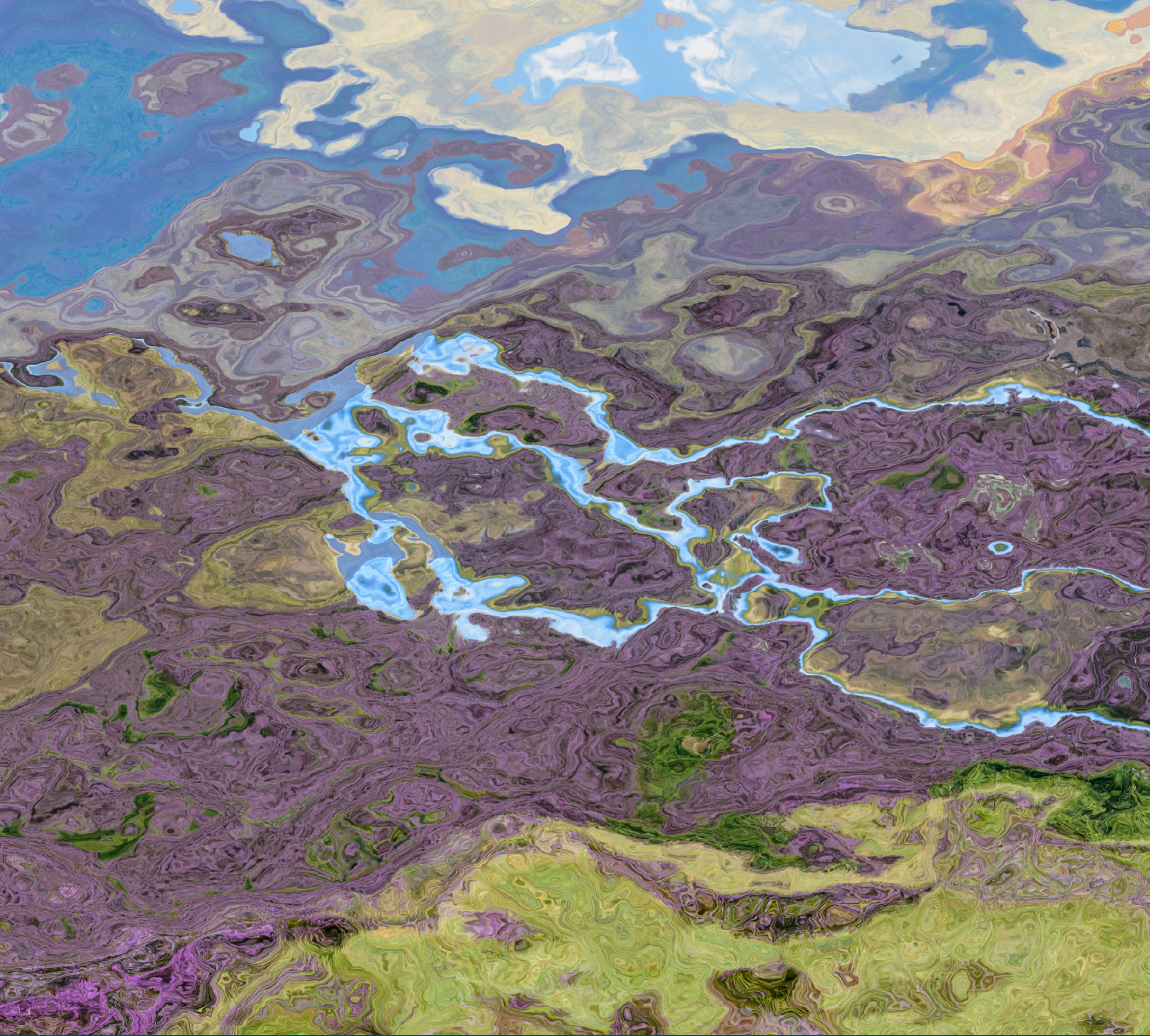


Quarterly report

# Munro Climate Change Leaders Fund

# MCCL.ASX

September 2023

# Munro Climate Change Leaders Fund & MCCL.ASX
## September 2023 – Quarterly report

**MCCL Fund quarter return**
-3.5%

**MSCI quarter return**
-0.4%

**MCCL.ASX Fund quarter return**
-3.5%

**MSCI quarter return**
-0.4%

QUARTERLY HIGHLIGHTS

- The Munro Climate Change Leaders Fund and MCCL.ASX both returned -3.5% for the September quarter.
- Performance for the quarter was led by Constellation Energy and Kingspan, which added 123 basis points and 98 basis points to returns, respectively. We provide further information on both Constellation Energy and Kingspan in the stock stories below.
- Global equity markets gave back some of the strong gains made for the calendar year during the September quarter. The market is grappling between rising earnings, which should lead to rising stock prices, and rising bond yields which should dampen the price investors are willing to pay for stocks.

