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Investing for a
world of change

Funding the Transition: Climate Solutions & Decarbonisation

July 2023

Target audience

Audience

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Past performance is not a reliable indicator of future results. If any currency differs from the investor's home currency, returns may increase or decrease as a result of currency fluctuations.

Investment objectives and performance targets are subject to change and may not necessarily be achieved, losses may be made.

Target returns are hypothetical returns and do not represent actual performance. Actual returns may differ significantly.

Environmental, social or governance related risk events or factors, if they occur, could cause a negative impact on the value of investments.

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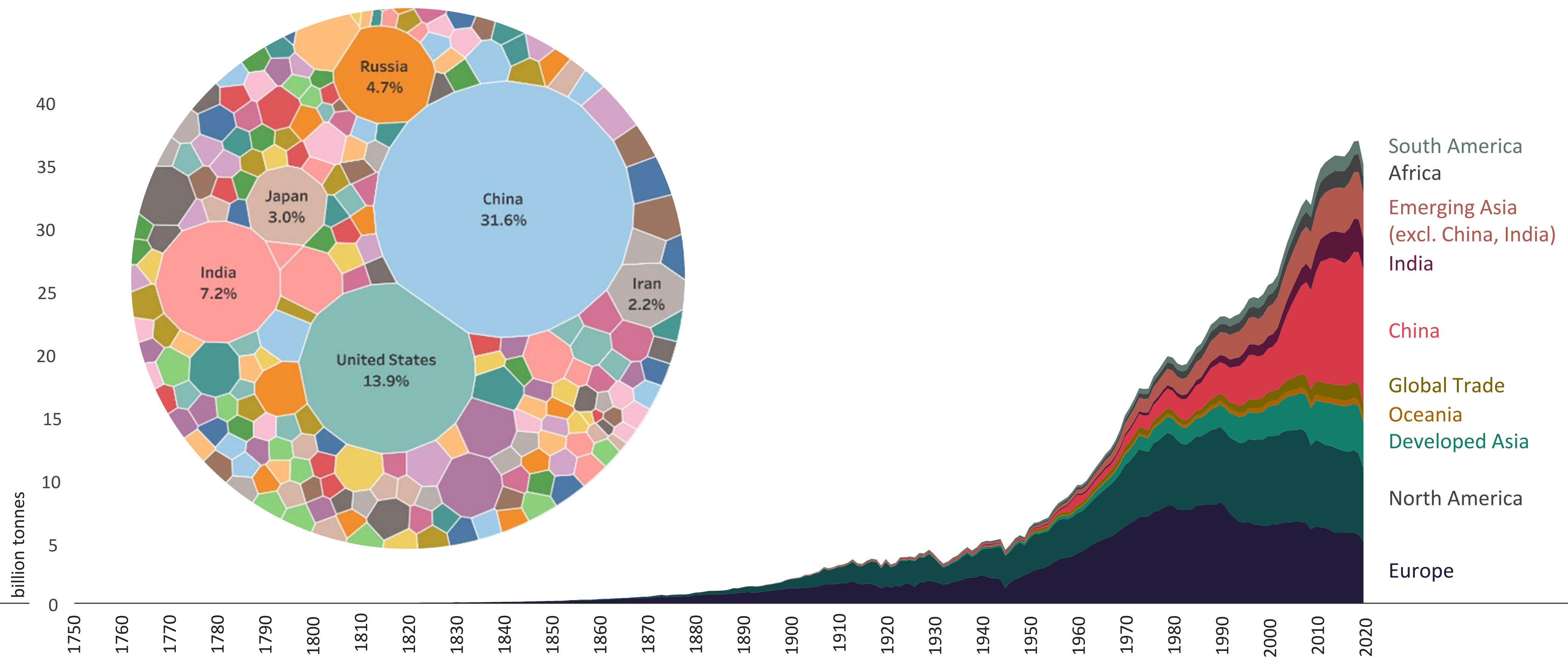
Sustainable Strategies: Sustainable, impact or other sustainability-focused portfolios consider specific factors related to their strategies in assessing and selecting investments. As a result, they will exclude certain industries and companies that do not meet their criteria. This may result in their portfolios being substantially different from broader benchmarks or investment universes, which could in turn result in relative investment performance deviating significantly from the performance of the broader market.

Transition: Where are the emissions?

Focusing on emerging market corporates is critical for net zero

- DMs account for bulk of historic emissions – BUT 13 of the top 20 emitting countries are now emerging markets (EMs)
- EMs currently account for 60% of today's emissions but are on a trajectory to represent 90% of emissions growth to 2030



Source: Our world in data based on the Global Carbon Project
This measures CO_2 emissions from fossil fuels and cement production only – land use change is not included. Statistical difference (included in the GCP dataset) are not included here.

Transition: Where are the emissions?

Five economic areas will define the outcome

1. Power
2. Mobility
3. Buildings
4. Industry
5. Agriculture

>90%

of emissions

Waste
3.2%

Transport
16.2%

Agriculture
land use
18.2%

26.8%
Production,
by-products,
Land use

Industry
5.2%

Building
17.5%

73.2%
Energy use

Other
sectors
7.8%

Fugitive emissions
from energy
5.8%

Agriculture
land use
1.7%

Industry
24.2%

Source: Our world in data (2019). Please note that this diagram has been redrawn by Ninety One.

Transition investments target sectors with the highest impact potential

We lean in to working with heavy emitters and invest in new infrastructure and new industries

85%

of CO_2 emissions are generated by 4 sectors that are reliant on the production and burning of fossil fuels

40
30
20
10
-10
Power
Buildings
Mobility
Industry
Net emissions
Agriculture, forestry, and other land
use CO_2 removal
2020
2030
2040
2050

