



Impax Environmental Markets

Investment companies | Initiation | 3 June 2024

Sustainable long-term growth

Impax Environmental Markets (IEM) aims to invest in good-quality, fast-growing companies that are providing innovative solutions to environmental challenges or improving resource efficiency. The pace of change may be slower in some countries than others and, overall, slower than many of us would like, but IEM's managers believe that it is inexorable, which they think underpins an attractive long-term outlook for the trust.

The advent of higher interest rates in 2022 appeared to trigger a widespread sell off of growth stocks and IEM was caught up in this. More recently, the underperformance of mid and small caps has also weighed on IEM's portfolio companies' valuations. However, the managers report that the underlying demand for the products and services supplied by the businesses in IEM's portfolio was not much affected. They observe that, for the most part, earnings have risen and many of IEM's stocks have become even cheaper. A discount to NAV has opened up on the trust's shares too.

Capital growth and a more sustainable world

IEM aims to enable investors to benefit from a highly differentiated, well-researched, and diversified portfolio of fast-growing, globally listed companies providing innovative solutions to environmental challenges or improving resource efficiency.

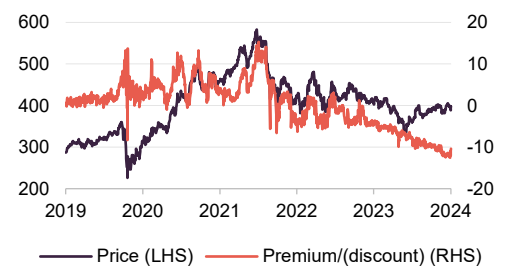
Year ended	Share price total return (%)	NAV total return (%)	MSCI ACWI total return (%)
31/05/2020	8.8	7.5	7.5
31/05/2021	49.7	47.9	23.4
31/05/2022	(7.1)	(0.9)	5.1
31/05/2023	(3.6)	(3.0)	2.6
31/05/2024	(0.6)	6.5	20.3

Source: Morningstar, Marten & Co

Sector	Environmental
Ticker	IEM LN
Base currency	GBP
Price	398.0p
NAV	444.0p
Premium/(discount)	(10.4%)
Yield	1.2%

Share price and premium/(discount)

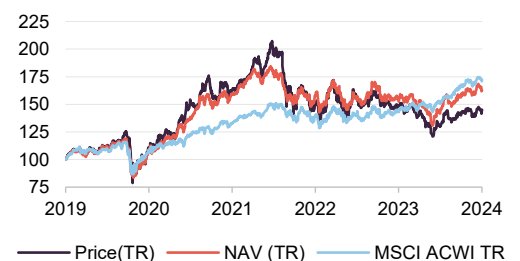
Time period 31/05/2019 to 31/05/2024



Source: Morningstar, Marten & Co

Performance over five years

Time period 31/05/2019 to 31/05/2024



Source: Morningstar, Marten & Co

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Domicile	England & Wales
Inception date	22 February 2002
Manager	Bruce Jenkyn-Jones, Jon Forster, and Fotis Chatzimichalakis
Market cap	1,044.9m
Shares outstanding (exc. treasury shares)	262,526,339
Daily vol. (1-yr. avg.)	625,703 shares
Net gearing	6.6%

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Analysts

James Carthew
jc@quoteddata.com

Matthew Read
mr@quoteddata.com

[Click to provide feedback to the company](#)



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More information is available at the company's website impaxenvironmentalmarkets.co.uk

Impax Asset Management is one of the largest investors in the transition to a more sustainable economy, with £40bn of AUM

The central premise of the trust is that its companies will grow faster, and therefore outperform, a broader selection of companies

Fund profile

IEM's managers founded it on the belief that, with insatiable demand for higher living standards on a finite planet, companies enabling the cleaner and more efficient delivery of basic needs – such as power, water, and food – or mitigating environmental risks like pollution and climate change, will grow earnings faster than the global economy over the long-term. IEM aims to provide its shareholders with exposure to this. The manager uses a proprietary classification system to define these markets. As of today, the system identifies six sectors: energy, clean and efficient transport, water, circular economy, smart environment, and sustainable food. The range of activities included has naturally grown as technologies advance and more industries look to address material environmental challenges.

Market-leading environmental manager

IEM's AIFM is Impax Asset Management (AIFM) Limited (Impax), which from its foundation in 1998 has grown to be one of the largest investors in the transition to a more sustainable economy, with £40bn of AUM at the end of 2023 and a substantial investment team based across Europe, North America, and Asia. The three lead managers working on IEM are Jon Forster, Fotis Chatzimichalakis and Bruce Jenkyn-Jones (see page 19 for more information on the management team).

Measuring success

For the purpose of this report, we have compared IEM with returns generated by the MSCI All Countries World Index (MSCI ACWI). IEM's factsheets use that index and another – the FTSE ET Index – which is a combination of FTSE ET100 (post 2014) and FTSE ET50 (pre-2014) indices.

The FTSE Environmental Technologies Indices were developed in collaboration with Impax and under the direction of the independent FTSE Green Industries Advisory Committee. This index series encompasses companies that have at least 50% of their revenues derived from environmental products and services with clear and significant impact. Impax and FTSE no longer collaborate on these indices and as such, the construction methodology for inclusion has meaningfully diverged. The central premise of the trust is that these companies will grow faster – and therefore outperform – a broader selection of companies. In this regard, MSCI ACWI might be seen as a better benchmark.

A long-term secular growth opportunity at a cyclically low price

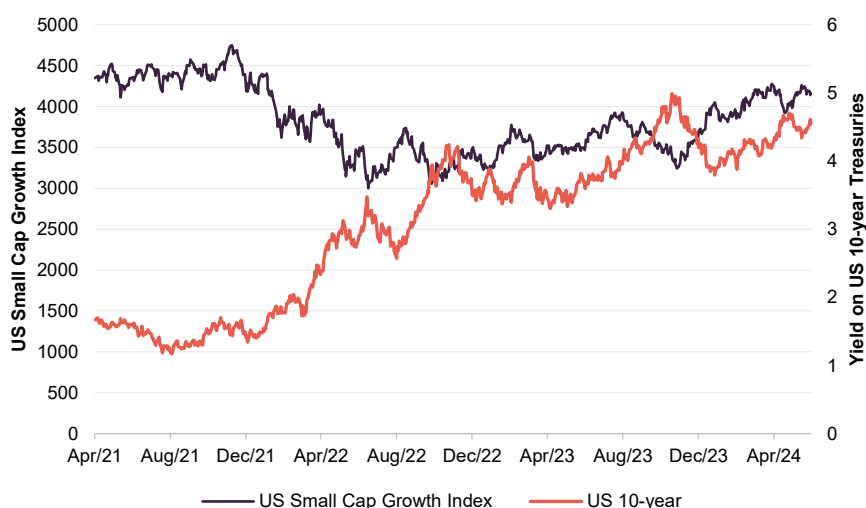
An investment in IEM is targeted to be an investment in the companies that are enabling the transition to a more sustainable world. IEM's investments aim to tackle long term threats such as climate change, plastic pollution, crumbling infrastructure, rivers choked by sewage, rising population and the increasing demand for finite resources.