MUNRO MEDIA

The fourth era is here: Artificial Intelligence, 27 July 2023
Watch the video here

Livewire Markets, 24 August 2023
The bull and bear case for Nvidia

Bussiness Breakdowns podcast, 13 September 2023
Kingspan: Influential Irish Insulation

CONTENTS

QUARTERLY COMMENTARY

# Fund commentary

The Munro Climate Change Leaders Fund returned -3.5% for the September quarter (-5.8% from equities and 2.2% from currency), while the MSCI ACWI returned -0.4% (-2.4% from equities and 2.1% from currency).

Equity markets declined during the quarter, as some of the gains from the preceding two quarters were given back. The quarter started well for the stock market; however, markets began their decline at the end of Q2 earnings season. A 'travel-and-arrive' phenomenon started to take place, with many stocks failing to live up to lofty expectations when they reported their results. US 10-year treasuries jumped during the quarter from 3.8% to 4.6% due to robust economic data from the US and an increase in oil prices. Hawkish commentary from central banks also added to the move, with rates now seen higher for longer. This brought valuations into focus and led to multiple deratings, particularly for growth stocks.

Fund performance for the quarter was led by Constellation Energy and Kingspan, which added 123 basis points and 98 basis points to returns, respectively. We provide further information on both Constellation Energy and Kingspan in the stock stories below.

Other positive contributors over the quarter included MSCI (23 bps), Nvidia (17bps) and Clean Harbours (7bps). The positive investment case on MSCI Inc. centres on its dominant position in ESG data and ratings. As companies and investors continue to sign up to net zero goals, we expect that businesses that collect, verify, and analyse emissions and other related data will become increasingly valuable. The major government regulatory bodies are now also increasingly requiring improved data collection and disclosure, and this adds a further tailwind for growth for MSCI (see slide below). Nvidia, provides high performance graphics processing units (GPUs) that help reduce power demand in data centres, which accounts for 2% of global electricity use. While Clean Harbors services include hazardous waste cleanup, transportation, incineration/disposal operations, as well as a used oil collection and re-refining business (that is, it recycles used oil). Both Nvidia and Clean Harbors have featured as stock stories in previous Munro Climate Change Leaders Fund quarterly reports (March 2023 report here, June 2023 report here).

Our largest detractors over the quarter were NextEra Energy (-143 bps) and electric vehicle (EV) suppliers Infineon Technologies (-108 bps) and Samsung SDI (-92 bps).

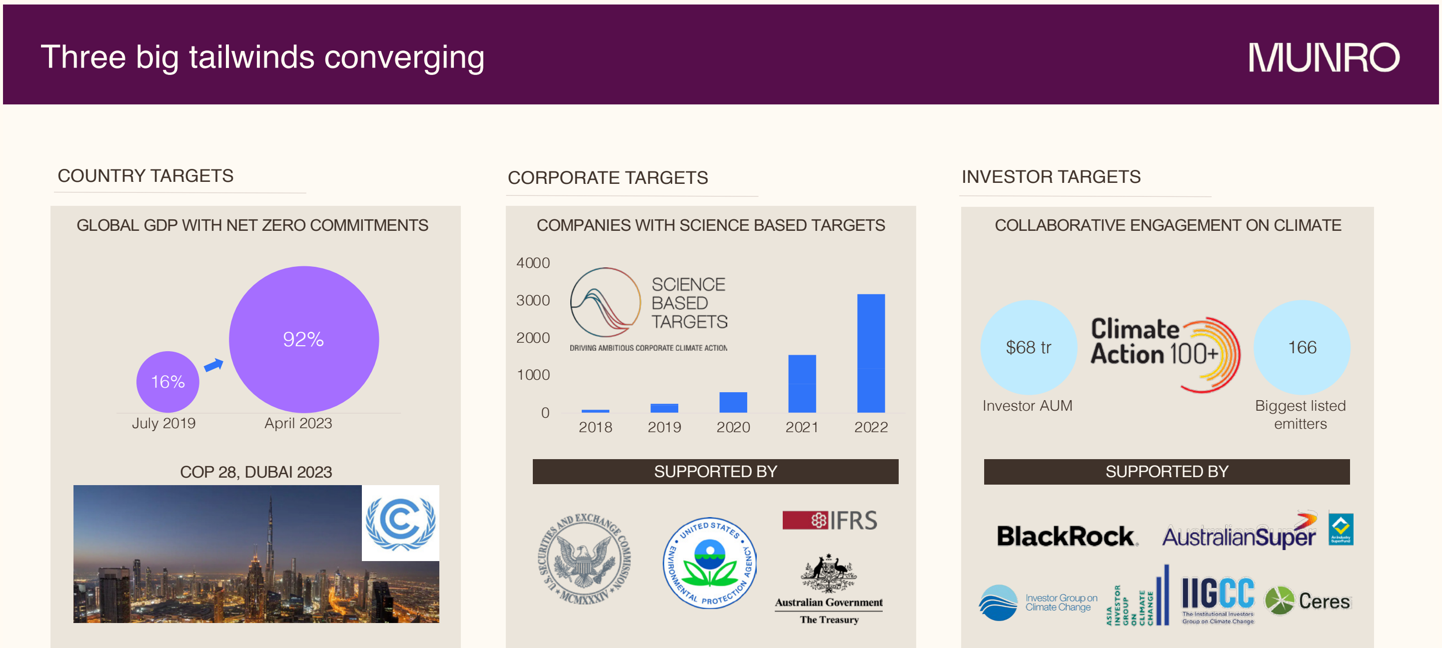
NextEra has been under valuation pressure for some time from higher interest rates (along with the broader utilities sector), as higher bond yields make its, and other utilities', dividend yields look relatively less attractive to investors. Beyond the "valuation re-set" the market is also concerned that higher rates will inhibit it and the sector's ability to continue to rapidly roll our renewables. Renewables growth has been a primary driver of NextEra's consistent 10% p.a. earnings growth over the last 10 years. Utilities tend to use considerable amounts of debt to finance new solar, wind and storage projects, and with higher interest rates, the worry is that these companies will not be able to build out these projects to the same extent in the future. NextEra, for its part has refuted this notion and pointed to its considerable balance sheet strength as well as the considerable industry support for renewable energy from US state regulators (who set the capex the industry is to deploy into renewables and other projects), demand from corporates for signing renewables PPAs (see Constellation and Microsoft agreement below), as well as federal support from the US Inflation Reduction Act that provides huge incentives and cash flow support to industry (listen to a podcast with Portfolio Manager, James Tsinidis and Responsible Investment Manager, Mike Harut here).