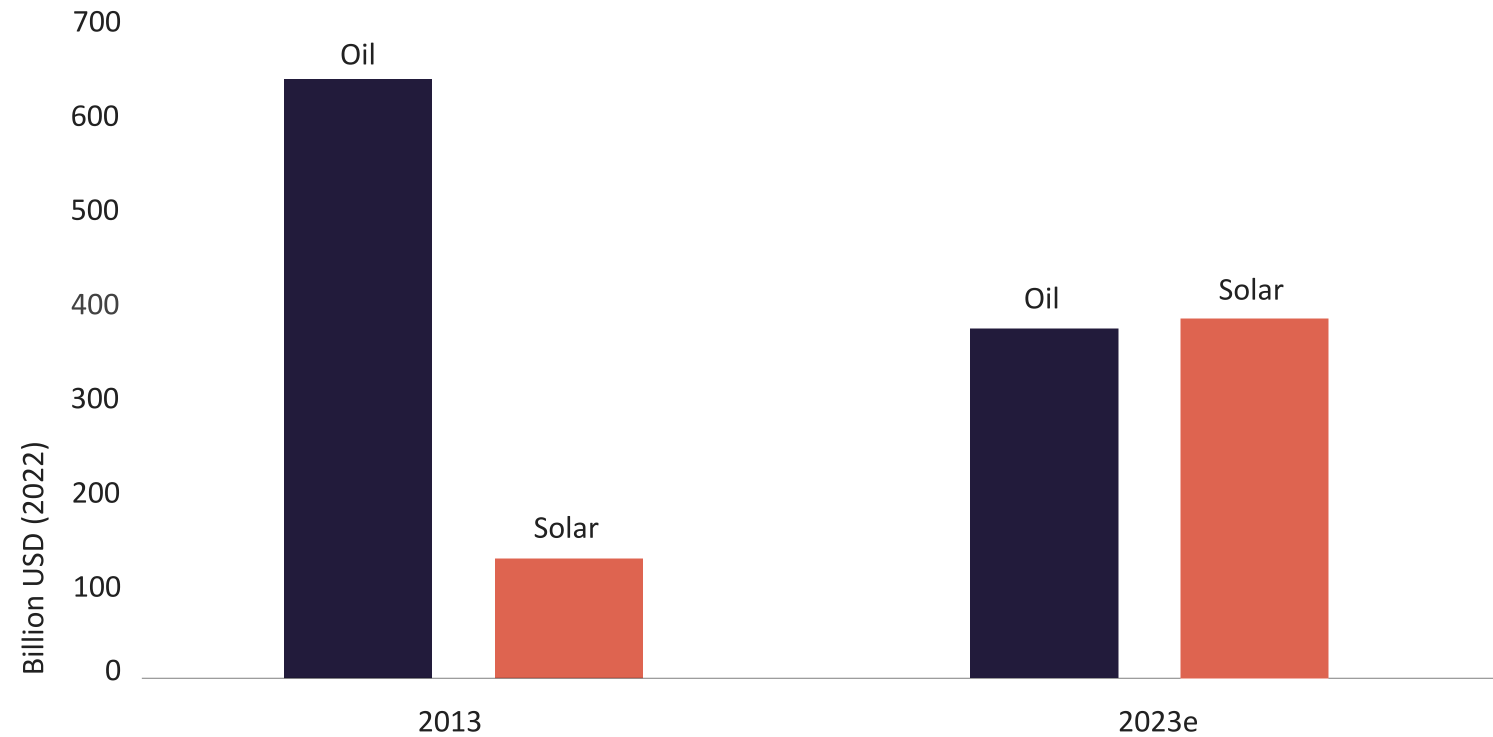
Both climate solutions (new infrastructure and industries) and decarbonisation of heavy emitters requires funding

Source: McKinsey, (2022) The Net Zero Transition

Solar investment is eclipsing oil production investment

Massive Shift in Energy Investment

Oil Production Investment and Solar Investment



More than one billion dollars is now spent every day on solar, which is set to overtake investment in oil production for the first time

Source: IEA, World Energy Investment (2023)

Growth in clean energy investment has been strong, but uneven

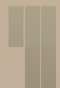
Change in annual clean energy investment in selected countries and regions between 2019 and 2023e

China
European Union
United States
Japan
India
Africa
Brazil
Middle East
Indonesia
Russia

- 10 20 50 80 110 140 170 200

Billion USD (2022)

There are bright spots in other countries, but more than 90% of the increase in clean energy investment since 2021 has taken place in advanced economies and China.



What is Transition Investment?

Transition assets need to meet minimum standards

Minimum standard for all transition assets:

1 Do they have a credible net-zero commitment?

2 What proportion of Capex/Opex is allocated to net zero?

3 Do they have a credible transition plan?

4 Are there carbon intensity reduction targets?

Only when these minimum standards are achieved can a company be classified into one of five categories:

Transitioning
- Has a Paris- aligned pathway or
- Contributes significantly to carbon mitigation (reduction or avoided) or
- Emission intensity may be close to or near to net zero
- Generating ~85% green revenue

Committed to Transition
- Committed to net zero
- Has a robust transition strategy but
- Requires significant transition investment to achieve a Paris-aligned pathway

Transition Enabler
- Required to enable the transition to net zero for other sectors
- May not have Paris-aligned pathway
- Committed to net zero the transition to net zero

Interim to Phase-out
- Currently needed
- but
- Should be phased out in line with a
- Paris-aligned pathway by latest 2050

Aiming to Transition
- Committed to net zero and is taking action to reduce emissions and
- Ahead of its peer group but
- No clear pathway to net zero