However, the managers believe that there are also short-term considerations that suggest that IEM's shares are particularly attractive at the moment, which they characterise as: a potential turning point in US interest rates; the unusually long period during which large caps have been outperforming small caps; and a reduction in the valuation premium that investors are paying for the superior earnings potential of stocks in IEM's portfolio.

Three reasons why IEM may be attractive currently

A rising cost of capital tends to weigh on growth stock valuations, and talk of higher interest rates in the US appeared to lead to a dramatic sell off in growth stocks in 2021/2022. In October 2023, as commentators started to suggest that US rates would soon fall, growth stocks rallied. However, in 2024, some disappointing inflation figures seem to have muddied the waters.

Figure 1: US 10-year Treasury yields



Source: Bloomberg

While US interest rate cuts have been delayed, it still seems likely that they are on the way. This could be the catalyst needed for more positive sentiment towards IEM's stocks. However, the managers note that – given low levels of debt across the holdings, and strong fundamental earnings growth, rate cuts are not a prerequisite for performance.

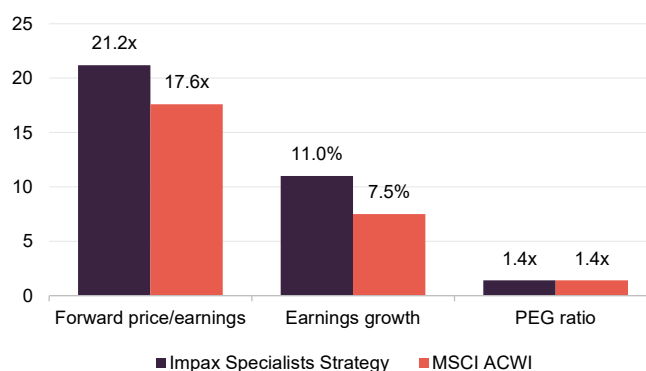
The chart uses the US Small Cap Growth Index as an equivalent chart using large caps would be distorted by the effects of the AI-related surge in US mega cap technology valuations. As we discuss on page 14, that has affected IEM's returns relative to MSCI ACWI.

Figure 2: Large cap versus small cap



Source: Morningstar, based on MSCI ACWI Large Cap and Small Cap indices, rebased to 100

Figure 3: Relative valuation as at 31 March 2024



Source: Impax

Over the very long term, evidence suggests that small cap stocks tend to outperform larger ones. Some concern over a slower US economy may have weighed on small caps in 2019, but then markets were knocked by COVID. Investors seemed to seek safety in large caps but later traded back into small caps, perhaps on hopes of a recovery. However, from about March 2021 onwards, large caps have pulled ahead again, helped by enthusiasm for mega-cap, AI-related names.

Figure 3 looks at the relative valuation of Impax's Specialists Strategy versus MSCI ACWI. The manager says that while Impax's stocks are more expensive, this reflects their much faster earnings growth. It feels that the valuation premium is back down within its normal range.

IEM's investment approach

IEM's opportunity set available to it today is considerably wider and deeper than when it was launched

IEM is over 20 years old, and its managers say that the opportunity set available to it today is considerably wider and deeper than when it was launched. To qualify for IEM's investable universe, a company must derive at least half of its revenues from environmental markets (in practice the figure for IEM's portfolio much higher at around is about 85%). In 1998, Impax reckoned that there were about 250 companies that were meeting that hurdle. Now, there are around 1,500 companies that fit IEM's investment approach, and around 260 are under active consideration as potential investments.

IEM small and medium-sized companies are not early-stage, unproven businesses

While there are many large businesses that have some exposure to environmental markets, IEM's investments are predominantly in small and medium-sized companies, which tend to be more focused on this area. Nevertheless, the managers comment that these are not early-stage, unproven businesses.

Impax says that companies in these markets are generally characterised by high levels of corporate activity, lower levels of sell-side coverage, rapid technological innovation, and regulatory momentum. It feels that this complexity can lead to mispricing, which it aims to exploit on IEM's behalf.

The taxonomy

Impax classifies the universe into six core themes:

Energy

Alternative energy; energy management and efficiency; hydrogen; smart grids; biofuels; industrial, consumer and buildings efficiency; wind; power storage and uninterruptible power supply; solar; lighting; developers and independent power producers.

Clean and efficient transport

Transport solutions; advanced aviation; buses and coaches; advanced shipping; road vehicles and devices; railways; pollution reduction; e-bikes and bicycles; shared mobility.

Smart environment

Environmental services and resources; digital infrastructure; research and development and consultancies, efficient IT; finance and investment; cloud computing; testing and monitoring; digital collaboration solutions; pollution control; environmental resources.

Water

Water infrastructure and technologies; distribution and infrastructure; treatment; efficiency; utilities.

Circular economy

Resource efficiency and waste management; general and hazardous waste management; recycled, recyclable products, and biomaterials; resource circularity and efficiency; technologies.

Sustainable food

Sustainable food and agriculture; organic and alternative; agri- and aquaculture; technology and logistics; forestry; safety and packaging.

This taxonomy evolves over time and team members, including those dedicated to analysing policy in this area, are encouraged to think about what else might fit the remit. The Impax team gave serious consideration to including nuclear energy in the mix, for example, but rejected it. In part because it felt that the tail risks were too high.

Growth at a reasonable price

The six themes outlined above comprise a diverse opportunity set, but the stocks that IEM invests in have a common factor beyond helping to address resource efficiency and environmental solutions. The manager believes these are secular growth sectors, parts of the market that can deliver long-term growth across economic cycles and deliver superior growth over the long term.

