Regnan Turns Spotlight on the Principles of Impact Investing and its Value for Asian Investors

As an affiliate of J O Hambro Capital Management (JOHCM), responsible investment fund manager Regnan has the mandate to focus on delivering innovative and credible sustainable and impact investment solutions. It leverages its history of more than two decades of experience at the forefront of the industry, having embarked on this course well before the trend took hold globally. Regnan, in fact, traces its roots back to Monash University, Melbourne back in 1996, when it was established to investigate and address impact and ESG-related sources of risk and value for long-term shareholders in Australian companies. 2020 marked a new chapter in the Regnan story, as it moved directly into sustainable and impact investment management, and the firm now operates as a standalone sustainable investment business within Pendal Group, an Australian-listed investment manager and owner of JOHCM. Hubbis had the opportunity to meet with Tim Crockford, the London-based Senior Fund Manager, Head of the Regnan Equity Impact Solutions team. Tim joined Regnan in June 2020 and has 14 years' industry experience, having moved over from his role as founder of the Hermes Impact team in 2016 and also manager of the Hermes Impact Opportunities Equity Fund from its launch in December 2017. He and his team recently launched the Regnan Global Equity Impact Solutions Fund and are spreading the word of impact investing amongst Asia's wealth management community.

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TIM CROCKFORD
Regnan

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In a nutshell, what is the Regnan proposition and offering today?

The mission is simple – we are mandated to drive positive impact and investing for a more sustainable future. We want to help make responsible investment the standard way to invest, and to make it more nuanced, intellectually robust and effective. We have launched our Regnan Global Equity Impact Solutions Fund as the first of what we hope and expect will be a variety of specialist impact investing funds in the foreseeable future.

You came to Regnan from Hermes, which you had joined in 2009 and where you had started their drive towards impact investing, then launching their first impact Fund in December 2017. Why did you switch to Regnan?

Investors often ask us about the background of the team and our different skills. Perhaps the best way to answer this is that we wanted to focus less on ESG integration, which is focussed on ESG risk mitigation, and more on the underlying challenges that impact investing seeks to address. Regnan opens the doors to precisely that. We want to do good for the world and society at large by investing in and supporting businesses that are genuinely impactful, and all at the same time, achieving attractive returns for investors, which in turn helps recycle money into the hands of companies with impactful products and services. Regnan gives us a knowledge platform to get a deep understanding of how these products and services can make a difference, and allows us to better focus our engagement on driving additional positive impacts at the companies producing them.

What are the key issues you hope to address, and how is Regnan making a difference through this first Fund you have launched?

The basic premise is that the new fund targets investment in selected companies that are providing innovative solutions for environmental and social problems.

Here in Asia, we want to help the region's wealth management community and investors catch up to some of the momentum we have been seeing in Europe and the US as more and more private wealth focuses on these issues and sees that this is not simply an altruistic approach, the selection of investments in this type of Fund will boost performance and at the same time reduce long-term ESG-risk by avoiding what could become stranded assets in industries that are being challenged by the ongoing transition to a more sustainable future.

All of the companies in the portfolio have at the centre of their businesses some sort of solution to either a specific environmental or social challenge. The idea is that by investing exclusively in companies that are able to solve these types of problems, we are supporting the transition to a world increasingly focused on sustainability, increasingly focused on trying to find solutions for these major challenges.

And it is commercially driven as well as having the wider environmental and social impact; this is because revenues derived from these sorts of products and services will no doubt grow substantially over the years, driving up these companies' valuations given their significance to their total cash flow. We have seen that with the explosion of interest in some headline businesses and themes, for example, electric vehicles and Tesla's valuation, but there are many other areas across a wide variety of sectors and services that will directly benefit from these powerful trends that are yet to be discounted in the price for some companies that face strong and persistent earnings growth as their revenue base expands.

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In your view, what is impact investing?

Impact investing is all about investing with the intention to generate a measurable positive environmental or social impact, and investors typically have a variety of objectives. We aim to make the world a better place by investing in companies finding innovative solutions to urgent problems facing the environment and society, and then engage with these companies to try and help them operate better. We target attractive long-term investment returns from these solutions, the success of which will drive the financial value of investee companies. We continually review companies' effectiveness in helping solve these environmental and societal problems by measuring their impact in hard numbers and tracking the change our engagement helps to drive.