Aligned Transition

Categorisation in action

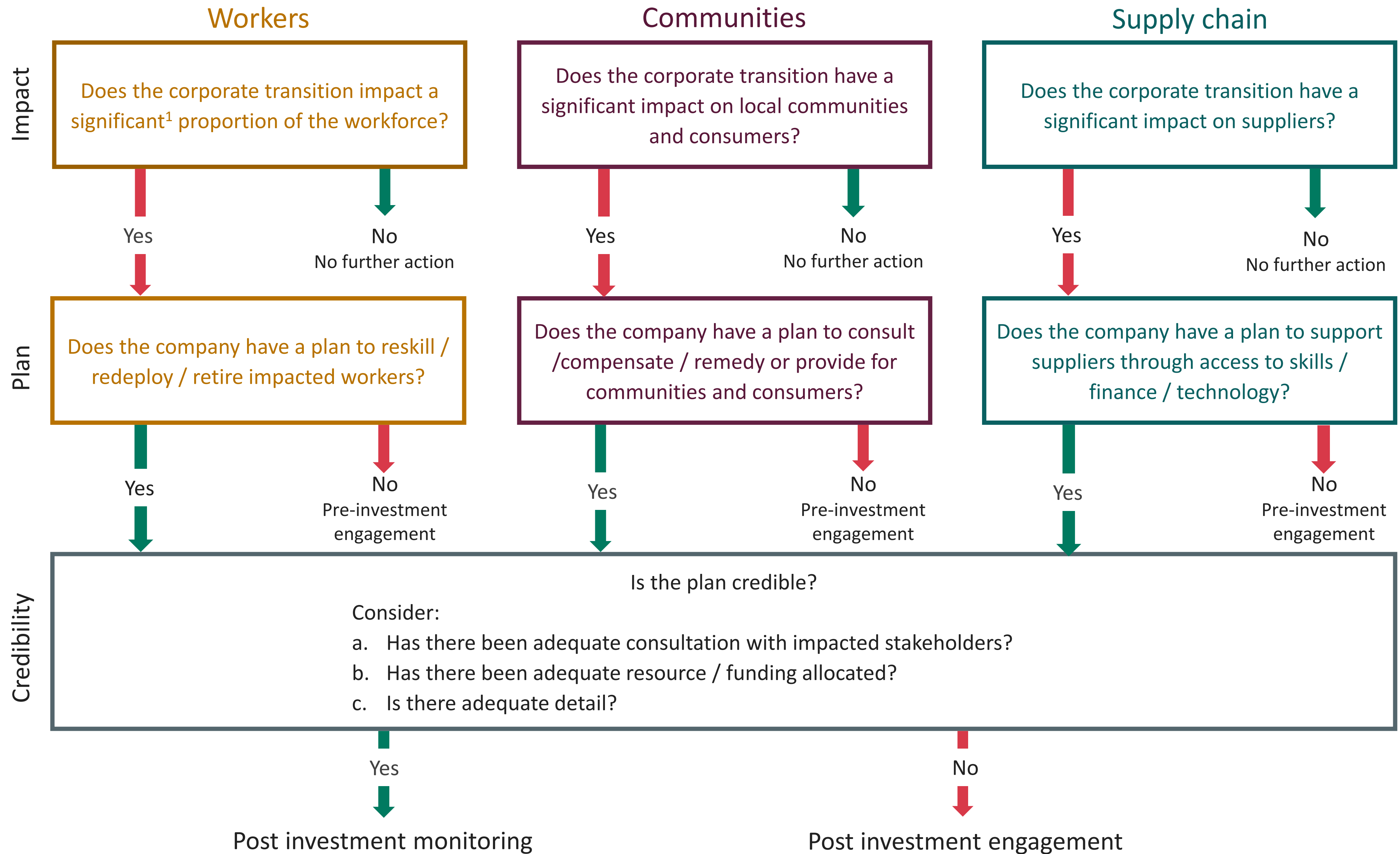
Only when the minimum standard for all transition assets are achieved can a company be classified into one of five categories

Transitioning/ Mitigating	Committed to Transition	Transition Enabler	Interim to Phase-Out	Aiming to Transition
Ørsted Schneider Electric VINFAST	NEXTera ENERGY Google CEMEX	LIASA ALBEMARLE	RWE	bp

Aligned Transition (Transitioning/Mitigating; Committed to Transition; Transition Enabler; Interim to Phase-Out)

Source: Ninety One

Just Transition assessment framework



Judgement to be applied when considering significance of impact. [1] >10% of workforce as a rough proxy

Transition investments in context

	Reduces portfolio-level carbon footprint	Leveraged to decarbonisation trend	Invests and engages in high-emitting sectors	Influences real-world decarbonisation
Green bonds	✓	✓	✓	✓✓
Low-carbon screen or index equities	✓✓✓	✗	✗	✗
Climate solutions	✓✓	✓✓✓	✓	✓✓✓
Transition investments	✗	✓✓	✓✓✓	✓✓✓

Source: Ninety One

A transition equity universe looks very different to global equities

Sector breakdown of the transition universe compared with global equities

Global Equities
Transition Universe

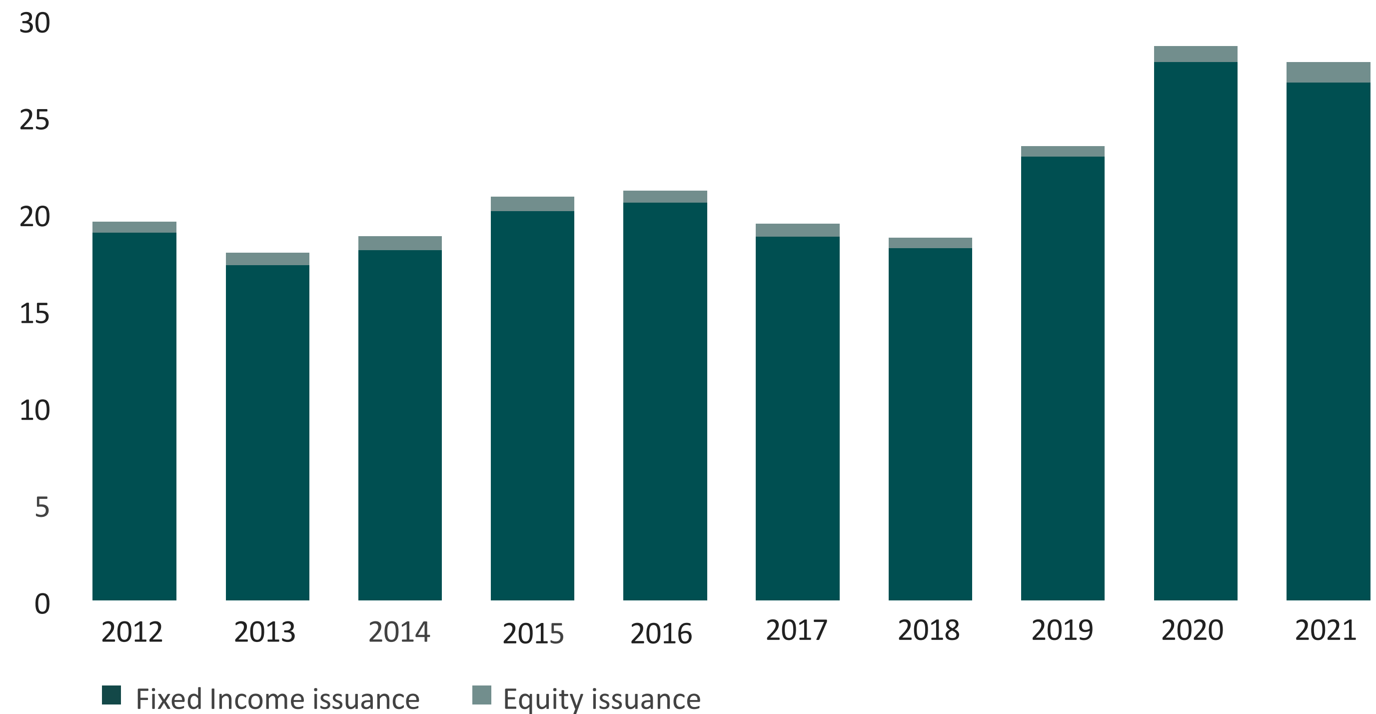
30%
25%
20%
15%
10%
5%
0%

Information technology
Financials
Healthcare
Consumer discretionary
Industrials
Consumer staple
Consumer services
Energy
Utilities
Materials
Real estate

Source: Ninety One, MSCI. Transition Universe created based on 51 high-emitting GICS sub-sectors. Weights as at 31 December 2022

Transition debt will be the workhorse of transition finance

The lower cost and flexibility of debt markets compared to other financing methods makes debt issuance attractive for companies



Debt ownership can present a powerful opportunity to engage with companies on their transition

Source: Ninety One, https://www.sifma.org/resources/research/fact-book/

Breaking down barriers

Will I not blow my emissions budget?