The dynamic with NextEra and the other US utilities also pressured suppliers like Quanta Services (who provide the engineering and construction for these projects) and First Solar (who make solar panels manufactured in the US). For now, we expect the market to remain concerned until rates find some stability. But when rates do settle, we expect it will open up some compelling entry points for these stocks, as the companies do have decades of renewables lead growth ahead of them, such is the need to address the climate transition.

QUARTERLY COMMENTARY

# Fund commentary

Finally, electric vehicles stocks and their suppliers also broadly came under pressure during the quarter as the macro weakened (autos are a cyclical industry). The industry leader, Telsa, continues to cut the average selling prices of its cars, and this is resulting in worries about order volumes and prices for it and EV companies' suppliers. On top of this, markets are concerned about some loss of share in China for international companies (China is a key Auto EV market) particularly as geopolitics and government relations around the world worsen. While we again, acknowledge that short term, the macro worries are legitimate (particularly as China slows), the EV penetration is only just beginning, and this provides a long tailwind for growth for the content providers into EVs.




Source: Net Zero Tracker, TCFD; UNFCCC, Science Based Targets Initiative, Climate Action 100+, Munro Partners, January 2023

Note: Science Based Targets (SBT) is an organisation which shows companies and financial institutions how much and how quickly they need to reduce their greenhouse gas (GHG) emissions to prevent the worst effects of climate change. SBT is a partnership between CDP (Carbon Disclosure Project), the United Nations Global Compact, World Resources Institute (WRI) and the World Wide Fund for Nature (WWF)].SBT data includes companies with targets set and those committed to do so within 2 years. It excludes financial institutions and SMEs with fewer than 500 employees (unless in oil and gas sector).

# Market Outlook

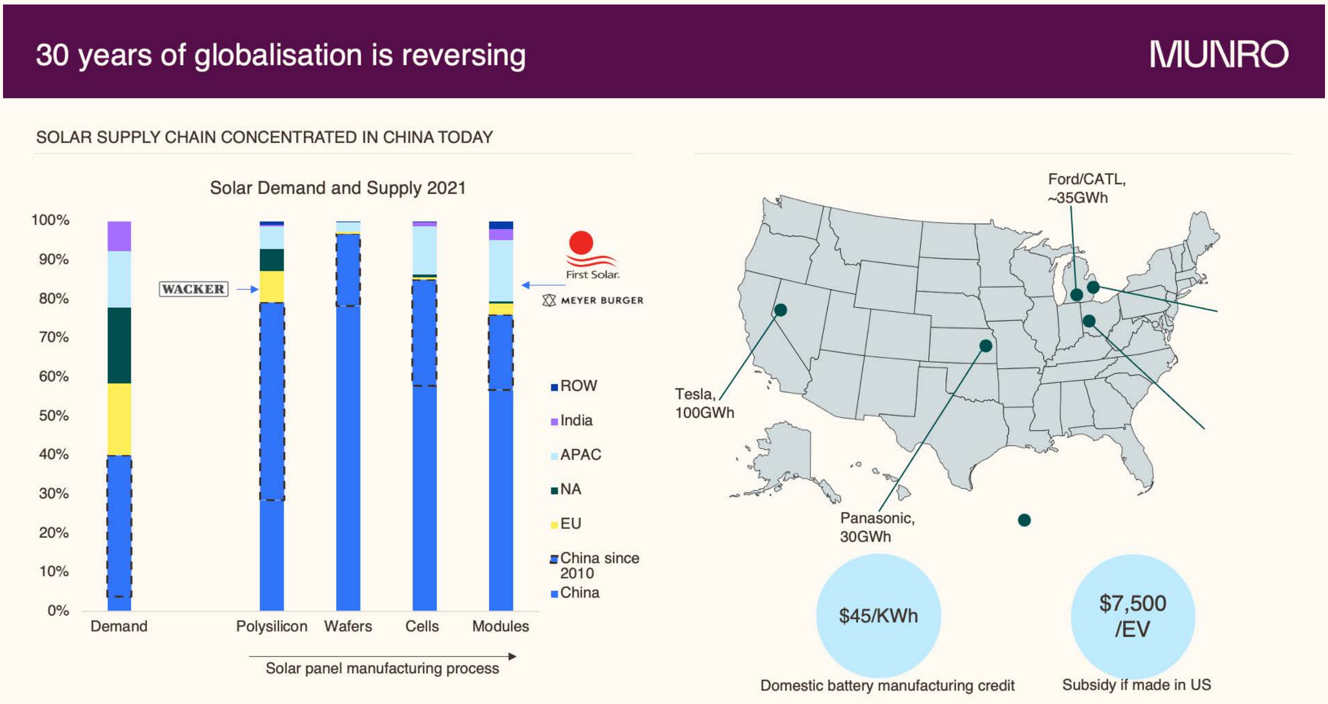
Global Equity markets gave back some of the strong gains made for the calendar year during the September quarter. The market is grappling between rising earnings, which should lead to rising stock prices, and rising bond yields which should dampen the price investors are willing to pay for stocks.

