UK EQUITIES

MARTIN CURRIE
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UK SMALL CAPS: TRANSFORMATIVE TRENDS

DECARBONISATION AND THREE NET-ZERO HEROES

Portfolio Manager, Dan Green taps into four key long-term investment themes where pioneering goods and services are an emerging trend: The digital economy, consumer brands, content & intellectual property (IP) creation and **decarbonisation**. In this second instalment of a four-part series, he looks at the structural transformation being taken towards net-zero carbon solutions in the UK and overseas, highlighting three companies that could benefit.

Dan Green, CFA

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- The UK government wants to decarbonise all sectors of the economy by 2050
- This will require substantial investment from the government and the private sector
- UK small caps are supporting the shift towards net-zero solutions by adapting existing business models or providing products and services that enable others to minimise their carbon footprint

The Digital Economy | Consumer Brands | Content and IP Creation | **Decarbonisation**

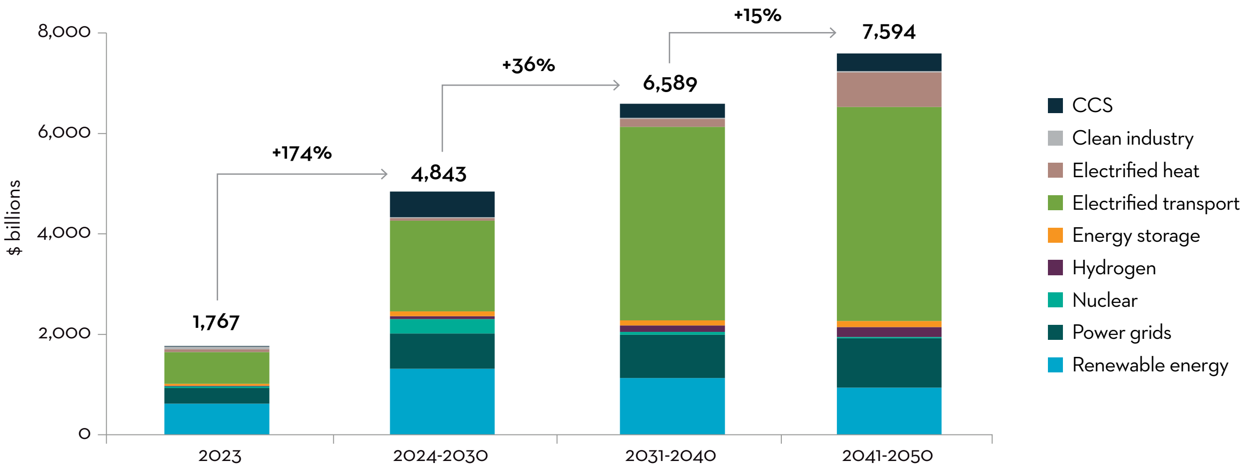
The future is bright

The structural transformation of our world to a lower carbon economy is already underway and vast amounts of capital are needed to reach the ambitions set. Whether operating domestically or internationally, we have identified a number of UK-listed small caps, which stand to benefit over the long term from the regulations fuelling this acceleration in investment.

UK decarbonisation proposals require massive investment

The UK government has set out its proposals for decarbonising all sectors of the economy by 2050, in a net-zero strategy it has coined, 'Build Back Greener'. The National Infrastructure Commission has highlighted that large volumes of renewable energy will be needed to meet net-zero ambitions, and the degree of investment required to support the initiative will be substantial. To reach these targets, areas such as private sector investment will require between about £20 billion and £35 billion per year between 2025 and 2050[1].

2023 energy transition investment versus required annualised levels in NEO 2022 Net Zero Scenario



Source: Statista and BloombergNEF as at 30 January 2024. Energy Transition Investment Trends 2024.

[1]Source: National Infrastructure Commission as at October 2023. *https://nic.org.uk/app/uploads/Final-NIA-2-Full-Document.pdf*

Companies making the difference

It is clear the transformation to lower-carbon solutions has become an important cornerstone in the strategy of every company. A number of UK small caps are already driving this change – either by adapting their business models in line with government decarbonisation targets or by supplying goods and services that enable other businesses or consumers to decrease or offset carbon emissions.

Volution

Volution manufactures energy efficient ventilation products for residential homes and commercial properties. The business aims to provide healthy indoor air in a sustainable manner. It wants 90% of plastic in its products to be recycled by 2025 (currently at 76%) and low carbon products to account for 70% of sales, which it surpassed in the 2023 financial year.