Agent of Disorder

Linear portfolio emissions reduction targets

Focus on carbon-intensity measures

Agent of Order

Targets based on portfolio coverage encouraging an increased proportion with credible science-based transition targets and plans

Emissions intensity alone is a flawed approach. Carbon reduced and carbon avoided are better measures of real-world impact at this stage of the world's transition

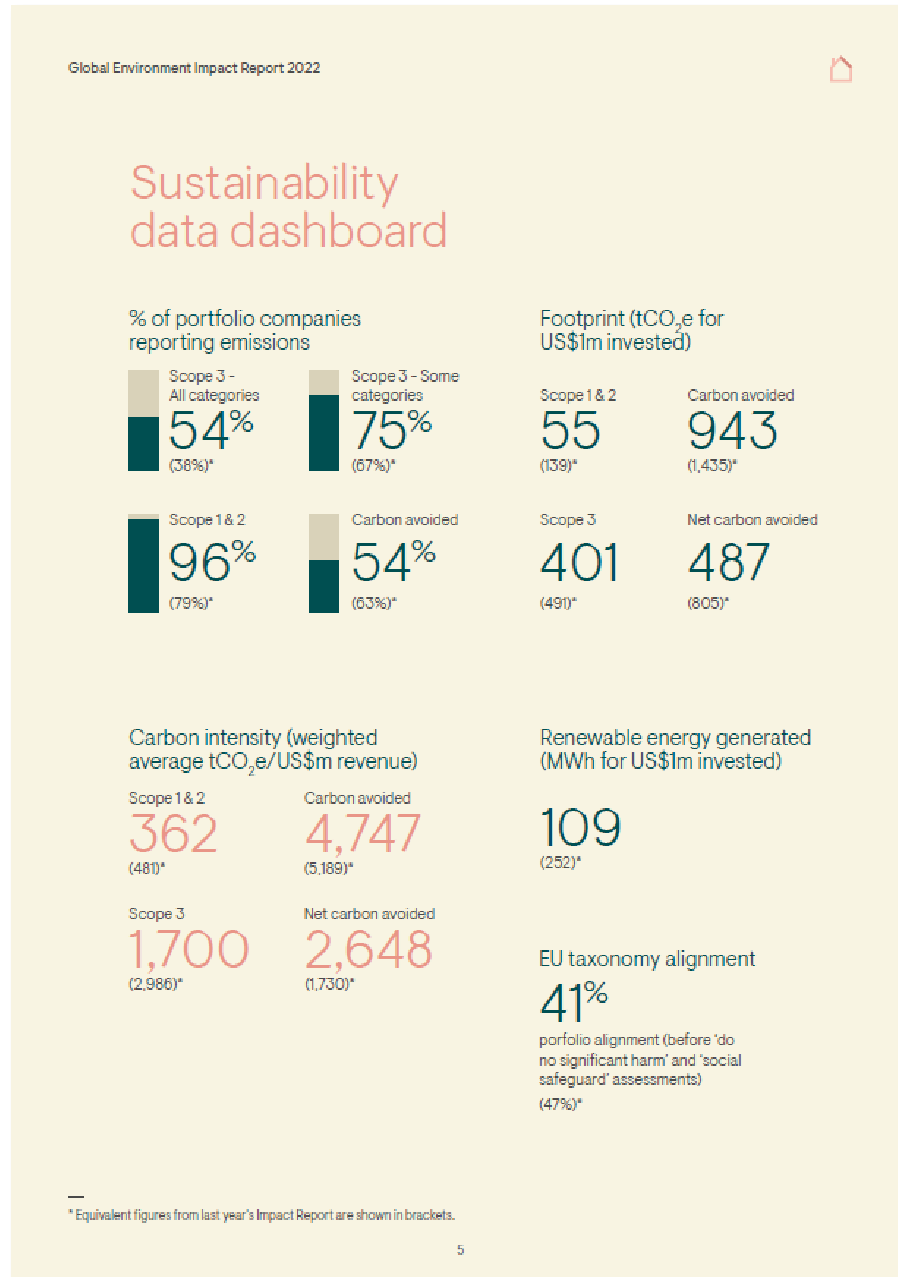
Ninety One Carbon Avoided:

emissions avoided by using a product that has less carbon emissions than the status quo

Ninety One Carbon Reduced:

investments with companies that are significantly reducing GHG emissions with a credible trajectory to net zero.

Impact reporting example (equities): NextEra



Global Environment Impact Report 2022

Sustainability data dashboard

% of portfolio companies reporting emissions

Scope 3 - All categories
54%
(38%)*

Scope 3 - Some categories
75%
(67%)*

Scope 1 & 2
96%
(79%)*

Carbon avoided
54%
(63%)*

Footprint (tCO_2e for US$1m invested)

Scope 1 & 2
55
(139)*

Carbon avoided
943
(1,435)*

Scope 3
401
(491)*

Net carbon avoided
487
(805)*

Carbon intensity (weighted average tCO_2e/US$m revenue)

Scope 1 & 2
362
(481)*

Carbon avoided
4,747
(5,189)*

Scope 3
1,700
(2,986)*

Net carbon avoided
2,648
(1,730)*

Renewable energy generated (MWh for US$1m invested)

109
(252)*

EU taxonomy alignment

41%
porfolio alignment (before 'do no significant harm' and 'social safeguard' assessments)
(47%)*

* Equivalent figures from last year's Impact Report are shown in brackets.