Rigorous due diligence

Every potential investment is assigned to a pair of analysts who will conduct rigorous due diligence on it. The first step is to ascertain the percentage revenue exposure that the business has to environmental markets, to ensure that it meets the strict 50% threshold, filtering out any business that is simply greenwashing. This has helped identify the roughly 1,500 companies that Impax considers to be eligible investments for IEM. These companies should have proven and profitable business models. The managers would normally avoid cyclical businesses with high levels of balance sheet debt (above about 3x EBITDA).

10-step fundamental analysis process

A 10-step fundamental analysis process follows, which helps whittle the universe down to an 'A-List' of about 260 companies approved for investment and examines.

- **Snapshot and investment thesis** – Role in the transition to a more sustainable economy
- **Market** – Opportunity for growth
- **Competitive advantage** – Technologies, brand, intellectual property, scale, distribution capabilities
- **Business model and strategy** – Credibility of plans, route to market
- **Risks** – Industry dynamics, policy, macroeconomics, and societal forces
- **ESG** – Effective governance structures, management of material ESG risks,
- **Management** – Experience, effectiveness, and succession
- **Valuation scenarios** – Fair value assessment, best/worst case scenarios
- **Trading** – Liquidity, portfolio allocation
- **Catalysts** – Route map to entry

This includes detailed financial and operational due diligence, and the construction of a financial model to inform a valuation assessment, which delivers a pricing range within worst and best-case assumptions.

Diversified 55-65 stock portfolio

The managers debate the merits of potential candidates for the portfolio and construct IEM's diversified 55-65 stock portfolio on a bottom-up basis. This is informed by an assessment of the current valuation relative to the best/worst case valuation scenarios referred to above, but consideration is given to risk limits, macroeconomic factors and the identification of stock-specific catalysts that might trigger a re-rating. Those factors also influence the managers' sell decisions.

The managers want every holding to be able to make a meaningful contribution to the trust's returns. Typically, the position size for a new investment will be about 1.0%–1.5% of total assets. The largest positions will be about double that and the managers operate with a soft limit in mind of about 5%.

The share prices of stocks in the portfolio are monitored continually against Impax's valuation models and as long as the team is happy with those models, positions

may be trimmed or added to as appropriate. A 20% stock price fall relative to the local index over a three-month period automatically triggers a reassessment of the investment thesis for that company. Similarly, if a stock goes through the upper valuation range, the managers will revisit the thesis and position size in the portfolio. The team is also in regular dialogue with the management of portfolio companies, checking up on ESG and sustainability issues as well as operational developments.

IEM's managers say that, in practice, many investments are held for the long term because they continue to justify their place in the portfolio.

Investment restrictions

IEM has the following maximum exposures in place in order to ensure that there is a reasonable diversification of risk in its portfolio:

- not more than 10% of net assets will be invested in any one company at the time of investment; and
- IEM will not make an investment if as a consequence of that investment individual holdings of 5% or more would in aggregate represent more than 40% of net assets.

In addition, the managers have some soft upper limits around exposure to emerging markets (20%), renewables (15%) and debt (10% in non-utility companies with a net debt to EBITDA over 3x). The managers also look to manage risk in the form of exposure to more volatile or cyclical sectors such as automotive (15%) and construction (20%).

ESG in practice

ESG analysis is a core part of Impax's bottom-up analysis. Unlike at some companies, responsibility for ESG analysis lies with the primary investment professional covering the stock. As part of the investment process, companies are assigned an ESG score based on an examination of their governance; material environmental and social risks; climate risks; human capital management and equality, diversity, and inclusion; and controversies associated with the business.

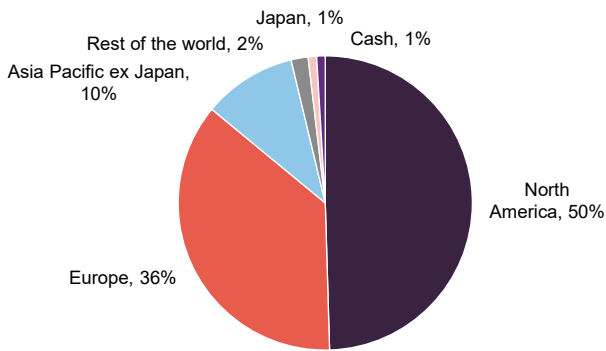
The ESG analysis identifies areas where Impax sees a need for improvement; these then become priorities for engagement and progress with resolving them is monitored. Failure to address an issue of importance is likely to be grounds for ejecting a stock from the portfolio.

IEM devotes considerable effort to reporting on ESG to investors. Pages 34 to 41 of IEM's [latest accounts](#) cover this area. Notable disclosures include IEM's 84% revenue exposure to the UN's Sustainable Development Goals, and the 40 sets of discussions that it had with 28 portfolio companies, engaging with them on their management of climate-related risks, impacts on nature, the way that they recruit and treat staff, and on issues of governance.

Asset allocation

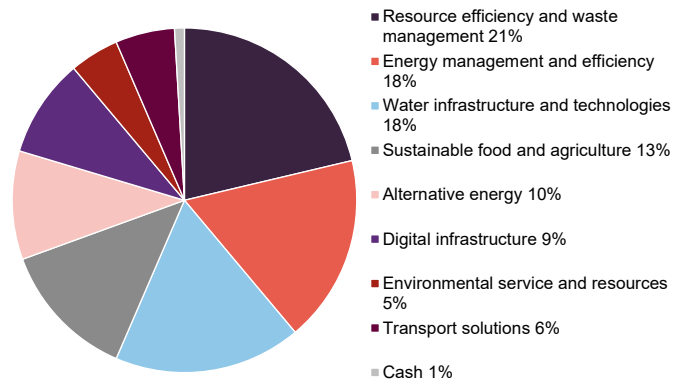
At the end of April 2024, IEM had 62 holdings. IEM's geographic exposure is not much changed from that at end 2023. Figure 6 illustrates the extent to which IEM's portfolio is biased to small- and mid-cap stocks. However, there is not much difference between the trust and the MSCI ACWI when it comes to looking at how cyclical or defensive the portfolio is, the result of a deliberate effort by the managers to increase the portfolio's exposure to defensives.