In its core markets of the UK, Nordics, Germany and Australia, regulatory drivers seeking to reduce carbon emissions from residential property are driving sales with high energy costs now providing extra stimulus.

For example, all new housing in the UK is set to be net zero carbon ready from 2025, requiring sophisticated ventilation and heat recovery products. These structural drivers have enabled Volution to consistently increase earnings per share over the last decade at a compound annual growth rate (CAGR) of 12.7%. This has been achieved through a combination of organic and inorganic growth.

Now operating under 21 brands with sales offices in 14 countries, Volution has a strong competitive position. This has led to operating margins of over 20% and a high return on capital employed (ROCE). 60% of its revenues are generated from non-UK customers, enabling the business to capitalise on the decarbonisation of the global economy. This highlights that UK small caps are not just aligned to the domestic economy.

Source: Volution as at 2023. Volution Group Plc Annual Report. *https://www.volutiongroupplc.com/application/files/9516/9868/0584/Annual_Report_2023.pdf*

The information provided should not be considered a recommendation to purchase or sell any particular security. It should not be assumed that any of the securities discussed here were, or will prove to be, profitable.

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Foresight Group

Foresight Group is a sustainability-led alternative investment manager with 80% of its assets under management (AUM) in infrastructure focusing on renewable energy, sustainable infrastructure and waste projects, as well as batteries and forestry.

When it first listed, Foresight had an AUM of c. £4.5 billion and in the past three years this has grown to £12.5 billion. This has been achieved through a combination of organic growth and acquisitions. We forecast the company to be able to grow its AUM by over 25% a year on a rolling, three-year basis supported by demand for investment in decarbonising the world economy. The outlook is supported by resilient market trends as global alternatives AUM is forecast to grow from $13.3 trillion at the end of 2021 to over $23 trillion by 2026[2].

Foresight's history and expertise in infrastructure means it is well placed to benefit from the transition to clean energy. This potential was supported by BlackRock's acquisition of Global Infrastructure Partners, an alternative asset manager, in January 2024.

In the statement accompanying the acquisition, it said *"infrastructure is forecast to be one of the fastest growing segments of private markets in the years ahead. A number of long-term structural trends support an acceleration in infrastructure investment. These include … a movement towards decarbonization and energy security in many parts of the world."*[3]

[2]Source: Foresight Group Holdings Limited as at 30 September 2023. *https://media.umbraco.io/foresight/i2ydmhaa/fghl-h1-fy24.pdf*
[3]Source: Blackrock as at 12 January 2024.
https://www.blackrock.com/corporate/newsroom/press-releases/article/corporate-one/press-releases/blackRock-agrees-to-acquire-global-infrastructure-partners

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Mears

Mears is the largest provider of specialist housing maintenance and management services to publicly funded customers. It is backed by a strong social purpose and industry reputation for service quality.

Mears has created an end-to-end decarbonisation service to support clients with the huge challenge of improving social housing stock. The UK government aims to raise the carbon efficiency of all social housing stock by one energy performance certificate band by 2030 and has released £800 million for the English Social Housing Decarbonisation Fund (SHDF).

Social housing trade publication, Inside Housing, has estimated the cost of decarbonising the UK's social housing stock at £104 billion or around £21,000 per property, which would suggest this could be a significant growth opportunity for the business[4].

In their half year results for financial year 2023, Mears stated they had submitted successful grants on behalf of clients that will contribute to a total works value of £120 million to be delivered over the course of 2024 and 2025[5]. Additionally, this will provide opportunities for future waves of SHDF funding applications.

*Monthly trade publication that covers the UK's social housing sector.

[4]Source: Inside Housing as at 23 November 2020. *https://www.insidehousing.co.uk/insight/the-cost-of-net-zero-social-landlords-decarbonisation-plans-revealed-68497*

[5]Source: Mears Group PLC as at 30 June 2023. *https://www.mearsgroup.co.uk/financial-reports/mears-group-plc-half-year-results-2023*

Source: Bloomberg, 28 February 2024 unless otherwise stated.

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"Mears has created an end-to-end decarbonisation service to support clients with the huge challenge of improving the social housing stock."

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- Smaller companies may be riskier and their shares may be less liquid than larger companies, meaning that their share price may be more volatile.

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