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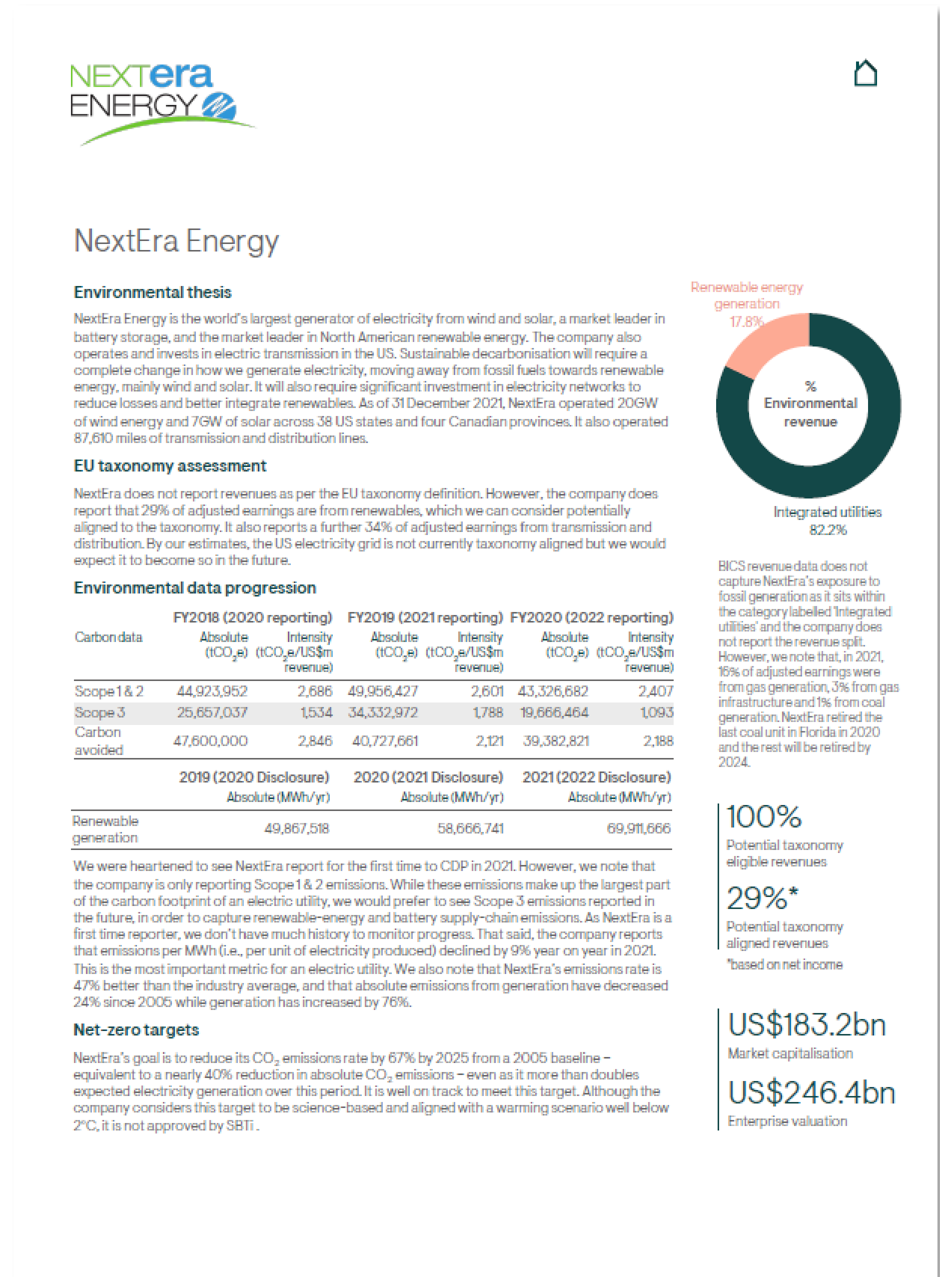


NEXTera ENERGY

NextEra Energy

Environmental thesis

NextEra Energy is the world's largest generator of electricity from wind and solar, a market leader in battery storage, and the market leader in North American renewable energy. The company also operates and invests in electric transmission in the US. Sustainable decarbonisation will require a complete change in how we generate electricity, moving away from fossil fuels towards renewable energy, mainly wind and solar. It will also require significant investment in electricity networks to reduce losses and better integrate renewables. As of 31 December 2021, NextEra operated 20GW of wind energy and 7GW of solar across 38 US states and four Canadian provinces. It also operated 87,610 miles of transmission and distribution lines.

EU taxonomy assessment

NextEra does not report revenues as per the EU taxonomy definition. However, the company does report that 29% of adjusted earnings are from renewables, which we can consider potentially aligned to the taxonomy. It also reports a further 34% of adjusted earnings from transmission and distribution. By our estimates, the US electricity grid is not currently taxonomy aligned but we would expect it to become so in the future.

Environmental data progression

	FY2018 (2020 reporting)		FY2019 (2021 reporting)		FY2020 (2022 reporting)	
Carbon data	Absolute (tCO_2e)	Intensity (tCO_2e/US$m revenue)	Absolute (tCO_2e)	Intensity (tCO_2e/US$m revenue)	Absolute (tCO_2e)	Intensity (tCO_2e/US$m revenue)
Scope 1 & 2	44,923,952	2,686	49,956,427	2,601	43,326,682	2,407
Scope 3	25,657,037	1,534	34,332,972	1,788	19,666,464	1,093
Carbon avoided	47,600,000	2,846	40,727,661	2,121	39,382,821	2,188

	2019 (2020 Disclosure) Absolute (MWh/yr)	2020 (2021 Disclosure) Absolute (MWh/yr)	2021 (2022 Disclosure) Absolute (MWh/yr)
Renewable generation	49,867,518	58,666,741	69,911,666

We were heartened to see NextEra report for the first time to CDP in 2021. However, we note that the company is only reporting Scope 1 & 2 emissions. While these emissions make up the largest part of the carbon footprint of an electric utility, we would prefer to see Scope 3 emissions reported in the future, in order to capture renewable-energy and battery supply-chain emissions. As NextEra is a first time reporter, we don't have much history to monitor progress. That said, the company reports that emissions per MWh (i.e., per unit of electricity produced) declined by 9% year on year in 2021. This is the most important metric for an electric utility. We also note that NextEra's emissions rate is 47% better than the industry average, and that absolute emissions from generation have decreased 24% since 2005 while generation has increased by 76%.