Figure 4: IEM portfolio by geography as at 30 April 2024



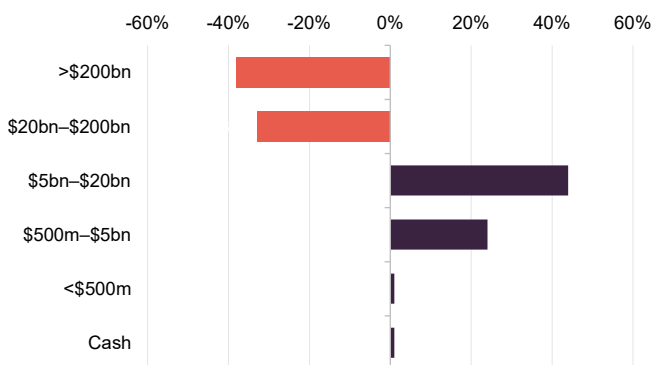
Source: Impax, figures as a percentage of net assets

Figure 5: IEM portfolio by sector as at 30 April 2024



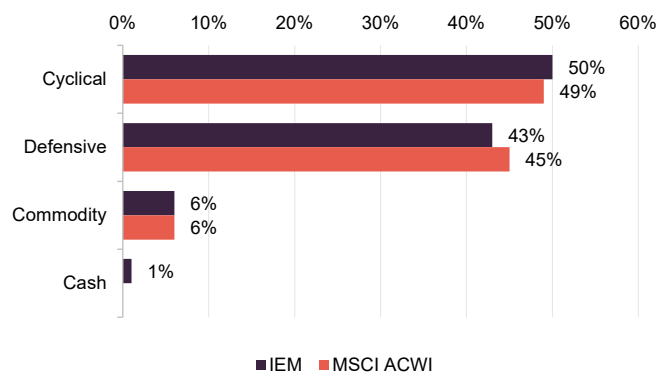
Source: Impax, figures as a percentage of net assets

Figure 6: IEM relative to MSCI ACWI by market cap as at 31 March 2024



Source: Impax

Figure 7: IEM versus MSCI ACWI – cyclicals versus defensives



Source: Impax

Relative to MSCI ACWI, the portfolio tends to be underweight North America and overweight Europe. That is largely a function of the absence of mega-cap stocks that would not meet IEM's environmental revenue criteria. However, the managers say that an analysis of where IEM's companies generate their revenue would compare fairly closely with that of the wider MSCI ACWI.

Top 10 holdings

Since the end of 2023, EDP Renovaveis, Eurofins Scientific, Northland Power, and Repligen have fallen out of the list of IEM's 10-largest holdings to be replaced by DSM Firmenich, Littlefuse, Kingspan, and Prysmian.

Figure 8: IEM 10-largest holdings as at 30 April 2024

Stock	Subsector	Country	As at 30/04/24 (%)	As at 31/12/23 (%)	Change (%)
Aalberts	Water distribution and infrastructure	Netherlands	3.3	2.6	0.7
Pentair	Water distribution and infrastructure	United States	3.2	2.8	0.4
PTC	Efficient IT	United States	2.9	2.6	0.3
DSM-Firmenich	Sustainable agriculture	Netherlands	2.8	2.2	0.6
Stericycle	Hazardous waste management	United States	2.7	2.7	-
Clean Harbors	Hazardous waste management	United States	2.6	2.3	0.3
Littlefuse	Industrial energy efficiency	United States	2.2	2.1	0.1
Kingspan	Buildings energy efficiency	Ireland	2.2	2.2	-
Prysmian	Smart and efficient grids	Italy	2.1	1.7	0.4
Spirax-Sarco Engineering	Industrial energy efficiency	United Kingdom	2.1	2.6	(0.5)
Total			26.1		

Source: Impax

Figure 9: Aalberts (EUR)



Source: Bloomberg

We discussed some of these with the managers:

Aalberts

Aalberts (aalberts.com) is a European-based but global water distribution and infrastructure company. Its four divisions cover fluid control and integrated piping systems used in eco-efficient heating and cooling systems in buildings; ultra-clean, ultra-precise, and highly durable equipment and systems that enable accuracy, control, and increased productivity in semiconductor fabrication, including motion control and vibration isolation systems; precision-manufactured parts and surface treatment solutions for automotive, aerospace and marine customers; and technologies such as precision extrusion and surface treatment for various industrial customers.

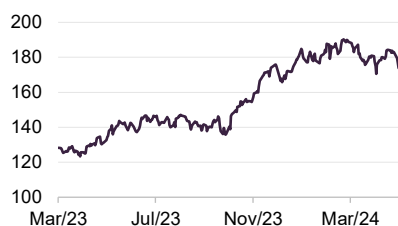
Impax notes that Aalberts has a strong balance sheet and is focused on improving its profitability. In 2023, Aalberts delivered organic revenue growth of 4.5%, and improved margins, but at 15.7% these remain shy of its target of 16–18% by 2026. IEM's managers say that it continues to innovate, while focusing on driving up free cash flow.

Figure 10: Pentair (USD)



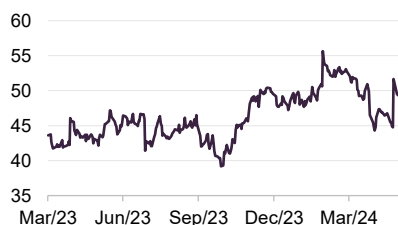
Source: Bloomberg

Figure 11: PTC (USD)



Source: Bloomberg

Figure 12: Stericycle (USD)



Source: Bloomberg

Pentair

Pentair ([pentair.com](https://www.pentair.com)) is a US water distribution and infrastructure company that has three strands to its business – water supply, disposal, and industrial filtration; water and ice; and pool and spa. The first strand provides pumps and filtration equipment to a wide variety of end customers; the second provides water softening, purification, and ice-making equipment; and the third covers filters, pumps, maintenance products, and accessories.

Impax says that it was attracted to it as a relatively cheap (mid-teens p/e), cyclical business that was seeking to improve its profitability. Pentair has set itself a target of achieving a 24% return on sales (ROS) by the end of its 2026 financial year. Q1 2024 figures showed fairly flat revenues, but on an adjusted basis, saw a 90bp improvement in ROS to 21.4%. The CEO said that for the first time in nearly four years, the company was entering what it believes to be a more normal operating environment. Impax says that the company is benefiting from increasingly stringent waste management regulation, the closure of alternative in-house facilities, and a greater focus on hazardous chemicals such as PFAs (see below).

PTC

PTC ([ptc.com/en](https://www.ptc.com/en)) creates software that is used by engineers to design products (using CAD) and optimise how they are manufactured and serviced. Product, application and service life cycle management means that products and services in use can be monitored (the former using the 'internet of things'), enabling extensions to their lifecycles through preventative maintenance. Customers include Volvo Construction Equipment, ABB (for its data centre infrastructure management), and Electrolux.