In the short term, the market narrative has been taken over by dislocations in the bond market, and this warrants attention. With the US economy clearly slowing and the Fed close to finishing its rate hiking cycle, investors are perplexed by the rise in US 10-year bonds, which are now pushing close to 5%. There are several possible explanations for this, be it excess supply, lack of foreign buying, term premiums, etc., but regardless of the cause, this is a negative development. Higher rates now put pressure on the valuation of growth stocks and will affect economic growth later. While we remain confident that our companies can continue to grow earnings through this changing outlook, the risks have clearly increased. In response, we have added to the most resilient businesses in our portfolio with the strongest balance sheets.

Over the medium term, we still believe that we are closer to seeing the end of interest rates rising, and we ultimately see this volatility as an opportunity. Structural growth will continue, and we can see earnings accelerate in certain pockets of the market – particularly in areas supported by structural growth in spending like Climate spending (at least US$50 trillion to decarbonise the planet). As time goes by we see peak rates and earnings re-accelerating, and this is a good time to be leaning into our best ideas.

One such idea within Climate is in the structural growth associated with US reshoring. The US government via the IRA, Chips and Infrastructure Acts is putting intense focus on bringing key industries "back home". This tailwind cuts across numerous sub-themes within the Climate investment opportunity. It incentivises renewable energy suppliers (like wind and solar original equipment manufacturers (OEMs), and electric vehicle suppliers (like batteries and semiconductor companies) to build capacity and grow in the US. We show this opportunity in the slide below, showing the sheer amount of growth that is required in non-Chinese solar panels as an example of how the US has fallen behind and must catch up. On the right-hand side we show some of the mega projects in batteries that have been announced post the IRA.

The US onshoring is a tailwind for growth for many of the obvious climate champions, like First Solar or Samsung SDI, but the focus on energy security and the US' ability to undertake the energy transition supports numerous other parts of the Climate universe. We'd point here to all the energy efficiency companies that will sell products into these mega plants (like HVAC and insulation), the companies that will assist with building and powering the sites (like the grid companies) and the companies that will help with handling materials (like hazardous waste companies).




Source: International Energy Agency (2021), Morgan Stanley

## STOCK STORY: CONSTELLATION ENERGY

Constellation

AREA OF INTEREST: **Clean energy**

MARKET CAP: **USD 35.4bn**

Constellation Energy added 123bps to Fund performance for the quarter.

Constellation Energy (CEG) was spun out of Exelon Energy in January 2022 and is an independent power producer that owns and operates the largest nuclear fleet in the US, holding >55% of the nation's unregulated capacity. With plants stretching from the Midwest across to New York, CEG provides >165TWh of carbon-free electricity to Americans each year, which amounts to ~120mn metric tons of CO2 avoided annually.

We still view nuclear as the cornerstone of the US energy transition, as the only scalable carbon-free source of baseload power. Over the third quarter, we've seen the reliability of the grid tested, a key example being in Texas, where a level 2 emergency was declared, and power prices reached the $5,000/MWh cap for ~2 hours in an attempt to curtail demand due to "very weak wind conditions". As the US continues to build out its renewable energy fleet and everything around us is electrified, we expect these grid issues to only be further exacerbated.