Net-zero targets

NextEra's goal is to reduce its CO_2 emissions rate by 67% by 2025 from a 2005 baseline – equivalent to a nearly 40% reduction in absolute CO_2 emissions – even as it more than doubles expected electricity generation over this period. It is well on track to meet this target. Although the company considers this target to be science-based and aligned with a warming scenario well below 2°C, it is not approved by SBTi .

BICS revenue data does not capture NextEra's exposure to fossil generation as it sits within the category labelled 'Integrated utilities' and the company does not report the revenue split. However, we note that, in 2021, 16% of adjusted earnings were from gas generation, 3% from gas infrastructure and 1% from coal generation. NextEra retired the last coal unit in Florida in 2020 and the rest will be retired by 2024.

100%
Potential taxonomy eligible revenues

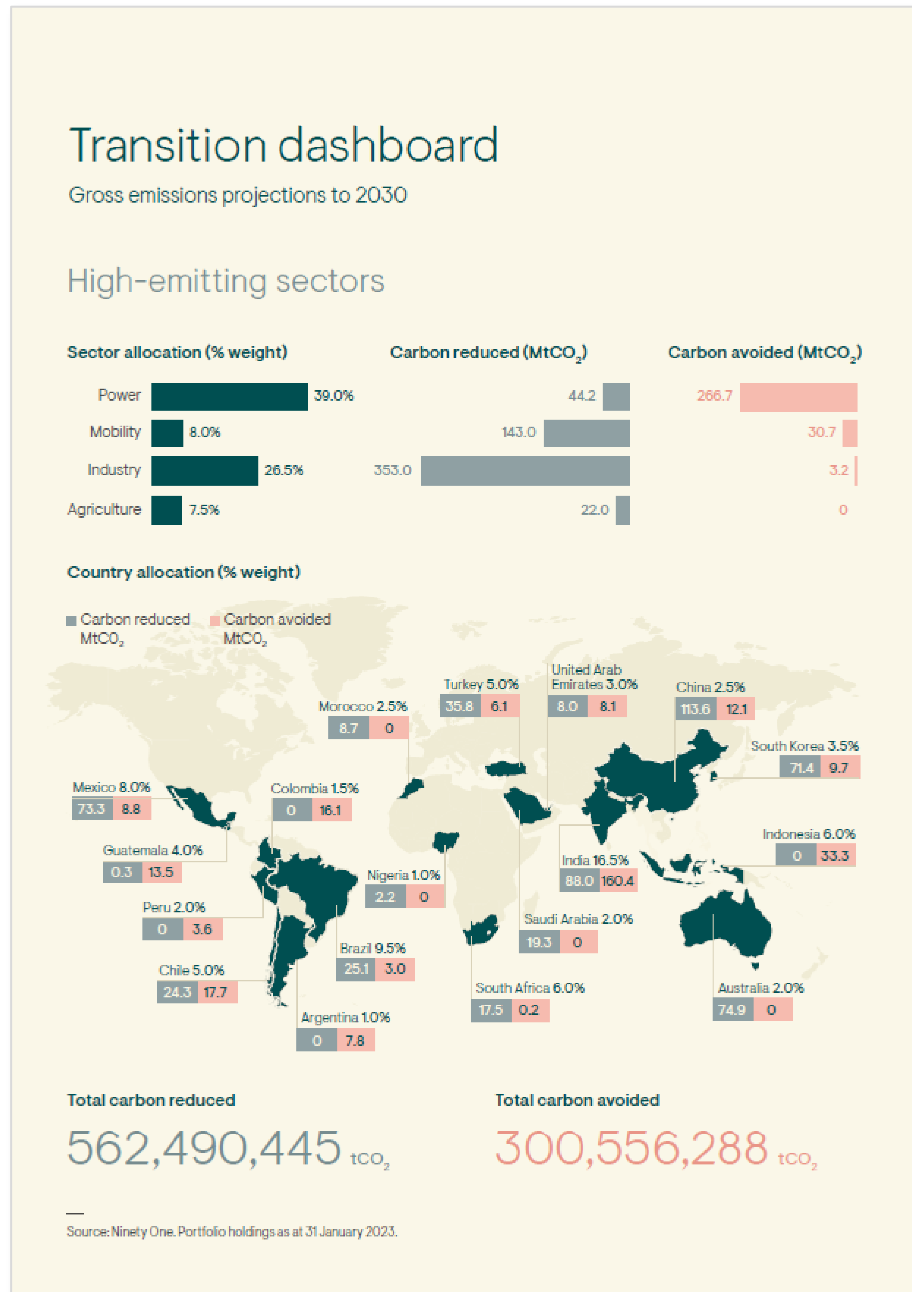
29%*
Potential taxonomy aligned revenues
*based on net income