Impax says that this is a business with predictable recurring revenues (much of which is on a subscription basis) and strong free cash flow generation. Engineers trained on PTC software tend to stick with it.

PTC's latest quarterly figures showed an 11% year-on-year improvement in recurring revenue, slightly ahead of expectations, and a 19% improvement in cashflow, which is contributing to a reduction in debt. Management is guiding towards full-year EPS up between 22% and 56% on the prior year.

Stericycle

Stericycle ([stericycle.com](https://www.stericycle.com)) is a medical waste company. Impax likes these sorts of businesses as they have strong barriers to entry which helps create pricing power.

Stericycle was a company that IEM had held but had sold out of when it suffered some issues a few years ago. These included questions about pollution from an incinerator in Utah; a class action lawsuit in relation to excessive price increases; and a debt-fuelled acquisition of a secure document destruction business. However, the management team was shaken up in 2019, and two or three years ago, Impax assessed the company's response to these issues, concluded that it was on the right track, and reinitiated a position.

Impax says that the company is improving its balance sheet by selling off non-core businesses. It is also driving margin improvements through headcount reduction and says that it is on track to realise an estimated \$40m–\$45m of in-year cost

Figure 13: Clean Harbors



Source: Bloomberg

savings. Q1 2024 figures showed a fall in secure document destruction revenue, but earnings per share were up 16% year-on-year.

Clean Harbors

Clean Harbors ([cleanharbors.com](https://www.cleanharbors.com)) is another hazardous waste management business, working with industrial customers, providing services such as end-to-end hazardous waste management, emergency spill response, industrial cleaning and maintenance, and recycling services.

In the company's Q1 results, it said that strong demand for its services resulted in a better-than-expected performance, with its environmental services division proving a big driver of this. This division reported a 16% increase in adjusted EBITDA and a 130bp margin improvement on 10% revenue growth year-on-year. It guided towards 11% growth in EBITDA and adjusted free cash flow of about \$370m for its full financial year. It is also looking forward to the commercial launch of its Kimball, Nebraska incinerator.

New environmental standards bring new opportunities for these types of business. For example, Impax highlights the potential need to tackle PFAs (per- or poly-fluorinated alkyl substances, a group of over 4,700 industrial chemicals used in everyday products, which degrade very slowly, and some of which have been proven to be toxic, although most have not yet been tested and it thinks almost all may prove to be so. You can read much more about the managers' thoughts on this topic [here](#).

Portfolio activity

Impax says that it added seven new positions to IEM's portfolio and sold four over the 12 months ended 31 March 2024.

Figure 14: IEM portfolio new positions over 12 months ended 31 March 2024

Stock	Country	Sector	End weight (%)
Contemporary Amperex Technology	China	Transport solutions	1.23
Dabur India	India	Resource efficiency and waste management	1.64
Mondi	UK	Sustainable food and agriculture	1.63
Prysmian	Italy	Energy management and efficiency	1.77
Shimano	Japan	Transport solutions	1.27
Steris	US	Resource efficiency and waste management	1.49
Veralto	US	Environmental services and resources	1.25

Source: Impax

We discussed Contemporary Amperex Technology, Steris, and Prysmian with the managers:

CATL

Contemporary Amperex Technology or CATL ([catl.com/en](https://www.catl.com/en)) is a Chinese energy storage technology business and the global leader in EV batteries, which it supplies to a wide range of OEMs. Impax says that CATL dominates the battery chemistry

sector and is investing considerable sums in R&D to maintain this lead. It also has a strong balance sheet and the cash flow to support this.

Impax observes that there are question marks over its US business, as protectionism and national security concerns have led to a ban on the use of Chinese batteries by the US Defense Department, and some would like to go further. However, Impax believes that this stock looks attractive even if its US sales fall to zero.

Steris

Steris (steris.com) provides sterilisation equipment and consumables to the healthcare sector. Impax is attracted to the company's efforts in the circular economy, maintaining and repairing equipment, for example. Impax says that Steris has a strong market position in the US, which helps with pricing power. It also has good repeat business.

Prysmian

Prysmian (prysmian.com/en) is an Italian company that is a global (50+ countries) manufacturer of cables, ranging from high-voltage cables needed to upgrade and extend national and regional power grids, to medium- and low-voltage cables used in construction and infrastructure projects, and optical fibres, copper cables and connectivity systems for the telecommunications sector. Impax says that, given their criticality, customers need to be comfortable with the quality of the products that Prysmian supplies. This enhances the barriers to entry for competition in this area.

Figure 15: IEM portfolio sold positions over 12 months ended 31 March 2024

Stock	Country	Sector
Dialight	UK	Energy management and efficiency
Giant Manufacturing	Taiwan	Transport solutions
Indraprastha Gas	India	Alternative energy
Smurfit Kappa	Ireland	Sustainable food and agriculture

Source: Impax

Smurfit Kappa

Smurfit Kappa (smurfitkappa.com) is a packaging and paper company. Impax decided to sell it after it announced a planned merger with WestRock. The managers were unsure about the mooted benefits of the transaction and had doubts about the quality of WestRock's assets. The proceeds from the sale were switched into Mondi, which they feel has a strong track record across its activities, which range from forestry to manufacturing boxes.

Performance

Figure 16 looks at IEM's performance relative to the MSCI ACWI. Over the past five years, various macroeconomic factors appear to have had a significant influence on IEM's absolute and relative returns. However, this is a stock picking approach and

so we have included an analysis of the major contributions and detractors that individual stocks contributed to IEM's performance.

Figure 16: IEM performance relative to MSCI ACWI over five years ended 31 May 2024



Source: Morningstar, Marten & Co

In 2021, interest rates had been slashed and fiscal stimulus ramped up in the wake of the pandemic, which seemed to provide a significant boost to growth stocks. In addition, the build-up to COP26 saw over 130 countries adopt net zero targets, and the Biden government signalled its intent to deliver sizeable incentives for clean energy, which were subsequently realised in 2022's Inflation Reduction Act. The managers feel that all of this underlined the long-term potential of IEM's investment approach. As the portfolio performed well, IEM's shares also moved to trade on a significant premium to NAV.