Investing for impact has expanded well beyond private equity and private debt into listed equities over the past few years. And today, the overall market for impact investing is substantial. The Global Impact Investing Network (GIIN) estimates the impact investing market has grown to USD715 billion in the GIIN Annual Impact Investor Survey.

What exactly is the new Fund and what are you trying to achieve, and how?

Launched in October 2020, the Regnan Global Equity Impact Solutions strategy is a high conviction, diversified, global multi-cap portfolio with very low portfolio turnover and a strong emphasis on driving impact through engagement. We aim to generate long-term outperformance by investing in mission-driven companies that create value for investors by providing solutions for the growing unmet sustainability needs of society and the environment. We use the United Nations Sustainable Development Goals (SDGs) as an investment lens, looking for solutions that contribute towards specific SDG Targets.

As to performance, we aim to generate market-beating long-term investment returns by investing in the best and brightest solutions to the world's environmental and societal problems. Specifically, we believe we will outperform the broad global equity market due to the growth in the addressable markets for the solutions being sold by our portfolio companies, as demand for these solutions grows. We invest in companies that provide solutions that have a positive impact on people and the planet. We identify early growth opportunities that meet a structural, underserved need. We take advantage of market inefficiencies in pricing in long-term systems change.

But what differentiates Regnan and your new Fund from the many other ESG and impact investing funds?

First, I want to reiterate that this is not ESG-driven, it is an impact investment fund, targeting products and services that are making a real difference in environmental and social matters.

We assess both impact and investments and we do not follow the usual approach of outsourcing the analysis and measurement of impact to a separate team. This is because the impact case is the investment case.

To achieve this, we have assembled a pioneering team with

a diverse skillset. Our four-person investment team has designed and built an approach that has pioneered impact investing in public equity markets. Our diverse skill set ensures that we have all of the expertise required within the team.

Moreover, we have created our proprietary Regnan SDG Taxonomy, building a comprehensive proprietary framework to identify companies that provide solutions to the environmental and societal challenges facing the world.

What are the impact themes you focus on and that thereby product the impact investment case you refer to?

There are eight themes. I will list them here, as they help inform potential investors of where we can truly make a difference, but also helps identify where they can boost their investment returns.

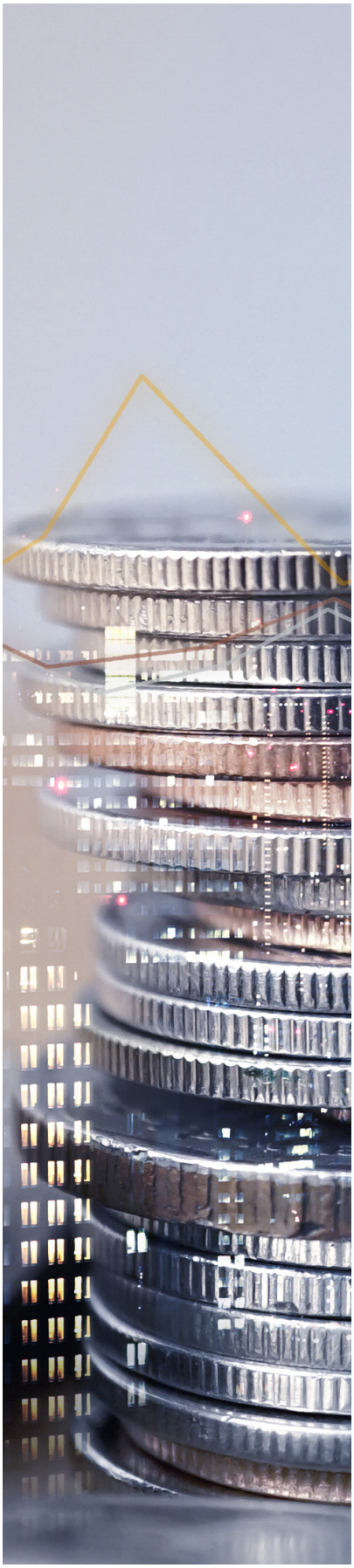
Health & Wellbeing focuses on improved life expectancy and quality of life. Energy Transition is all about transforming the energy system to power a low-carbon economy. Future Mobility is linked to this as it is promoting low-carbon transportation. The so-called Circular Economy centres on the cycles of resource efficiency, reusability and recyclability. Food security takes a global perspective on sustainable food supply and productive farmlands. Education naturally targets global access to quality education. Financial Inclusion is about the democratisation of access to financial services, especially for the underserved populations around the world. And Water, naturally, is about the preservation of water and ensuring access to water for all.