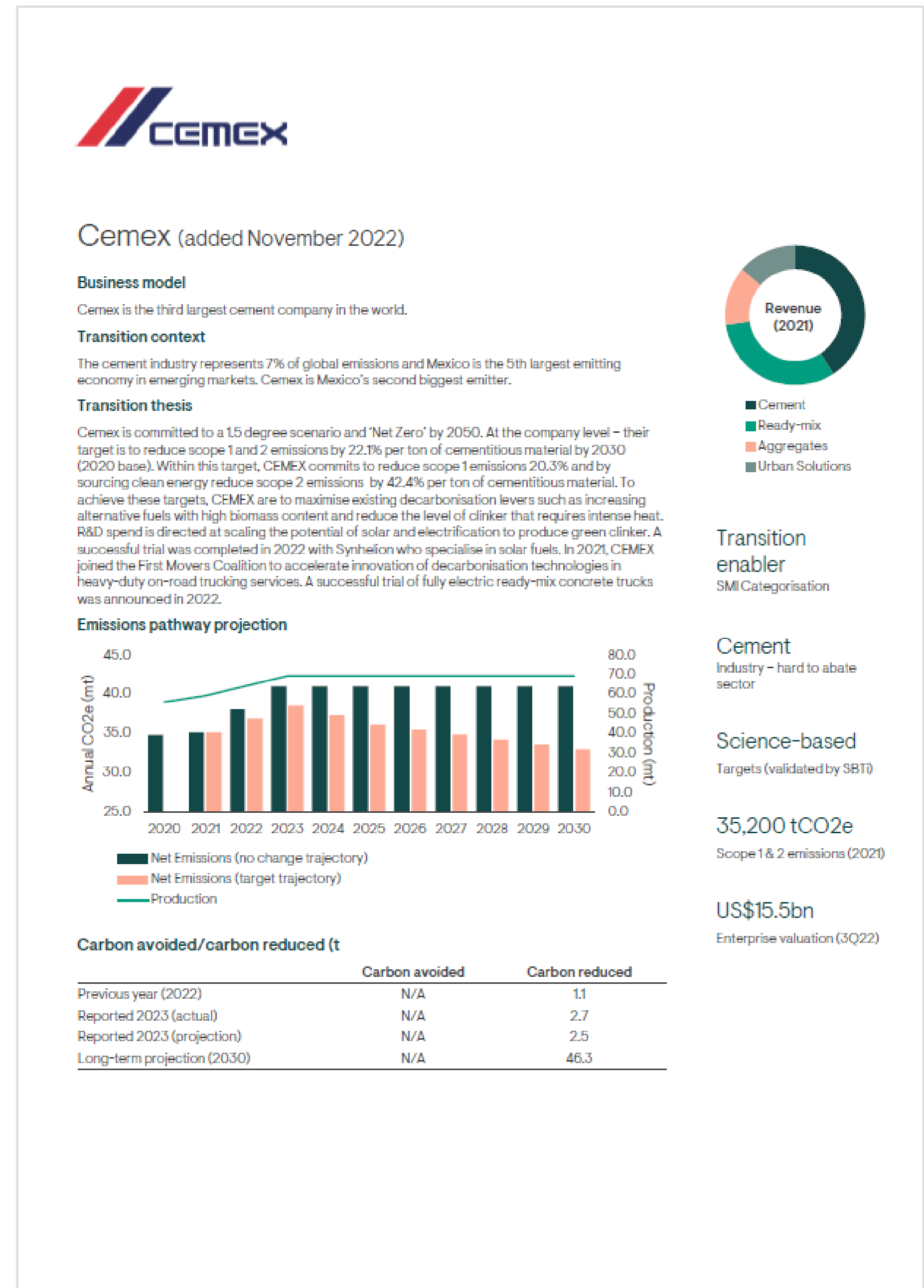
US$183.2bn
Market capitalisation

US$246.4bn
Enterprise valuation

Source: Ninety One as at December 2023 based on the Emerging Market Transition Debt model portfolio. Example used for illustrative purposes only.

Impact reporting example (debt): Cemex





CEMEX

Cemex (added November 2022)

Business model

Cemex is the third largest cement company in the world.

Transition context

The cement industry represents 7% of global emissions and Mexico is the 5th largest emitting economy in emerging markets. Cemex is Mexico's second biggest emitter.

Transition thesis

Cemex is committed to a 1.5 degree scenario and 'Net Zero' by 2050. At the company level – their target is to reduce scope 1 and 2 emissions by 22.1% per ton of cementitious material by 2030 (2020 base). Within this target, CEMEX commits to reduce scope 1 emissions 20.3% and by sourcing clean energy reduce scope 2 emissions by 42.4% per ton of cementitious material. To achieve these targets, CEMEX are to maximise existing decarbonisation levers such as increasing alternative fuels with high biomass content and reduce the level of clinker that requires intense heat. R&D spend is directed at scaling the potential of solar and electrification to produce green clinker. A successful trial was completed in 2022 with Synhelion who specialise in solar fuels. In 2021, CEMEX joined the First Movers Coalition to accelerate innovation of decarbonisation technologies in heavy-duty on-road trucking services. A successful trial of fully electric ready-mix concrete trucks was announced in 2022.

Emissions pathway projection

Carbon avoided/carbon reduced (t

	Carbon avoided	Carbon reduced
Previous year (2022)	N/A	1.1
Reported 2023 (actual)	N/A	2.7
Reported 2023 (projection)	N/A	2.5
Long-term projection (2030)	N/A	46.3

Transition enabler
SMI Categorisation

Cement
Industry – hard to abate sector

Science-based
Targets (validated by SBTi)

35,200 tCO2e
Scope 1 & 2 emissions (2021)

US$15.5bn
Enterprise valuation (3Q22)

Source: Ninety One as at December 2023 based on the Emerging Market Transition Debt model portfolio. Example used for illustrative purposes only.

The actionable steps

Asset owners should assess the transition plans of their heavy emitters

Encouraging and catalysing transition should replace divestment policies

Asset owners should consider dedicated transition investments

Adopting carbon avoided and carbon reduced and measuring alignment with net zero are more appropriate measures than carbon intensity at this stage of the energy transition

A transition-based approach can reduce the risk of a disorderly transition

Evidence suggests that Transition Finance (including solutions) is set to enjoy strong growth

Planetary Pulse Research Shows:

60% believe that transition finance will grow rapidly

52% believe that transition finance is a major commercial opportunity

20% say they are researching transition-finance opportunities

8% are building their internal capabilities in transition finance

Source: Ninety One Planetary Pulse Survey 2022

Reporting Collateral

Investment Institute

Ninety One
Investing for a world of change

A disorderly transition

Averting chaotic disorder in a transition to net zero

March 2023

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Investment Institute

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Why corporates must act

Written by Imperial College London

February 2023

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Ninety One announces full-year results for year ended 31 March 2022. Read more. →

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Sustainable investing

A disorderly transition

Evidence suggests the transition to a low-carbon economy will be disorderly. By allocating to 'transition assets', investors can mitigate some of the disorder, while potentially generating positive outcomes for their portfolios. This paper makes the case for transition investing, and explains how to identify a true 'transition asset'.

Date published: 21 Feb 2023
Read time: 25 minutes

Chapters

01 Fast view
02 A matter of how disorderly
03 Are asset owners embracing transition investments?
04 Developing a transition framework
05 Transition investments for asset owners
06 The impact of transition finance on portfolios
07 Actionable steps
08 Appendix

A transition to net zero is unlikely to be neat or methodological. Industries will not find low-emission technology that steadily reduces global emissions by 7.6% each year; a pace of reduction which would halve emissions by 2030. As timelines lag there is likely to be a scramble to catch-up.

We already see signs of shifting supply and demand patterns creating volatility, not to mention protectionism, in markets. Evidence suggests we are at the start of a disorderly transition. Next to the actions of policy makers, how disorderly the transition becomes will be influenced by asset owners, investors, and companies' own emission reduction plans.

The transition requires huge investment in new green infrastructure. But reaching net zero depends on more than this. High emitters in traditional 'smoke-stack' industries require funding to spur their transition to a low-carbon world. Just how much funding and the conditions upon which it is received becomes the crucial question. There are five economically important, high-emitting sectors where successful transitions will generate powerful change. These are power, buildings, mobility, industry and agriculture which together generate more than 90% of global emissions. Each of these sectors is capital intensive with substantial fixed assets and long-standing business models. Change will not be quick or easy.