Figure 17: IEM cumulative returns for periods ending 31 May 2024

	3 months (%)	6 months (%)	1 year (%)	3 years (%)	5 years (%)
IEM price	2.6	11.2	(0.6)	(11.0)	44.9
IEM NAV	2.9	12.8	6.5	2.3	62.6
MSCI AC World Index	3.1	13.5	20.3	29.7	72.0

Source: Morningstar, Marten & Co

Inflation then began to rise and this was then compounded by the impacts, particularly on energy and food costs, of Russia's invasion of Ukraine, fears grew of interest rate rises and this appeared to weigh on growth stocks. IEM tracked sideways against the MSCI ACWI for about a year, but was left behind as markets got caught up with excitement around mega-cap AI-related stocks. Another factor

that appears to have influenced IEM's relative returns has been the outperformance of large caps versus small caps.

This combination of factors seems to have weighed on IEM's discount too, and that widening has depressed IEM's share price returns.

You can access up to date data on IEM and other funds on our [website](#)

We have not included a peer group section in this note. The other two funds in the AIC's environmental sector are much smaller, less liquid, and have higher running costs, but crucially have quite different investment approaches to IEM's. IEM has much better long-term returns than both of these funds. Over the short term, Menhaden Resource Efficiency's NAV has been boosted by sizeable positions in three of the 'magnificent seven', stocks that would not meet the environmental revenue criteria for inclusion in IEM's portfolio. You can access up-to-date data on these and other funds on our [website](#).

Contributors/detractors to IEM's NAV returns

Impax kindly supplied us with some performance attribution figures for IEM over the 12-month period ended 31 March 2024.

Contributors

Figure 18: IEM five-largest contributors to NAV return over 12 months ended 31 March 2024

	Sector	Average weight (%)	Contribution (%)
Advanced Drainage Systems	Water distribution and infrastructure	1.8	1.3
Azek	Recycled, recyclable products and biomaterials	1.6	1.3
Lennox International	Buildings energy efficiency	1.6	1.1
Pentair	Water distribution and infrastructure	2.4	1.1
PTC	Efficient IT	2.5	1.0

Source: Impax

Impax says that Advanced Drainage Systems provides sustainable water management solutions. Increased frequency of storms and flooding is helping to underpin demand. Higher demand is helping to drive higher margins and improve returns on capital.

Azek is recycling materials to make environmentally sustainable outdoor living products. Sales have been growing at 15% CAGR since 2018. Lennox International supplies heating and cooling products to the North American market, having sold its European business in September 2023. Higher margins have been driving improved profitability, and the company has just launched a new line of products that use refrigerants that have a low global warming potential if released into the environment.

Pentair and PTC are discussed above on page 11.

Detractors

Figure 19: IEM five-largest detractors from NAV return over 12 months ended 31 March 2024

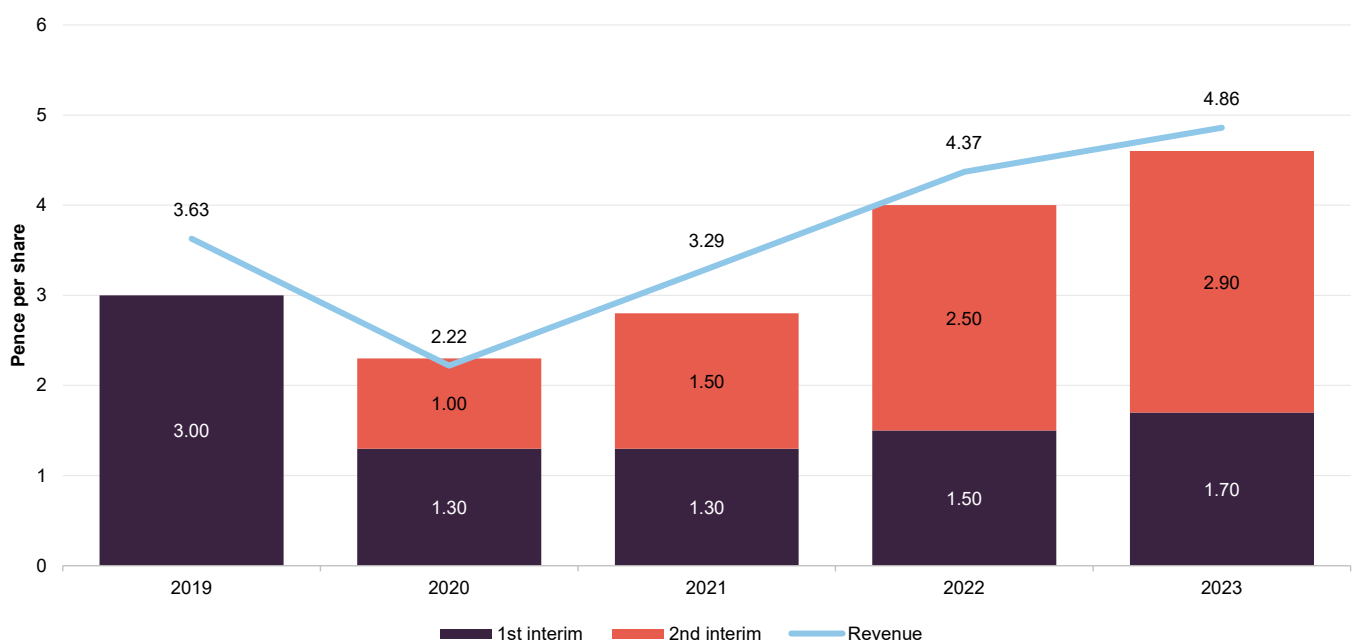
	Sector	Average weight (%)	Contribution (%)
Solaredge Technologies	Solar energy generation equipment	1.2	(2.0)
EDP Renovaveis	Renewable energy developers and independent power producers	2.2	(1.1)
Northland Power	Renewable energy developers and independent power producers	2.2	(0.9)
NIBE Industrier	Buildings energy efficiency	1.0	(0.9)
Corbion	Sustainable agriculture	1.4	(0.7)

Source: Impax

Impax says that higher interest rates have fed through into reduced demand for US residential solar installations as the cost of financing rose. In addition, lower prices made solar installations less attractive in Europe. This impacted on Solaredge Technologies. Lower power prices also weighed on renewable energy producers and developers such as EDP Renovaveis and Northland Power. Demand for heat pumps was lower than expected (in part as new housing starts fell). Inventory levels were too high, and this hit NIBE Industrier. Input cost inflation and lower demand hit margins at Corbion, and the company initiated a restructuring programme.

Dividend

Figure 20: IEM dividend history



Source: Impax Environmental Markets

IEM is focused on generating capital gains rather than income. It declares two dividends in each financial year, with dividends mainly financed from current year net income. The board's policy is to pay out substantially all of IEM's income as a dividend.

