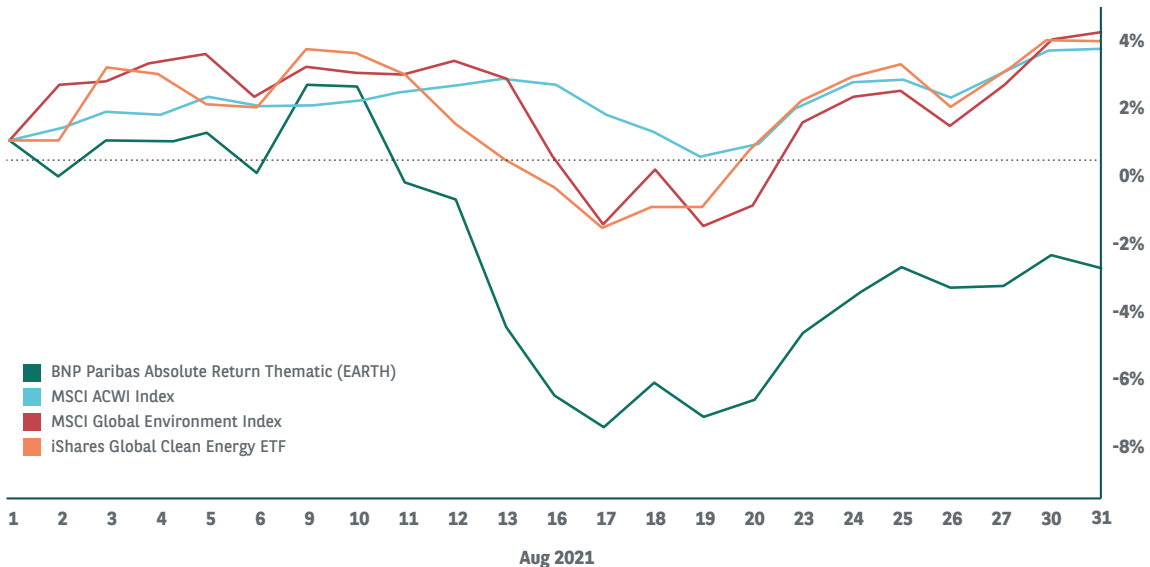
The portfolio's main detractors were solar holdings SunRun and Sunnova, as well as hydrogen fuel cells manufacturer Plug Power. We maintain our conviction in each of these positions and expect to see further upside.

BNP Paribas Ecosystem Restoration

We are not permitted to publish performance figures for BNP Paribas Ecosystem Restoration until one year from inception. You can obtain the latest performance, attribution and contribution for the Fund from your regular sales contact.

BNP Paribas Absolute Return Thematic (EARTH)

Our long/short strategy was -3.4% lower in August, underperforming the broader environmental market as high conviction names sold off during the summer’s volatility. However, the fund’s YTD performance, at -6.8%, still places it in the top tier versus its peers.



Source: Bloomberg, 30 August 2021. All figures are net of fees (in EUR). The value of your investment may fluctuate. Past performance or achievement is not indicative of current or future performance. Performance of EARTH I-Plus Capitalisation net of fees: 6 months: 7.32%, 3 months: -1.67%, 1 month is 9.82%. YTD (as of 30/07/21 is 7.32%).



“Our positions in green hydrogen and US residential solar should see a strong acceleration in performance in the coming months”

Top contributors

UK hydrogen fuel cell company Ceres Power was the strongest contributor this month, after the UK government outlined its national hydrogen strategy building which sees the UK hosting 5GW of hydrogen-generation by 2030. SolarEdge also performed well, on the back of a strong set of results and a robust outlook for next year, as did Daqo, a high conviction polysilicon play, which we expect to benefit from strong demand for solar products.