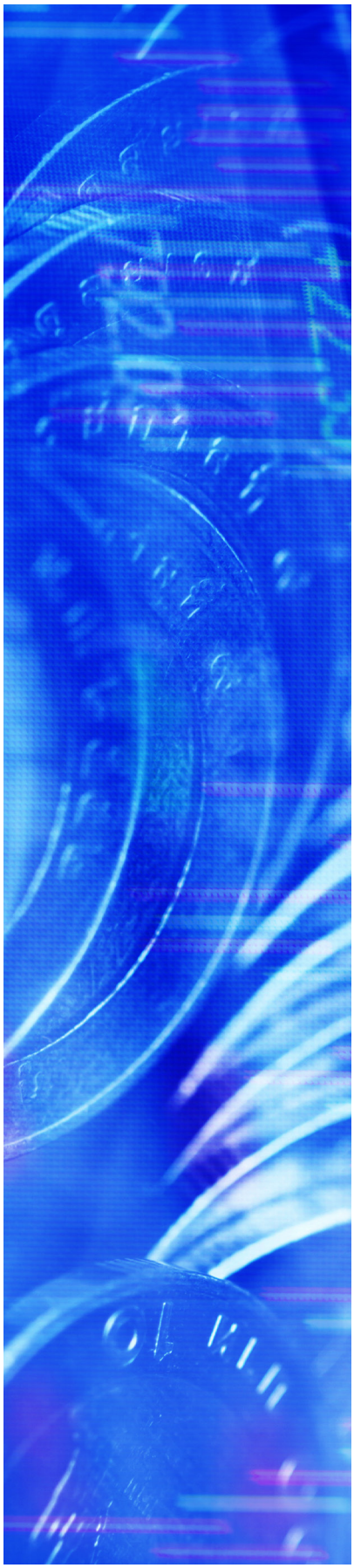
There are rather a lot of themes there, so how do you narrow things down to actually select your investments in the new Fund?

We make a five-step impact assessment. So, once we have identified a company that offers a compelling solution to a problem, it has to pass five impact tests before we consider investing in it. The headlines for these five steps are first Nature, so does the company's solution directly drive a positive impact by contributing to a specific SDG target? Then we have Intentionality, which determines how central the solution is to the company's strategy and mission. Additionality assesses whether the positive impact would occur if the company's solution did not exist. Balance centres on the company's actual and potential negative impacts. And finally, Directionality analyses the trajectory of the company when it comes to all four tests I have listed just now.

But there must be a financial analysis of these companies that ultimately determines your investment or exclusion of such companies?

We then move to our value analysis. If the company has passed the five impact tests, it must then pass our value analysis, consisting of three steps. These are first, the value creation analysis, where we study the company's historical value creation record, estimate





the company's total addressable market, in other words, the likely size of the market for the solutions it is providing over the next 10 years, then we work back from that to estimate cash flow growth. We also seek to understand the company's competitive position in this market, to help estimate how much of the market growth can be captured by the company.

Secondly, our value distribution analysis looks at where the value is created, in other words, whether this value is spread between shareholders, customers and employees and if it being distributed in such a way that should lead towards sustainable growth over the long term.

Finally, the value gap analysis centres on a comparison of our own financial forecasts with those of consensus, to look at whether the company's potential for value creation is already reflected in the share price. This involves risk analysis that assesses the risks to the company's future success and how well the company is likely to deal with them, and the effect that these risks could have on the investment thesis.

Does a fund such as the new Regnan strategy actually make a difference?

We believe so, yes, but we are only part of the global drive to impact investing. Our belief is rooted in the evidence that we have already had positive results from our corporate engagements.

The more funds that come on board, the more companies must focus their governance, products and services on impactful business in order to attract investment and reduce their cost of capital – we have seen this pick up over the last twelve months.