In common with most other trusts, IEM's revenue and dividends were impacted by the pandemic, but have made a full recovery since.

As at 31 December 2023, IEM had built up a revenue reserve of £14.9m, equivalent to about 5.57p per share. In addition, at the next AGM in May 2024, shareholders will be asked to approve the cancellation of the share premium account so that the balance of that account (£423.098m as at 31 December 2023) can be converted into a distributable reserve if needed.

Premium/(discount)

Over the 12 months ended 31 May 2024, IEM's discount moved within a range of 3.6% to 12.6% and averaged 8.1%. As at 31 May 2024, IEM was trading on a 10.4% discount.

Figure 21: IEM premium/(discount) over five years ended 31 May 2024

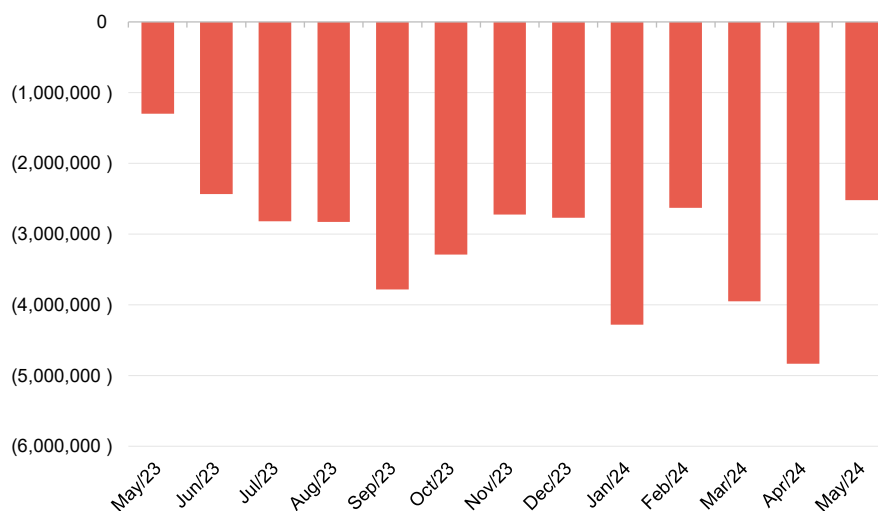


Source: Morningstar, Marten & Co

As is typical for most investment companies, at the AGM (the last of which was held on 20 May 2024), shareholders are asked to give permission for up to 14.99% of the shares in issue to be repurchased and 10% of shares in issue to be issued without pre-emption. Shares are bought back at a discount, enhancing the NAV for ongoing shareholders. IEM has been buying this stock into treasury. When the discount is eliminated, IEM would then be able to reissue these shares at a premium

to NAV (as it was doing prior to 2022), further enhancing the NAV for ongoing shareholders.

Figure 22: IEM shares repurchased by month



Source: Impax Environmental Markets, Marten & Co (figures to 30 May 2024)

As Figure 22 shows, IEM has been buying back shares consistently since the discount started to widen again last April.

Fees and costs

IEM's management fee arrangements were revised with effect from 1 January 2024. The fee is calculated monthly at one-twelfth of 0.9% on the first £475m on net assets, 0.65% on the next £925m, and 0.45% on the balance. The manager is appointed under a contract subject to 12 months' notice.

Apart from the investment management fee and the directors' fees (see page 21), in 2023 the largest overheads were secretary and administrator fees of £266k (FY22 £250k), custody fees of £179k (FY22 £170k), and FCA and listing fees of £113k (FY22 £107k).

IEM's ongoing charges figure for 2023 was 0.83%, up slightly from 0.81% for the prior year. However, IEM updates these figures monthly and as at 30 April 2024, it said the ongoing charges figure was 0.81%.

Capital structure

As at 31 May 2024, IEM's issued ordinary share capital was 305,623,539 shares of which 43,097,200 were held in treasury. The number of shares with voting rights was 262,526,339.

At 31 May 2024, just three shareholders had declared an interest in more than 3% of the company:

- Rathbones Investment Management 12.0%

- Brewin Dolphin 4.3%
- Joseph Rowntree Charitable Trust 3.4%

Gearing

IEM recently extended the size of its borrowing facilities, although these are still not particularly large. The AIFM has directed that IEM's maximum gross leverage (debt as a percentage of NAV) is 130%, but IEM's limited facilities should keep it well within that. Impax and the trust's board have said that they have a tolerance for up to 10% gearing depending on valuations and market conditions.

On 6 September 2023, IEM's existing five-year £50.3m facilities with Scotiabank came up for renewal which, due to IEM's growth, represented net gearing of only 3% at that time. As a result, and based in part on what it saw as a compelling portfolio valuation, IEM decided to put in place a mix of structural fixed and floating rate debt which had a mix of maturity dates and interest rates.

IEM placed €60m of privately placed notes with Pricoa Private Capital (part of PGIM, Inc), which were predominantly used to repay the pre-existing Scotiabank debt facilities. It also put in place a new £35m, two-year multi-currency revolving credit facility with Scotiabank. The interest on this is floating at reference rate plus 1.6%.

At its peak in 2014, gearing was about 10%, but 6–7% is a more usual level, and as at 30 April 2024, IEM's gearing was 6.6%.

Continuation vote

A continuation vote will be put to shareholders at the AGM in 2025 and every three years after that.

Management team

As at 31 March 2024, Impax had 51 portfolio managers and analysts (40 equity specialists and 11 fixed income) with an average of 18 years' industry experience. 23 of these were based in North America (Portsmouth, New Hampshire and New York), 23 in Europe (London and Dublin), and five in Asia (Hong Kong and Tokyo). In addition, there were five in Impax's quantitative research group, 18 in the sustainability centre (which covers sustainability and policy research, engagement, and thought leadership), and another nine in the trading and implementation team.

Each of the portfolio managers is also an analyst.

The three lead managers on the trust are Jon Forster, Fotis Chatzimichalakis, and Bruce Jenkyn-Jones. Each of the three managers is personally invested in the trust and they have recently increased their positions.

Jon Forster

Jon co-manages Impax Asset Management's Specialists and Climate strategies. Specialising in new energy, water, and waste support services, he researches stocks globally with a focus on the industrials and utilities sectors.

He has been part of the Impax team for over 20 years, having first joined in 2000 from Alchemy Partners, where he had spent two years providing consultancy work to their portfolio management team. He began his career in 1994 at HSBC Investment Bank working on their acquisitions team.

