

# Sustainability and governance: the keys to future growth



**GILLES CONSTANTINI**  
Portfolio Manager  
Montpensier Finance



**OLIVIER FELLOUS**  
Portfolio Manager  
Montpensier Finance



**CLÉMENT ALBERTO**  
SRI Analyst  
Montpensier Finance

**A** focus on long-term sustainability and governance issues is now a vital factor in assessing companies' growth prospects, as well as providing key themes for growth in the coming years, according to Olivier Fellous and Gilles Constantini, managers of the Montpensier Best Business Models SRI Fund.

'For a long-time shareholder returns and a company's societal impact were viewed as very separate factors. In today's world, the two are inextricably linked,' Constantini said.

The rise of regulation to penalise unsustainable practices is a material example. 'Steelmakers rely heavily on coal for their production needs, but over the last two years, the removal of free carbon credits has seen the CO2 price rising five-fold, which has provided a significant additional burden for companies in the sector,' he said.

In a similar fashion, recent penalties imposed on companies in the finance sector under anti money-laundering rules have significantly affected share prices. 'For us, incorporating ESG analysis into our basic stock selection

methodology is an important way to try and avoid these types of pitfalls,' Fellous said.

At Montpensier, all the mutual funds share a company-level portfolio ESG rating methodology, based on a long standing MSCI partnership since 2015.

All portfolio managers are highly sensitive to ESG integration in the investment process and single stock analysis and monitor on a weekly basis the ESG rating of their portfolio.

Best Business Models SRI's investment methodology splits companies into four business model categories: transitional, rapid growth, mature growth and recovery. In addition, the fund implements a socially responsible investment approach that aims to exclude companies that would not be compatible with extra-financial criteria defined by the management team.

A four step SRI process is integrated into this methodology, Alberto said, SRI analyst at Montpensier. It begins with extended exclusion lists which screen out controversial sectors such as weapons- and tobacco-related companies. Then, all the companies featuring the worst ESG ratings or scandals according to MSCI are also excluded. Those that make it through these screens are then subjected to a proprietary analysis process. At the third step, corporate governance practices are scrutinized, while the final step is the Montpensier Impact Assessment, based around themes outlined by the UN Social Development Goals, with a particular focus on four areas: environment, resources, inclusion and basic needs.

Companies with the tailwind of good ESG features are likely to outperform going forwards, the pair believe. Within the 'Sustainable cities and communities SDG 11, for example, Fellous highlights Dassault Systèmes, which is contributing to a greener industrialisation process. 'Dassault Systèmes has recently completed a project in which it made a virtual twin of Singapore, and was able to map flows of traffic and people in great detail. As a result, they were able to go to the Singaporean government and demonstrate

how efficiency could be improved by, for example, building a new bridge or bus station where it is most badly needed,' he said.

## EVOLVING WITH ESG

ESG is providing strong investment themes that the fund will focus on in 2020, he said. The utilities sector is likely to be a major beneficiary of energy transition, with regulation and the five-fold increase in CO2 prices favouring low emitters and the cost of renewables due to rise as wind and solar energy increasingly take market share from fossil fuels, according to Constantini. 'This is a fantastic window of opportunity for utility companies. They were unpopular with investors from around 2010 to 2017, but earnings have rebounded since then, and their visibility has improved. On top of that, the sector averages 5% dividend yield,' he added.

One stock the managers favour within the utilities sector is ERG, a leading Italian operator in the market for energy production from renewable sources including wind, hydro and solar. The company has a predicted capacity growth of 20% by 2022 thanks to an increase in installed capacity to 3.6 gigawatts.

The vast demographic transition that is fuelling greater urbanization – particularly in developing economies – is another of the fund's biggest themes. 'The global population is increasing at 1% pa, while cities are growing at 2% pa,' Fellous said. 'There will be an estimated 2.5 billion more citizens in towns by 2050.'

This will see 1.6 million people per week needing to be accommodated in cities, requiring vast infrastructural changes, he said. A play on this for the fund is the Dutch industrial conglomerate Aalberts, which provides 'mission critical tech'. For example, hydronic flow control that enables its clients to save energy and water and thereby to construct more eco friendly buildings.

'Another of the company's applications is in the sustainable transportation field: it is a manufacturer of valves for battery cooling in electric vehicles,' Fellous said.