To help drive positive impact, we firstly aim to keep companies on mission, by investing only in companies highly focused on solutions to the UN SDG targets. We engage with management to influence strategy and try to keep them focused on business areas that contribute to solutions, promote better business practices and disclosure, and to reduce negative impacts by talking to the management of portfolio companies about issues such as the environmental footprint of their supply chains and working conditions in their suppliers' factories. By reducing negative impact, we aim to magnify the total net positive impact.

We also endeavour to support management by investing in companies we believe should outperform the market in the long term. Assuming we retain our initial conviction, sometimes this means accepting underperformance in the short term because the management prizes long-term potential over the next quarter's earnings. The Fund's support, as a long-term investor, increases the portfolio companies' capacities and abilities to stay impactful.

Sometimes, it seems that there is some confusion over impact investing and ESG investing. You focus on impact investing, but can you help demystify the lines in the sand between these areas?

We agree that there is indeed some confusion in the

terminology. We focus on impact investing, and some products are termed 'impact', when perhaps they are not impactful and might be more in the ESG integration space. This is made even tricker, as increasingly, "ESG fund" is becoming a catch-all term for any responsible investment product. Actually, in the public equity space in particular, while this is an area that you're starting to see more fund launches, it is still fairly limited in terms of the number of funds that are actually doing what would globally be considered to be impact investing.

Impact investing is ultimately defined not only by the process but also the resulting portfolio, which needs to reflect the investor's intention to generate a positive impact. In practice, this means a portfolio constructed exclusively out of companies that are on a mission to solve either an environmental or social challenge. So, there is a problem with the misuse of labels, and it's worth going back to the roots in defining what impact investing actually is and what it's supposed to mean in terms of your portfolio construction.

In light of those comments, how can investors be confident that your new Fund is indeed the 'pure' manifestation of impact investing?

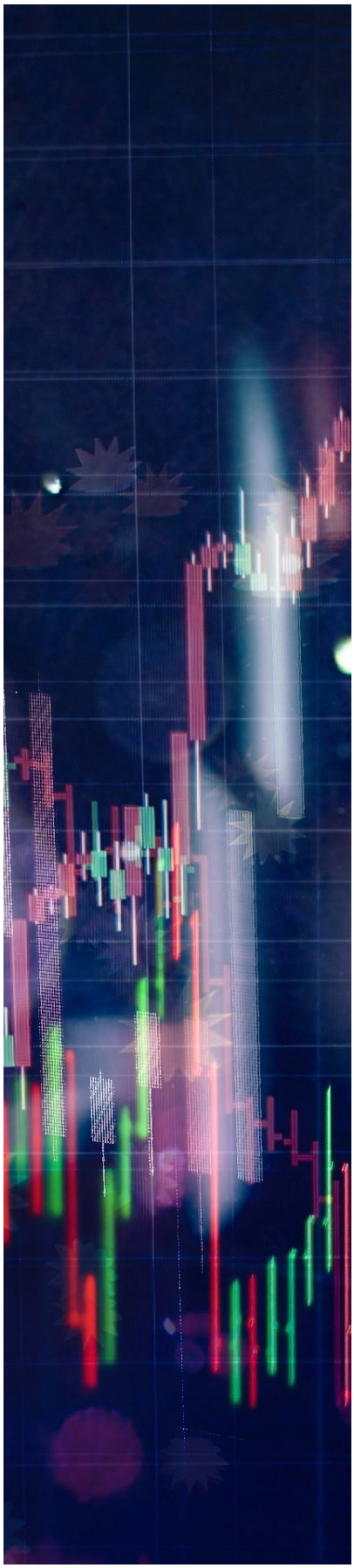
This relates of course to the selection, filtering and refinement processes I highlighted earlier. With respect to our new Fund itself, and how we try to differentiate ourselves, it is really from this razor-sharp focus on finding companies that are not just problem solvers, but are also selling a solution that is able to resolve a problem in a very innovative way. We often refer to it as the selection of the trailblazers within the impact space.

So, for example, just as an obvious example of an area perhaps that people expect us to be exposed to, we've never invested in solar, because a solar landscape is broadly a highly commoditised one. And there is in that segment a very limited amount of what we would term true innovation. Actually, if you look at how the cost of solar energy has come down over the years, it has come down dramatically, but it's mainly been driven by moving production based from west to east, it's been driven by cheaper labour, it's being driven by cheaper inputs. That is very different to other areas perhaps within the energy transition space, whereby you have had much more of a technological or technology-driven approach, which had driven costs down and broadened access to a particular solution.