Jon has a Bachelor's degree in German and Management Studies from Leeds University.

Fotis Chatzimichalakis

Fotis is a member of Impax Asset Management's portfolio management team, where he researches stocks globally, focusing on the information technology and industrials sectors.

Fotis originally joined Impax as an intern in 2015, initially working in the listed equities team. He has held his current role since 2021. Prior to joining the firm, he had an internship at Barchester Green Investment.

A CFA Charterholder, Fotis also holds the Investment Management Certificate.

He has master's degree in Civil Engineering from the National Technical University of Athens and a master's degree in Sustainable Energy Systems from the University of Edinburgh.

Bruce Jenkyn-Jones

Bruce serves as Impax's co-chief investment officer, listed investments. He is one of Impax Asset Management's longest-serving employees.

Bruce developed the firm's listed equities business and the division's investment thesis. He is responsible for overseeing and enhancing all aspects of the listed investments business, including monitoring performance, ensuring regulatory compliance, and spearheading product design. Bruce is a co-portfolio manager of the Impax Specialists and Climate strategies.

Before joining Impax in 1999, Bruce worked as a utilities analyst at Bankers Trust and as an environmental consultant for Environmental Resources Management.

An Oxford graduate with a Bachelor's degree in Chemistry, Bruce also holds a Master's in Environmental Engineering Technology, and an MBA from IESE Business School in Barcelona.

Board

The board's policy is that each of the directors will normally serve on the board for no more than nine years following their initial election by shareholders. The board has been refreshed recently, with two directors stepping down and two new directors – Guy Walker and Elizabeth Surkovic – appointed within the last 12 months.

Figure 23: Directors

Director	Role	Date of appointment	Length of service (years)	Annual fee (£)	Shareholding
Glen Suarez	Chairman	1 Oct 2022	1.6	48,000	30,875
Stephanie Eastment	Audit committee chair	1 Jul 2019	4.9	40,000	15,000 ¹
Aine Kelly	Senior independent director	15 Nov 2016	7.5	35,200	16,000
Guy Walker	Director	17 May 2023	1.0	32,000	17,580
Elizabeth Surkovic	Director	1 Jan 2024	0.4	32,000	2,763

Source: Note 1) including 8,500 held by a connected person

Glen Suarez

Having been appointed as a director on 1 October 2022, Glen took on the role of chairman on the retirement of John Scott at the conclusion of the AGM in 2023.

Glen is currently chairman of Knight Vinke Asset Management, having previously held the roles of CIO and deputy CEO. He is a non-executive director of BlackRock Throgmorton Trust Plc and a senior adviser to FMAP Limited, a consultancy founded by Lord Maude which advises governments on the implementation of public sector reform.

Glen was chairman of The Edinburgh Investment Trust Plc from 2017 to 2022, having joined the board in 2013. He was co-chair of the Capital Markets Advisory Committee, an independent body advising on accounting issues and standards between 2014 and 2020. Prior to this, he was a partner in Sodic Limited and head of European energy, infrastructure and utilities investment banking business at Morgan Stanley.

He is a Fellow of the Institute of Chartered Accountants in England and Wales and a member of the Royal Society of Arts.

Stephanie Eastment

Stephanie is a Fellow of the Institute of Chartered Accountants in England and Wales and a Fellow of the Chartered Governance Institute, with over 30 years' experience of the financial services industry. She qualified with KPMG and worked at Wardley and UBS in finance and corporate governance before moving to Invesco, where she worked for 22 years, ending as head of accounts and company secretariat for specialist funds, which included investment trusts.

She retired from Invesco in 2018 to pursue a nonexecutive director career using her wide knowledge and experience. She is also a member of the AIC's Technical Committee.

Stephanie is a non-executive director and audit committee Chairman of Murray Income Trust Plc, Herald Investment Trust Plc and Alternative Income REIT Plc and a non-executive director of RBS Collective Investment Funds Limited.

Aine Kelly

Aine is an independent impact investing consultant. Aine worked as head of financial sector and investor engagement at Big Society Capital from 2013-2016, followed by three years as a consultant on The Impact Management Project. She spent the previous four years at Barclays Wealth and prior to that she worked for 16 years in investment banking at Kleinwort Benson, JP Morgan and Citigroup. Aine has a wide experience of introducing new investment opportunities to investors and has covered UK, European and Asian equity markets. She has worked in London, New York and Zurich and is currently based in Ireland.

Aine is a member of the external board of advisors of Cork University Business School.

Guy Walker

Guy is currently senior independent director at JPMorgan European Growth & Income Plc, having joined them in 2021. He was previously managing director UK & European Equities at UBS Asset Management, and before that he held various roles at Schroder Investment Management, including as non-executive director of Schroder Pension Trustee Limited, global head of ESG investment and head of equity research. He helped to set up the Investor Forum in 2014 and still acts as a senior adviser to it.

Guy holds an MBA from the London Business School, an MA in Finance and Investment and a BSc in Engineering Science from the University of Exeter.

Elizabeth Surkovic

Elizabeth is head of policy at the Royal Society. She has worked for 30 years in environmental policy making and regulation in the private and public sectors and is now focused on the interface of science and policy. This background and experience provides her with a deep knowledge of many of the areas supporting environmental technology investments. During her career, she has been at the forefront of developing and delivering environmental policy in Europe and the UK as well as working globally with groups such as the OECD.

Prior to working at the Royal Society, she was a senior civil servant for HM Government in several Departments. Before joining the civil service, Elizabeth was a Director of the Chemical Industries Association. She is a continuing policy fellow at University of Cambridge's Centre for Science and Policy and a member of its admissions board.

Elizabeth holds a BSc in Biochemistry from Birmingham University.



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**50 Gresham Street, London EC2V 7AY
0203 691 9430**

www.QuotedData.com

Registered in England & Wales number 07981621,
2nd Floor Heathmans House,
19 Heathmans Road, London SW6 4TJ

Edward Marten (em@quoteddata.com)

Nick Potts (np@quoteddata.com)

Colin Edge (ce@quoteddata.com)

Eiman Ali (ea@quoteddata.com)

Aiman Shaikh (as@quoteddata.com)

INVESTMENT COMPANY RESEARCH:

Matthew Read (mr@quoteddata.com)

James Carthew (jc@quoteddata.com)

David Johnson (dj@quoteddata.com)

Andrew Courtney (ac@quoteddata.com)

Richard Williams (rw@quoteddata.com)

Harry Hartigan (hh@quoteddata.com)