Bottom detractors

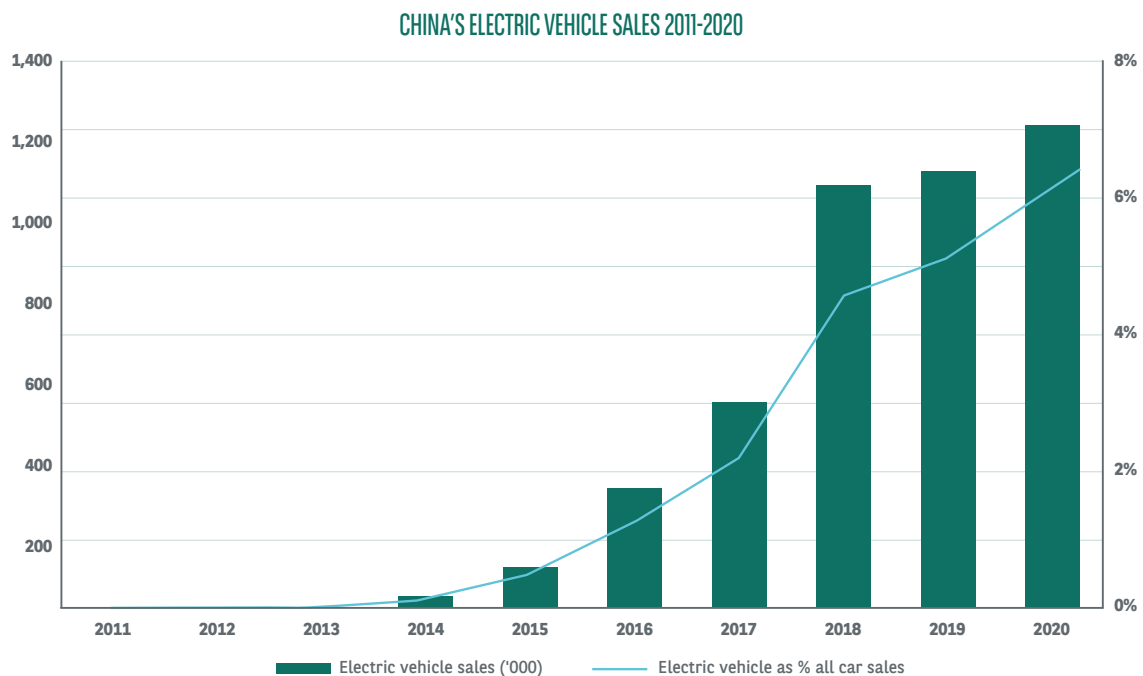
The portfolio’s main detractors were solar holdings SunRun and Sunnova, but we maintain our conviction in these positions and expect to see further upside. Atlantic Sapphire, the land-based aquaculture company, also lost ground after its stock price retraced in response to bottlenecks in its oxygen supply that have since been resolved.

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SECTORS IN FOCUS: ELECTRIC VEHICLES IN CHINA

Electric vehicles (EVs) in China present a massive opportunity for investors. The Chinese government has identified EVs as being a key pillar of its 'Made in China 2025' initiative, as well as its efforts to achieve carbon neutrality by 2060, and is aiming for new energy vehicles (NEVs)¹ to make up 20% of new car sales by 2025.

In our view, there is reason to believe the penetration of NEVs could be even faster. Not only is the industry being supported by favourable government policies and subsidies, its consumer profile has also been boosted by more competitive pricing, the introduction of new features and the roll out of charging stations. Recent data suggests NEVs represented 20% of new car sales in August² and growing momentum could see NEV penetration top 30% by the end of 2022, well ahead of government targets.



Source: BloombergNEF (BNEF), Electric Vehicle Outlook, 2021



To ensure supply can meet this growing demand, the government introduced a dual-credit policy to encourage EV production in 2017. Under this policy, automakers are required to meet an annual credit target by selling a certain percentage of EVs, a target that becomes more stringent each year. Those automakers that do not produce enough EVs, and do not increase their average fuel economy levels, are forced to buy credits from those companies with a surplus.

Overcoming the barriers

Range anxiety and the high cost of batteries have been ongoing consumer concerns, creating a barrier for EV adoption. However, advancements in battery technology and economies of scale have led to an 89% fall in the cost of lithium-ion batteries since 2010³. This has enabled automakers to launch EV models at more competitive prices and with increased range. For example, Tesla has launched a cheaper version of its Model 1 Y in China that costs 20% less and can achieve a comparable range (525km).