The Fund, therefore, aims to concentrate only on pure solutions providers, mission-driven businesses that are predominantly generating their revenues and profits from these particular environmental and social solutions. And then, we filter further by curating an explicit focus on only those solutions that we deem to be differentiated and innovative, and therefore able to generate an additional positive impact that their competitors or peers cannot match.

What are the key issues that would-be investors typically question you about?

However, the central questions focus on our approach to impact



investing, and how we balance our wider objectives with return expectations, as generally, investors do not really want to sacrifice returns for impact.

They also want to know what we actually invest in and sometimes think that we are little more than highly valued, highly trending stocks such as Tesla. But that is not the case at all. What you get with our Fund is a diversified collection of carefully selected names across different sectors and geographies. There are companies in there that are, for example, recycling steel dust, and that are actually highly cyclical businesses that are benefiting very much from this cyclical upturn that we're currently seeing.

In practice, the companies in this portfolio will be typically a smaller or medium-sized business, whereby the value of that company, the equity value of that company, is dependent on the success of this particular product or service that the company offers, which is solving either an environmental or social problem.

Accordingly, the ability of these companies to grow in valuation terms over the long term is dependent on their ability to grow their revenues by selling a successful solution to either an environmental, and social problem. The equation is therefore a simple one, whereby we have issues to solve like water shortages or emissions, or social problems, such as, of course, or even to help in a pandemic type environment. These are problems that increasingly need to be solved and need to be solved quickly. And that translates directly into revenue growth and therefore profit growth for these companies.

Why opt for the public market opportunities rather than investing at earlier stages privately?

We believe both public and private companies are invaluable to this expanding impact-driven corporate universe. However, public versus private have different risk and return profiles. We focus on the public arena, where the companies are already at a more advanced stage of their development. This might mean that the returns do not match the returns possible from the right private opportunities, but it also means that we are investing in companies with a more established history, public market accountability, more proven products and services and therefore importantly less risk. The private arena is really more institutional or very high net worth private investors. Our market worldwide and certainly within Asia is the mass affluent and HNW type investors who want to participate in this type of opportunity and who, if they want, can trade in and out of the Fund, for example, if they require liquidity, whereas the private market type investment is a far longer-term commitment.

Everything is inter-related; there are consequences of everything that mankind does, so for example, the globalisation and travel that appeared to offer us such freedom in the past is, of course, directly related to the spread of the virus. So, if you gaze in the crystal ball, what lies ahead?

It is tough to pinpoint what will emerge in the future, but what we can agree is that the need for im-

pactful businesses and investments has truly been accelerated by the events since early 2020. It is akin to an awakening, a broader recognition that these sorts of challenges need to be solved sooner rather than later and cannot be pushed back any longer, and that so much of our endeavours are inter-related and have broader negative impact on the world around us.

Environmental and social issues are therefore no longer be simply considered external problems, the cost of which can simply remain unaccounted for. Individuals, consumers, voters are increasingly demanding change. The result is like a domino effect, whereby governments are now being more proactive in terms of their legislation, in terms of their taxation, and that is creating rising costs for those companies that are the biggest social and environmental offenders, while incentivising those impactful businesses and encouraging their development.

So, if you are a company that has built your business around solving these problems, all of a sudden, what you have is a huge opportunity to solve these problems and like we've just discussed, this is resulting in revenue growth for you, because you sell a service or you sell a product that is able to help other companies, for example, mitigate their emissions, or for example, reduce their water usage or perhaps clean the wastewater from their manufacturing facilities.

So, wherever you are, whether you're a manufacturing business, whether you're a services business, you will look towards the sorts of companies that we are looking to invest in for a solution to these environmental or social challenges that you are creating as a business. And that is already creating an incredible momentum, as the drive is coming both from the end-user, the individuals, but from the governments, the municipalities and the larger corporations of the world that are either becoming more impactful themselves or are increasingly employing the products or services of the types of smaller to medium-sized impact-driven companies we are investing in through our Fund. We therefore have a virtuous circle that is sustaining itself and with increasing pace, agility and forward momentum, as these challenger companies gradually become much larger businesses. ■