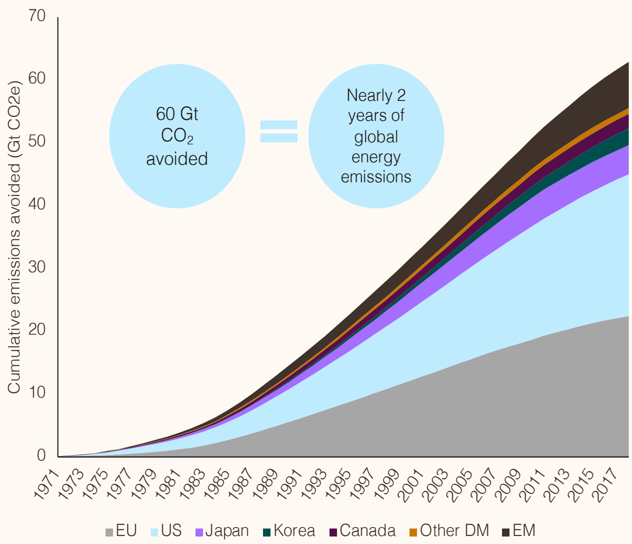
Independent power producers like CEG can generate significant profits on unhedged volumes during these periods of elevated power prices. As we have discussed before, the production tax credits (PTCs) provided by the Inflation Reduction Act (IRA) act as a natural hedge, setting a 'floor' for the power price they receive on their carbon-free generation. It was encouraging to see CEG upgrade their 2023 EBITDA guidance by $400mn on their 2Q23 earnings call as they continue to profit from these embedded 'free options' on power price volatility.

During the third quarter, we met with the CFO of CEG, and we spoke at length about recent commercial contracts they had been signing with companies such as Microsoft, which require 24/7 clean energy to power their data centres. Given the scarcity of such an energy source, as we discussed above, they have been able to sign these contracts at very attractive margins. We expect the trend of ESG-conscious corporates warming up to nuclear energy to continue despite its checkered history, especially as hyperscalers seek to build more energy-intensive data centres to lay the foundational infrastructure for cloud computing and generative AI.

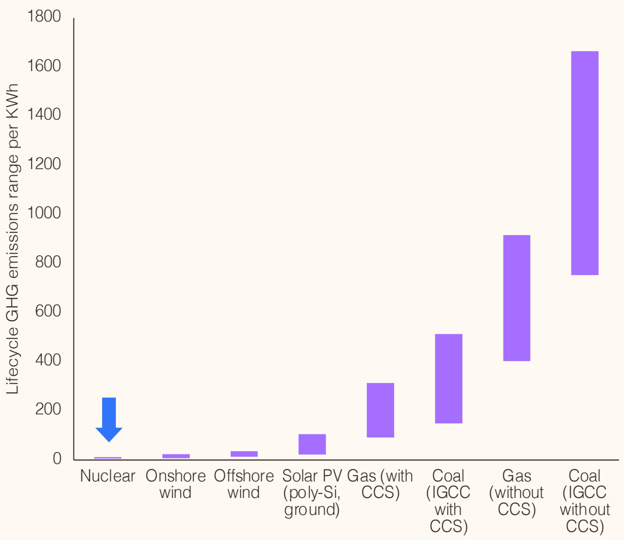
## Nuclear energy - carbon-free baseload power

MUNRO

A CLIMATE SOLUTION FOR DECADES




LOWEST LIFECYCLE EMISSIONS OF ANY FUEL SOURCE




Source: International Energy Agency (IEA), UN Economic Commission for Europe*these figures in respect of CO2 avoided, are based on estimates made by The International Energy Agency. See here for more information on how nuclear power avoids potential carbon emissions.

STOCK STORY: KINGSPAN

SUB AREA OF INTEREST: **Energy Efficiency**
MARKET CAP: **EUR 13bn**

Kingspan added 98bps to Fund performance for the quarter.

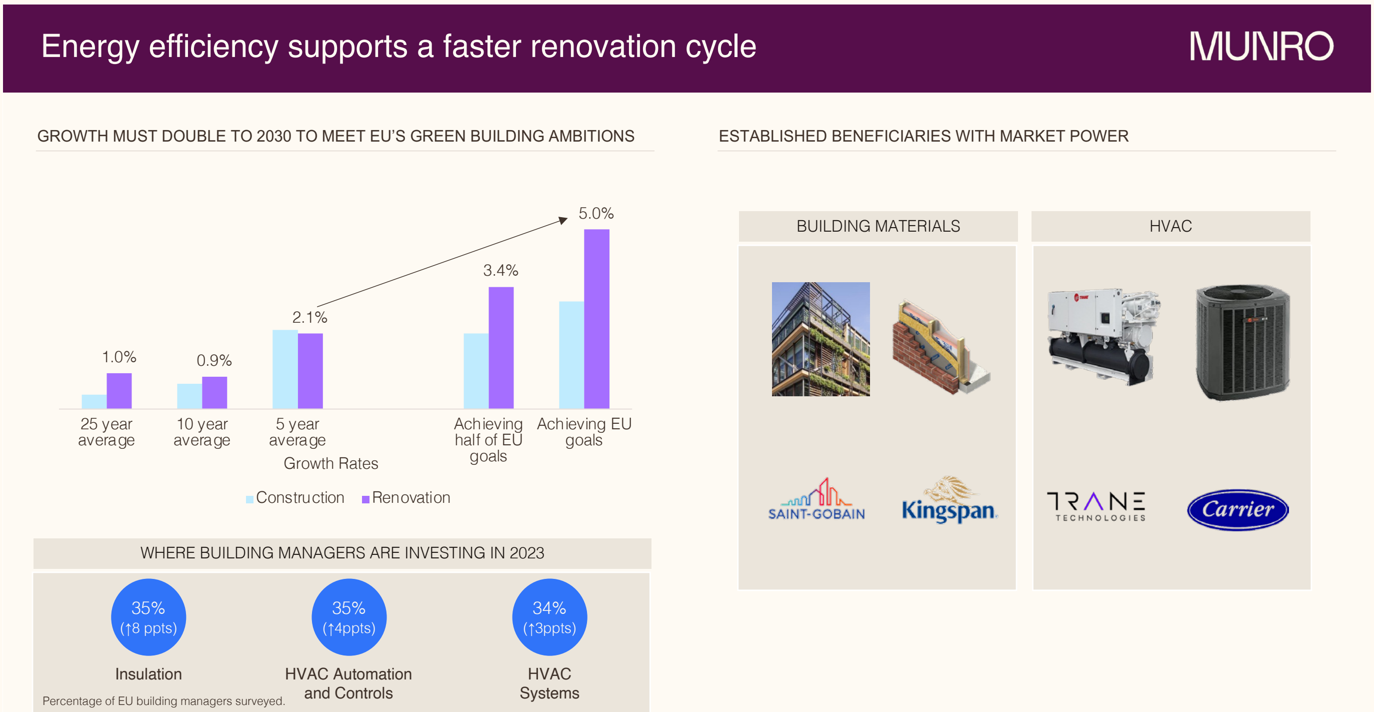
Kingspan is a global leader in high performance insulation and building envelope solutions. Eugene Murtagh founded Kingspan in 1965, and only recently stepped down as chairman in 2021, however maintains around 15% ownership of the company. His son, Gene Murtagh, has been the CEO since 2005 and holds a significant stake in the family business, creating strong alignment with shareholders - one of the six qualitative characteristics we think make a great growth stock.