Transition investments or transition finance is the burgeoning investment category that will support high-emitters in their efforts to reduce emissions. This is distinct from climate solution providers which offer the products and services that drive decarbonisation.

Transition investments for asset owners

Public companies account for a vast majority of the world's emissions forming an important transition universe both for equities and debt. We know the bulk of this transition potential sits in the five big-emitting sectors. Many of the companies in these sectors are household names for both developed and emerging economies. For equities, the long trading history that exists for these companies allows us to assess in detail how transition investments in equities can fit into asset owners' portfolios.

Transition debt forms the backbone for attracting new capital for transition plans. The lower cost and flexibility of debt markets support innovation and crucially the ability to link lending to transition-related goals and targets. Debt will also be the most effective tool to mobilise private capital from wealthy nations towards emerging markets where the bulk of emissions growth needs to be addressed.

In this section, we take a first look at the transition equity and transition debt universes. We look at some of the key questions asset owners are asking about the impact transition investments will have on their portfolios including the inflation landscape, return potential and the overall impact on portfolio-level emissions intensity.

The impact of transition finance on portfolios

Asset owners deciding to add allocations to transition finance want to understand how these assets might impact their portfolio. Questions that are top of mind ask whether the transition will be inflationary, are there market returns in transition and importantly how will emissions reporting be impacted. Some initial thinking on these questions:

Transition allocations provide resilience against inflation

There is healthy debate around the inflationary versus deflationary effects of the transition to a low-carbon economic model; it seems reasonable to expect, particularly in the light of the Russian invasion of Ukraine, that there will be upward inflationary pressures in the short to medium term, but that in the longer term we will arrive at a global energy system that is cheaper and less vulnerable to supply shocks. Given the clear inflation-sensitivity of the companies within the transition universe, it is worth having a closer look at the outlook for inflation as it relates to the transition more broadly.

The inflationary effects can be categorised in two distinct ways: first, there will likely be a substantial increase in demand for certain metals and materials – as well as certain energy and agricultural inputs. For example, the IMF see potential for a metal demand boom with a fourfold increase in the value of metals production over the next two decades driven primarily by demand for copper, nickel, zinc, cobalt and lithium. This rise in demand collides with an era of structural underinvestment caused by the excesses of the last commodity upcycle, increased environmental pressure on permitting and development, and pressure from shareholders to reduce spending.

Appendix

How a range of climate-aligned strategies impact real-world change

Climate-aligned strategies	Reduces portfolio-level carbon footprint	Leveraged to decarbonisation trend	Invests and engages in high-emitting sectors	Influences real-world decarbonisation
Green infrastructure	✓ Green infrastructure like the build out of renewable energy generation or wastewater treatment once built will displace a pre-determined amount of the high-emission alternative	✓ Green infrastructure projects will usually produce a finite outcome or capacity to reduce emissions. However, real-world demand for the financed assets should reduce the risk premium of the investment over its life	✗ Funding green infrastructure is directed towards climate solutions. In some cases these projects might indirectly help improve the carbon footprint of high-emitters e.g., more renewable capacity used in factories	✓✓ Green infrastructure will usually displace a high-emitting incumbent product or service. This has a measurable impact on reducing real-world carbon emissions and faster development will drive down transition risk
Green bonds	✓ Green bonds are similar to green infrastructure where the use of proceeds will be directed to a specified project where a pre-determined capacity to reduce emissions will exist	✓ As with green infrastructure projects, the use of proceeds from green bonds will usually produce a finite outcome or capacity to reduce emissions. However, we expect investor demand for these assets to remain high	✓ It is possible for high-emitting companies to issue green bonds where the use of proceeds are ring fenced for a green initiative. However, this is small part of the green bond universe and a tiny part of high-emitter issuance	✓✓ Use of proceeds directed towards building renewable capacity or building efficiency et cetera will generate a measurable impact on real-world emissions. Growth in the asset class can drive down transition risk
Low-carbon index equities	✓✓✓ Low-carbon screens based only on Scope 1 and Scope 2 emissions have lower footprints than traditional benchmarks but currently little or no account is taken of Scope 3 emissions	✗ Excluding high-emitting sectors will not create a portfolio that is exposed to the tailwinds and structural growth areas linked to the decarbonisation trends	✗ High-emitting sectors are screened and usually excluded based on Scope 1 and Scope 2 emissions	✗ This approach only reduces Scope 1 and 2 emissions at a portfolio level. Divestment or exclusions using this incomplete measure of emissions has minimal impact on the real economy and could potentially increase transition risk
Climate solutions	✓✓ Climate solutions invest in the initiatives and technologies driving decarbonisation like electrification and waste management. Some of these companies can have legacy businesses with emissions	✓✓✓ Companies offering decarbonisation solutions are those most likely to benefit should the speed of the world's transition pick up	✓ Some legacy high-emitting products and services might exist within solution providers. Ninety One's definition requires that more than 50% of revenues must be generated by the decarbonisation activities	✓✓✓ Climate solutions directly contribute to emissions reduction and are essential in displacing and disrupting incumbent products and services that are not sustainable
Transition Investments	✗ Emissions intensity will be higher for transition investments than other climate strategies. The higher starting point allows greater scale in seeing emissions driven down	✓✓ Transition investments in hard-to-abate but essential industries produce many of the materials needed to accelerate the transition. Demand for credible transition investments is expected to increase	✓✓✓ Transition finance includes high-emitting sectors that can both enable the low-carbon transition or materially improve the emissions in hard-to-abate activities based on credible transition plans	✓✓✓ Well-funded transitions for credible decarbonisation plans in high-emitting sectors will generate some of the largest reductions in carbon emissions over the medium to long term. It could also reduce levels of disorder and transition risk

Important information

Targeted or projected performance returns

These are based on Manager's good faith estimate of the likelihood of the performance of asset classes under current market conditions. There can be no assurances that any investment will generate such returns, that any client or investor will achieve comparable results or that the manager will be able to implement its investment strategy. Actual performance may be adversely affected by a variety of factors, beyond the manager's control, such as, political and socio-economic events, adverse changes in the interest rate environment, changes to investment expenses, and a lack of suitable investment opportunities. Accordingly, target returns and expected results may change over time and may differ from previous reports. Additional and supporting information is available upon request.

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