WELLINGTON MANAGEMENT®

Impact investing in practice: supporting the shift to alternative energy

Explore how our impact team support the shift to alternative energy while seeking to capture the associated return potential.

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Investors are increasingly attracted to impact investing because of its potential to deliver positive social and environmental outcomes while producing competitive financial returns. Our investment in a European renewable energy company illustrates how we seek to deliver both goals within our alternative energy theme.

The crucial role of alternative energy in the net-zero transition

As governments increasingly recognise the urgent need to stem the adverse effects of climate change, policy responses are accelerating. The Glasgow Climate Pact, in which representatives at the COP26 agreed to limit global temperature rise to 1.5C, provides further impetus to decarbonise the global economy and the sources of energy that support it.

Energy generation accounts for 27% of the annual 51 billion tons of greenhouse gas (GHG) emissions.[1] Decarbonising the energy infrastructure is therefore critical in helping the world reach net-zero GHG emissions, as many governments and companies — including Wellington Management — have pledged to do by 2050.

This accelerating transition towards net zero widens the opportunity for clean energy companies to take share of the energy market. Projections from the International Energy Agency suggest renewables may generate 45% of the world's electricity by 2040.[2] Generating more energy from renewable sources such as solar, wind and hydropower offers the added benefit of helping to clear polluted air. Billions of people still breathe air heavily polluted by fossil-fuel emissions or rely on dirty, often dangerous, home heating and cooking fuels. The social and health benefits and related cost savings of shifting to clean energy include declines in premature deaths.[3]

Applying alternative energy as an impact theme

We have identified alternative energy as a key impact theme within our approach and expect to see a widening range of investment opportunities that meet both our impact and return requirements. As discussed in our previous case study, each potential investment is underpinned by an impact thesis, usually referred to as "theory of change".

Our theory of change for this equity impact investment is that utility-scale renewables are core components to solving the decarbonisation challenge with speed and efficiency. We have identified this European company because its products and services help mitigate the effects of climate change by developing, constructing and operating energy projects based on renewable technologies — including wind, photovoltaics, solar thermal, biomass and hydroelectricity. The company's sustainability master plan aims to achieve total carbon neutrality for all operations. It continues to pursue major alternative energy projects, while further expanding its business in the installation of other energy-related infrastructure. It is also developing innovative programmes to support essential

infrastructure for the most neglected populations, such as seeking to increase access to renewable energy in underserved communities.

To measure and track progress against our impact thesis, we use key performance indicators (KPIs) that are in line with best practice as outlined in the Impact Management Project's Five Dimensions of Impact framework.[4] Specifically, for this investment, they translated into the following findings.

- **What** (*what is the outcome and how material is it for stakeholders?)*
  This company contributes to climate change mitigation and improved environmental sustainability by reducing GHG emissions through a higher share of renewable power.
- **Who** (*who are the stakeholders experiencing the outcome?*)
  This company's renewables capacity, installed and generated, serves customers in 15 countries and represents a meaningful contribution towards maintaining a livable planet.
- **How much** (*what is the degree of impact of these outcomes*?)
  During 2020, the company's installed renewable energy capacity reached over 10,000 megawatts (MW) and has in turn generated more than 24,000 gigawatt hours (GWh), the equivalent of the yearly demand of over seven million households.
- **Contribution** (*has the effort resulted in a better outcome than would have otherwise occurred*?)
  The total amount of annual CO2 emissions avoided through this company's renewable energy generation equates to over 13 million metric tonnes, or the equivalent of the emissions of 1.2 million households over the period.
- **Risk** (*what is the risk that the impact will differ from or fall short of what was expected*?)
  Renewable energy production can be undermined at times by adverse weather conditions. We are also encouraging the company to think about the unintended environmental impacts of renewable energy production and any potential displacement of communities.

Applying a qualitative overlay

We overlay these KPIs with regular qualitative assessments of a company's commitment to its impact goals. We seek to understand a company's or an issuer's holistic impact — looking at any negative externalities, such as environmental damage, associated with the company's or issuer's wider business activities, as well as any unintended negative consequences associated with the specific investment.

In this instance, we identified the environmental impacts of renewable energy production and the potential displacement of communities as key negative externalities but found that the adverse impact of both externalities was moderate and that the company's mitigation efforts were sufficient. Overall, our qualitative assessment of the company is positive. We are impressed with the company's ability to anticipate and adapt to evolving trends and to leverage its asset base for innovation. This company was also among the first to report on the alignment of its own activities with the EU Taxonomy criteria. We continue to believe the company's potential to innovate and drive value and sustainability outcomes may be underappreciated.

Alignment with the UN SDGS

While we do not manage our impact portfolio to a targeted level of alignment with the United Nations Sustainable Development Goals (UN SDGs), we tag for each company or issuer the goals that we believe they align with, as well as any of the 169 underlying targets outlined by the UN. In this case, the investment aligns with SDG 7, Affordable and clean energy, Target 7.2, which seeks to "substantially increase the share of renewable energy in the global energy mix by 2030".

An expanding opportunity set

With the transition to alternative, clean energy now progressing, we think there is growing scope to help accelerate the move away from fossil fuels, while capturing the associated return potential. Opportunities where we think we can achieve both tangible impact and attractive returns include:

- The many companies that are now engaged in the large-scale investment, construction and operation of wind and solar power, helping economies decarbonise quickly and efficiently.
- Providers of innovative solutions to power storage and distribution projects.

- Solar companies that design, manufacture, and distribute photovoltaic (PV) systems and solar modules that convert sunlight into electricity, preventing CO2 emissions.
- A growing supply of green bonds to support renewable energy generation issued by banks and supranationals covering projects such as solar and wind farms. Corporate issuers are now also increasingly coming to the green bond market to finance grid modernisation or the shift in their business model from fossil fuels to renewable energy sources.

    - As we explored in our previous case study, we view the impact investment universe through the lens of three broad categories — life essentials, human empowerment and environment — which encompass 11 themes. Our approach does not target explicit alignment with the United Nations Sustainable Development Goals (UN SDGs), but when the UN published its SDGs in late 2015, we were pleased to see how well our themes aligned with the UN goals, which we are proud to support.
    - Discover more about our approach and read other case studies: Global Impact Annual Report

[1]Breakthrough Energy 2020. | [2]World Outlook Energy International Energy Agency. | [3]Emil Dimanchev, et al., "Health co-benefits of sub-national renewable energy policy in the US," Environmental Research Letters, vol. 14, August 2019. | [4]The Impact Management Project, impactprojetmanagement.com.

The example is for illustrative purposes only and should not be interpreted as specific security recommendations or advice. KPI data is based on issuer or company reporting, proxy data and Wellington analysis. | Wellington determines the goals and targets that, in our view, each portfolio company or issuer is aligned with. Language for the goals and targets has been abbreviated, but not otherwise altered, from UN.org. Wellington Management supports the United Nations Sustainable Development Goals. | Sources: Wellington Management, UN.org. Data is that of a third party.

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