Buildings and construction contribute around 39% of energy-related carbon emissions globally, meaning that improving the energy efficiency of buildings is key to decarbonisation. Kingspan is pivotal to this effort, developing innovative products with market-leading thermal efficiency. Their leading product, Quadcore, is an insulated panel that boasts 20% better performance than PIR insulation and superior safety, especially in fire and smoke. Their insulation systems sold last year were estimated to have helped save 173Mt CO2e – more than a third of Australia's annual emissions.

The environmental and energy saving benefits drive their demand. For example, insulation (together with HVAC) is the most common area for investment for EU building managers, underpinned by tenants' willingness to pay increasingly more for green buildings and tightening minimum standards. Although not the most obvious or glamorous part of the transition, Kingspan's building technology is all around us, whether it be in the Tesla Gigafactory, Apple's Headquarters, or even the MCG in Melbourne.

Given their exposure to these secular tailwinds, Kingspan has grown its earnings at around 18% per year over the last ten years, despite selling into what are typically considered cyclical construction end-markets. At their latest half year result, we saw further evidence of Kingspan's earnings resilience, significantly outperforming analyst expectations for declining earnings growth, which resulted in stock outperformance.

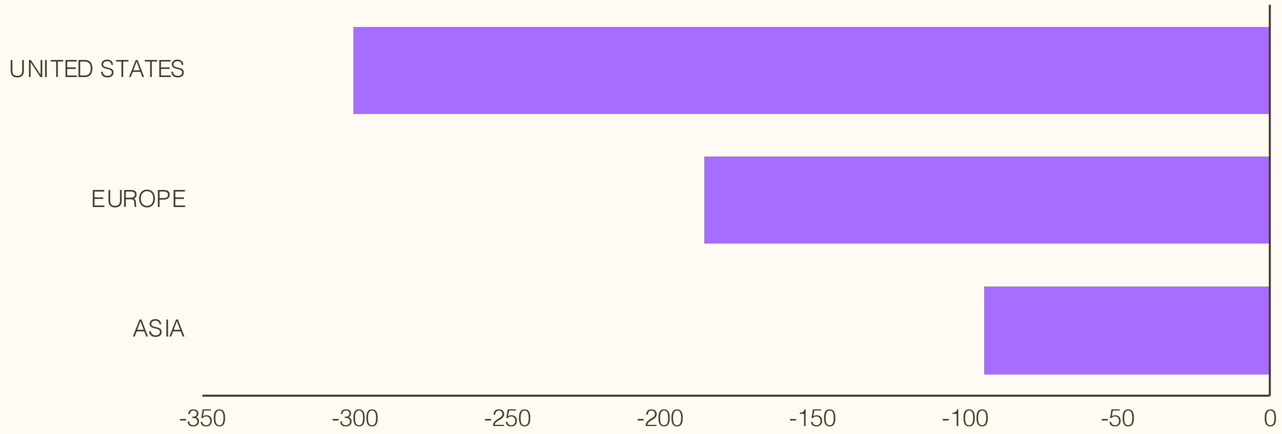
Listen to Nick Griffin talking about Kingspan in this podcast episode of Business Breakdowns.