The rollout of charging stations has also been a stumbling block, which has further fuelled range anxiety. As of July 2021, there were 884,400 public charging connectors in China according to BNEF, which compares favourably against other countries. However, charging speed and reliability remain an issue as many of the public chargers use slow AC and some connectors are not operational. Companies are offering solutions to this hurdle, with Tesla and Xpeng both expanding their fast-charging network, while Nio has developed a battery swapping model.



“Companies are offering solutions to this hurdle with expanding fast-charging networks and battery swapping models”

¹ Source: NEVs include battery electric vehicles, plug-in hybrid electric vehicles and hydrogen fuel cell vehicles

² Source: <https://global.chinadaily.com.cn/a/202109/10/WS613ab8eda310efa1bd66e96c.html>

³ Source: <https://about.newenergyfinance.com/electric-vehicle-outlook/>

Innovative new features

As a way to differentiate between each other, EV manufacturers are focusing on smart and autonomous features. Upcoming models will include innovations such as remote sensing LIDAR technology (Light Detection and Ranging) and Navigation Guided Pilot (NGP) systems, both of which will aid vehicles to drive from point A to point B largely without human intervention.

The Chinese government is supportive of the development of autonomous driving and aims to have 50% of new car sales equipped with Level 2 and Level 3 automation by 2025 and 70% by 2030¹. In our view, regulations that are supportive of these technologies will be a positive for the industry and can help enhance safety mechanisms and reliability.

With incumbent auto makers and technology giants both looking to enter the EV market, we expect it to get even more competitive going forward. This means it will be increasingly important to identify those companies not only with a strong brand presence, but whose offerings are differentiated in terms of hardware and software to serve the target audience, as well as maintaining a secure upstream supply chain.

Who are the main players?

Chinese electric vehicles manufacturers can be divided into two groups: EV startups and traditional OEMs that are shifting to EVs.

EV startups:

Nio: Founded in 2014, the company currently offers three premium electric SUVs, ES8, ES6 and EC6. Nio is best known for its battery swapping technology and battery as a service model which allows consumers to subscribe car batteries instead of purchasing it together with the car.

Xpeng: Founded in 2015, Xpeng currently offers two premium electric models, G3 SUV and P7 sedan and will start shipment of its third model, P5 sedan in October 2021. The company has strong in-house R&D capabilities in autonomous driving and started monetisation of its proprietary autonomous driving system XPiLOT since January 2021.

Li Auto: Founded in 2015, the company launched its first model, Li ONE, in November 2019, which uses an extended range electric vehicle (EREV) powertrain technology to tackle range anxiety. The company is planning to launch the second generation of EREV in 2022 and two models of BEV in 2023 with fast charging capabilities.

¹Source: <https://www.caixinglobal.com/2020-11-12/china-wants-self-driving-tech-in-half-of-new-cars-by-2025-101626619.html>

Traditional OEMs:

BYD: BYD started as a mobile phone battery manufacturer before entering the automotive industry in 2003 with the acquisition of Tsinchuan Automobile company. The company is now one of the leading EV manufacturers in China offering both PHEV and BEV, as well as electric busses and trucks. The company has a vertically integrated model and produces batteries and semi-conductors in house.

Geely: Founded in 1998 and one of the largest automakers in China, Geely is shifting to EV production and has a number of EV-related subsidiaries including Lynk & Co, Geometry and Zeekr.

The EV market is getting increasingly competitive as both incumbent auto makers and tech giants are looking to enter the industry. We believe identifying companies with strong brand presence, differentiated offerings on both hardware and software to serve the target audience, and a secured upstream supply chain will be key.

The Environmental Strategies Group

Our Environmental Strategies Group are an experienced team of thematic investors, led by Ulrik Fugmann and Edward Lees, with a deep understanding of businesses, industries and technologies. The team consists of portfolio managers, research analysts, investment specialists and a quantitative analyst. They benefit from access to our Sustainability Centre, Quantitative Research Group and global risk and trading platform.



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This piece was released in October 2021. It pertains to the investment update of our Environmental Strategies Group issued in Sep 2021.

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