Desjardins SocieTerra Cleantech Fund

Desjardins Wealth Management Investments

QUARTERLY COMMENTARY AS OF SEPTEMBER 30, 2023

IMPAX Asset Management

PORTFOLIO MANAGER:
Impax Asset Management

INCEPTION DATE:
June 14, 2016

CIFSC CATEGORY*:
Global Small/Mid Cap Equity

Contributors to relative performance

- **Lennox International** (Buildings Energy Efficiency, US) is a producer of heating, ventilation, and air conditioning (HVAC) systems. The company delivered a strong beat in its Q2 results, with commercial sales offsetting lighter residential performance. Commercial margins have roughly doubled year-over-year thanks to higher pricing and volume growth turning positive. Lennox continues to face some distributor destocking in residential, and management has lowered production volumes in response. While management tends to take a conservative view, full-year guidance has been raised and Q3 is typically the company's strongest period.

- **Repligen** (Resource Circularity &, Efficiency, US) is a life sciences company providing innovative bioprocessing technologies used to increase efficiencies and flexibility in the manufacturing of biological drugs. Shares initially rose in the wake of positive news flow from peers which suggested an improving demand environment for bioprocessing companies heading into the end of 2023. Repligen subsequently reported Q2 results with adjusted EPS beating estimates. Full-year earnings guidance was revised down, although this was set against a more positive outlook for Q4 and beyond.

- **Kingspan** (Buildings Energy Efficiency, Ireland) is a global market leader in high-performance insulation and related products. In July, the company made an unscheduled trading update, in which it announced it expected to report record trading profit in H1 2023. Since released, results show that this was underpinned by an improvement in margins, despite softer volumes. Strong free cash flow has also lowered debt, even after Kingspan announced it was taking a majority stake in Steico, a German producer of wood fibre insulation. Management has taken an opportunistic approach to M&A given depressed valuations in the sector and has indicated balance sheet strength is important given a "strong development pipeline."

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Detractors from relative performance

Despite starting the quarter on lower relative valuations, smaller companies tend to be viewed as more economically sensitive, both in terms of their business models and their levels of debt. As a result, smaller cap stocks have broadly detracted across the fund, with little regard for fundamentals. Value's outperformance of Growth has also acted as a headwind.

Within Environmental Markets, the fund's holdings in sustainable food & agriculture, as well as alternative energy, detracted from absolute performance. The market particularly punished companies with weak earnings on the day and softer-than-expected guidance. In sustainable food, customer destocking remains a challenge as distributors continue to run down high-cost inventories built up in the wake of post-pandemic reopening. While the long-term outlook for these companies remains positive, management conversations have indicated a lower level of visibility than previously thought, pushing out a positive inflection point.

Within alternative energy, a similar dynamic is weighing on the fund's solar energy holdings, where a combination of over-supply and uncertain legislative impact is creating an air pocket in both margins and demand. For renewable energy developers and IPPs, the issues continue to be those of rising project costs, perceived lower future returns, and, at the margin, the increasing yield on offer from bonds. A significant write-down from industry bellwether Orsted has also polluted sector sentiment. Despite this, we believe the market reaction is overly discounting the short term, often ascribing almost no value to pipeline or in-development projects. Indeed, conversations with fund holdings have indicated companies expect to protect or even increase margins as rates rise.

→ **SolarEdge Technologies** (Solar Energy Generation Equipment, US) is a manufacturer of solar inverters & optimisers. Despite solid operational revenues for Q2, shares pulled back sharply in the wake of disappointing forward guidance. The solar industry is facing several headwinds in the form of inventory destocking, Chinese panel oversupply and softer residential demand. The latter is particularly acute in US residential, where solar systems are largely financed through loans (meaning higher rates have worsened payback rates) and California's NEM (Net Energy Metering) 3.0 regulation has reduced the amount of money homeowners get paid for feeding solar energy back into the grid. SolarEdge had been expected to be more resilient than peers given the majority of its revenues come from Europe, but

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Detractors from relative performance (cont'd)

both management and investors had limited transparency on the extent to which Chinese oversupply was encouraging destocking. However, with the shares trading at historically depressed multiples, its regional tilt still gives the company a faster route to recovery just as a lengthy period of investment comes to an end.

→ **Xinyi Solar Holdings** (Solar Energy Generation Equipment, US) is a manufacturer of solar glass. The company reported H1 2023 numbers which saw an improvement in solar glass sales but a deterioration at the bottom line. A two-year bottleneck in polysilicon capacity, combined with higher energy costs, has driven up prices across the supply chain at the same time as solar glass competitors have aggressively expanded capacity. With supply constrictions easing and regulators placing new scrutiny on new capacity additions, Xinyi is positioned to benefit from both volume growth and margin re-expansion. The company is also selling more higher margin "thin glass."

→ **Generac Holdings** (Power Storage & UPS, US) is a leading designer and manufacturer of standby and portable generators for the residential, commercial, and industrial markets. The stock fell sharply after reporting weak Q2 results and softer guidance. Despite strength in its Commercial & Industrial (C&I) division, Generac's Residential division – and specifically its key Home Stand By business – is experiencing a prolonged downturn. Even so, margins are improving with signs of inventory normalization.

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Major changes to portfolio in the period

Added :

→ **Steris** (Resource Circularity & Efficiency, US) is a leading provider of sterilisation equipment and related services for the healthcare industry. The company has exposure to several secular tailwinds, including the increasing need for infection prevention, ageing populations, and rising outsourcing of medical device sterilization. Steris also has industry-leading water savings in its steam sterilisation products. Conservative guidance afforded an entry opportunity into the stock, which is well aligned with the circular economy and increases the fund's defensive healthcare exposure.

Sold :

→ There were no sales in the fund over the quarter.

*CIFSC refers to Canadian Investment Funds Standards Committee. The CIFSC has the mandate to standardize the classification of mutual funds in Canada. http://www.cifsc.org/.