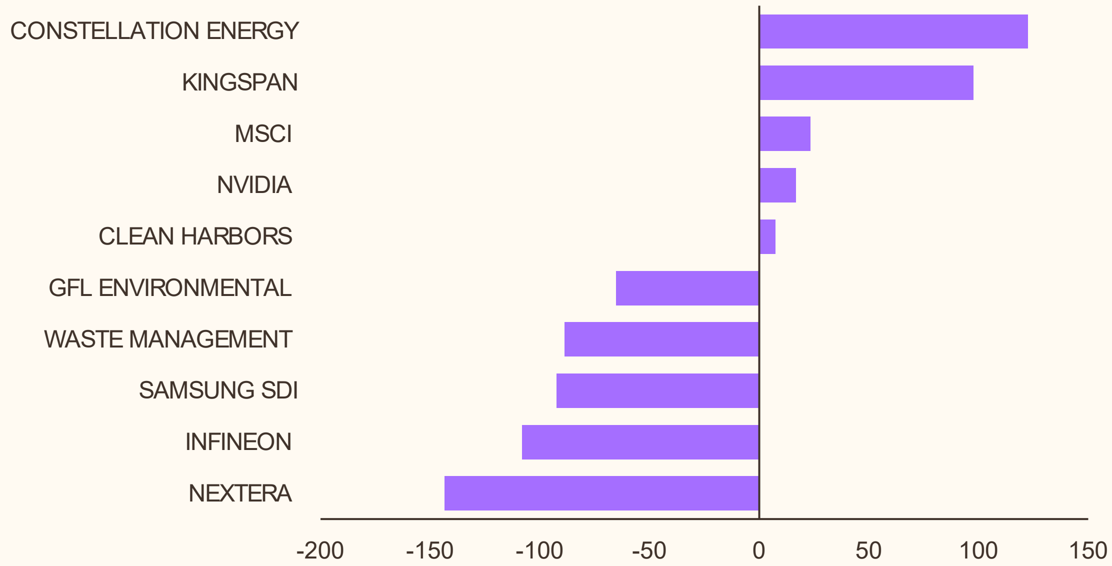

Source: Morgan Stanley, European Commission, Munro estimates. *EU Green Building Ambitions refers to Morgan Stanley's estimate of the growth rates required to meet EU 2030 goals.

QUARTERLY FUND ATTRIBUTION (BASIS POINTS)

## Region (equities only)




## Top & bottom contributors



QUARTER END EXPOSURE

## Category

| | |
|---|---|
| **EQUITIES** | 92% |
| **CASH** | 8% |
| **NO. OF LONG POSITIONS** | 20 |

## Sector

| | |
|---|---|
| **INDUSTRIALS** | 46.5% |
| **INFORMATION TECHNOLOGY** | 17.4% |
| **UTILITIES** | 14.7% |
| **OTHER** | 13.4% |

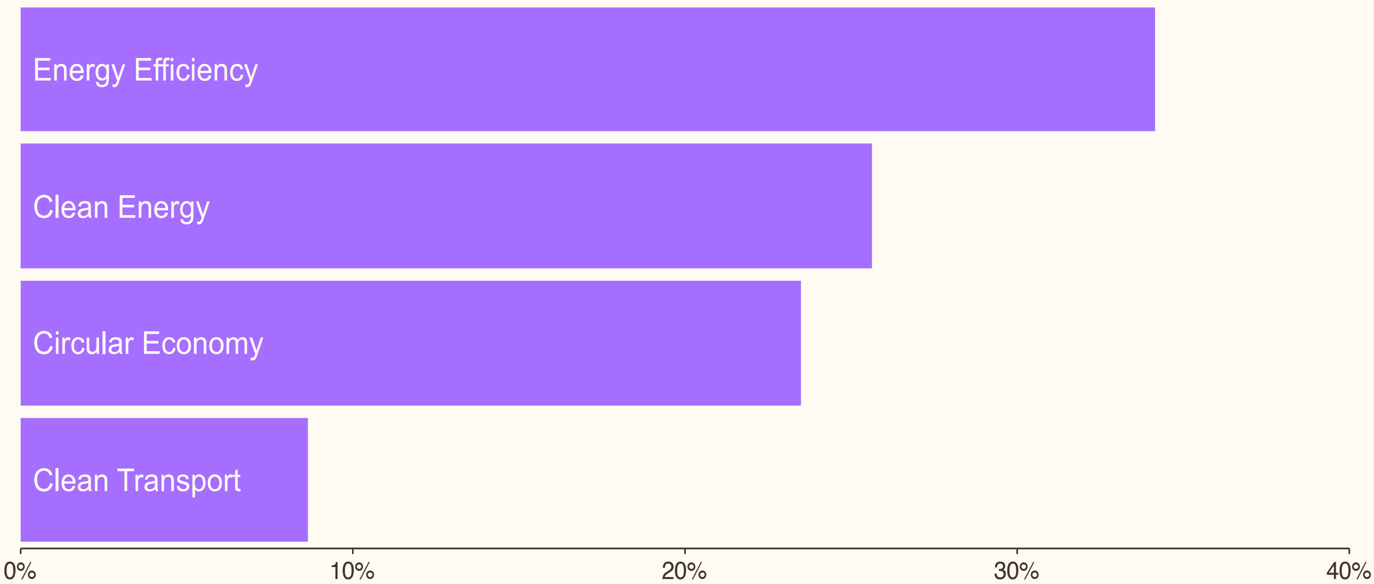
## Region

| | **LONG** |
|---|---|
| **UNITED STATES** | 82.2% |
| **EURO AREA** | 6.7% |
| IRELAND | 6.7% |
| **SOUTH KOREA** | 3.0% |
| **TOTAL** | 92.0% |
| **CASH** | 8.0% |

## Holdings

| **TOP 5 HOLDINGS** | |
|---|---|
| **CONSTELLATION** | 8.4% |
| **WASTE MANAGEMENT** | 7.3% |
| **CLEAN HARBORS** | 7.3% |
| **KINGSPAN** | 6.7% |
| **LINDE** | 6.3% |

## Sub-areas of interest



# Net Performance - MCCL

| | 3MTHS | 6MTHS | 1YR | INCEPT P.A. | INCEPT CUM. |
|---|---|---|---|---|---|
| **MUNRO CLIMATE CHANGE LEADERS FUND (AUD)** | -3.5% | 1.7% | 7.6% | -3.8% | -7.2% |
| MSCI ACWI TR INDEX (AUD) | -0.4% | 6.4% | 20.3% | 3.1% | 6.1% |
| EXCESS RETURN | -3.2% | -4.7% | -12.8% | -7.0% | -13.3% |

| | JUL | AUG | SEP | OCT | NOV | DEC | JAN | FEB | MAR | APR | MAY | JUN | TOTAL |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **2022FY** | | | | | 3.5% | 0.8% | -10.5% | -3.9% | 0.2% | -4.5% | -1.1% | -6.6% | -20.7% |
| **2023FY** | 10.6% | 0.7% | -2.4% | 3.3% | 2.9% | -7.2% | -0.5% | 1.6% | 6.2% | -1.8% | 4.1% | 3.1% | 21.3% |
| **2024FY** | 2.5% | 0.3% | -6.2% | | | | | | | | | | -3.2% |

# Net Performance - MCCL.ASX

| | 3MTHS | 6MTHS | 1 YEAR | INCEPT P.A. | INCEPT CUM. |
|---|---|---|---|---|---|
| **MCCL.ASX (AUD)** | -3.5% | 1.7% | 7.6% | -1.1% | -1.8% |
| MSCI ACWI TR INDEX (AUD) | -0.4% | 6.4% | 20.3% | 3.1% | 5.3% |
| EXCESS RETURN | -3.2% | -4.7% | -12.8% | -4.2% | -7.1% |

| | JUL | AUG | SEP | OCT | NOV | DEC | JAN | FEB | MAR | APR | MAY | JUN | TOTAL |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **2022FY** | | | | | | | -1.1% | -3.9% | 0.2% | -4.5% | -1.1% | -6.6% | -16.1% |
| **2023FY** | 10.6% | 0.7% | -2.4% | 3.3% | 2.9% | -7.2% | -0.5% | 1.6% | 6.2% | -1.8% | 4.1% | 3.1% | 21.3% |
| **2024FY** | 2.6% | 0.3% | -6.2% | | | | | | | | | | -3.5% |

Differences in performance between the Munro Climate Change Leaders Fund (unlisted fund) and MCCL (ASX quoted fund) relate to their respective inception dates, the buy/sell spread around the iNAV for MCCL, and the timing difference between the issuing of units during the day on the ASX for MCCL. This may result in reporting small differences in performance.

**IMPORTANT INFORMATION: Past performance is provided for illustrative purposes only and is not a guide to future performance.** Data is as at 30 September 2023 unless otherwise specified. GSFM Responsible Entity Services Limited ABN 48 129 256 104 AFSL 321517 (GRES) is the responsible entity of the Munro Climate Change Leaders ARSN 654 018 952 APIR GSF1423AU (Fund) (MCCL). GRES is the issuer of this information. Unit class A (MCCL) is an unlisted class of units in the Fund and Unit class E (MCCL.ASX) is an ASX Quoted class of units in the Fund. The inception date of MCCL is 29 October 2021, and the inception date of MCCL.ASX is 20 January 2022. Returns of the Fund are net of management costs and assumes distributions have been reinvested. Numbers may not sum due to rounding or compounding returns. The MSCI ACWI Index AUD refers to the MSCI All Country World Index Total Return Net Index in Australian Dollars. BPS refers to Basis Points. AOIs refers to Areas of Interest. EM refers to Emerging Markets (including China). This information has been prepared without taking account of the objectives, financial situation or needs of individuals. Before making an investment decision in relation to the Fund, investors should consider the appropriateness of this information, having regard to their own objectives, financial situation and needs and read and consider the target market determination (TMD) and the product disclosure statement (PDS) for the relevant class of units of the Fund. The MCCL TMD is dated 9 November 2022, the PDS and Additional Information Booklet are dated 10 December 2021, the MCCL.ASX PDS is dated 10 December 2021, these documents may be obtained from www.gsfm.com.au, www.munropartners.com.au or by calling 1300 133 451. None of GRES, Munro Partners, their related bodies or associates nor any other person guarantees the repayment of capital or the performance of the Funds or any particular returns from the Funds. No representation or warranty is made concerning the accuracy of any data contained in this document. This document is issued on 11 October 2023.