ASIA EQUITIES EX-JAPAN

NAVIGATING THE RENEWABLES ROUTE TO SEIZE INVESTMENT OPPORTUNITIES

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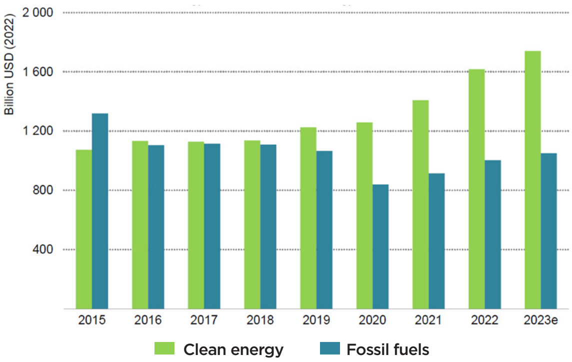
"The Long & Winding Road", the Beatles' 1969 anthem, seems appropriate for a world that has long been seeking ways to address environmental protections and preservation. Public excitement about carbon neutrality seems to have waned since COP26, the 2021 United Nations' summit on climate change, where many countries signed up to net-zero targets. The reality, though, is that renewables are becoming more prevalent, less pricey and more prominent – positioning many countries on a path towards steadily declining emissions.

GROWING PROLIFERATION OF RENEWABLES

Renewable technologies, and their potential for reducing carbon emissions, have had many false dawns. Some see the public's excitement in 2021 as another one. Especially since new coal power plants are still being opened in many parts of the emerging world; electric vehicle penetration is stagnating in Europe and the US; global CO2 emissions rose 1.1% in 2023;[1] and global warming exceeded 1.5 degrees Celsius in 2023 – for the first time across an entire year.[2]

Figure 1. Global Energy Investment in Clean Energy and in Fossil Fuels (2015-2023e)



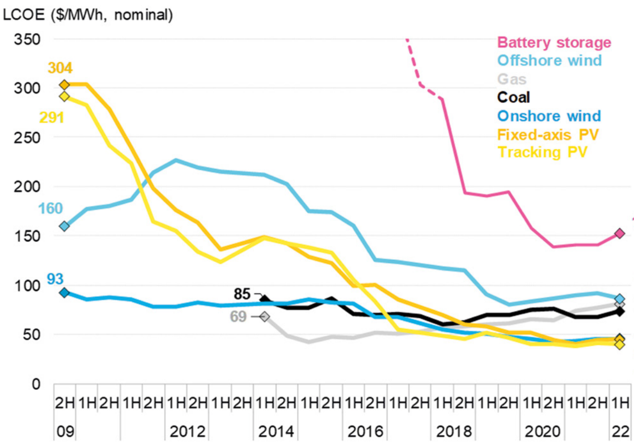
Note: 2023e = estimated values for 2023.
Source: IEA, World Energy Investment 2023, p. 8.

From our perspective, however, the shift to renewables has been accelerating over the past five years, as illustrated by *figure 1*. During 2023, an estimated 507GW of renewable electricity capacity were added, which is 2.5x what was added in 2019.[3] Spending on electric vehicles (EVs) is also increasing, with 13.5 million EVs being sold in 2023, compared to just 2 million in 2019.[4] As *figure 1* shows, a total of 1.75 trillion US dollars were invested in clean energy compared to 1.2 trillion US dollars in 2019, while fossil fuel investment has stagnated.

One key reason for the acceleration is that the technology, cost and capacity are now within affordable reach after many years of industry development, as seen in *figure 2* (on the following page). Solar and wind power can now generate electricity at lower cost than thermal, and their prices are still falling. These days renewable electricity generation can be economically competitive without subsidies.

[1] Source: Global Carbon Project.
[2] Poynting, Mark. "World's first year-long breach of key 1.5C warming limit", *BBC*, 8-Feb-2023.
[3] Pg. 14, Renewables 2023 Report, International Energy Agency.
[4] Pg. 22, Global EV Outlook 2023, International Energy Agency.

Figure 2. Global energy costs have levelled out (2009-2022)



Source: BloombergNEF. Note: The global benchmark for PV, wind and storage is a country-weighted average using the latest annual capacity additions. The storage LCOE is reflective of a utility-scale Li-ion battery storage system with four-hour duration running at a daily cycle and includes charging costs.

Battery and electric drive-train technology now allow EVs to provide a similar or better experience than internal combustion engine (ICE) vehicles. EVs are also being produced at more competitive prices compared to ICE vehicles. In addition, enormous amounts of production capacity for solar, wind, battery, and EVs are coming online thanks to technological developments and various political ambitions across the globe.

At Comgest, we believe that the solar, wind and battery value chains have a lot of growth ahead of them. According to our projections, global annual solar installation should increase from ~400GWh in 2023 to 1TWh by 2030,[5] while EV sales are estimated to grow from 13.5 million in 2023 to 40 million by 2030.[6] We believe that this surge in renewables sales volumes offers significant long-term investment opportunities for shrewd investors.

BUMPS IN THE ROAD TOWARDS A RENEWABLE FUTURE

— According to our projections, global annual solar installation should increase from ~400GWh in 2023 to 1TWh by 2030, while EV sales are estimated to grow from 13.5 million in 2023 to 40 million by 2030.

Despite the acceleration and growth in renewable energy options, we realise that the route to replace fossil fuels is neither smooth nor straight-forward.

Technology and cost still have hurdles to cross. For example, the availability of sunshine and wind varies depending on weather as well as time of day and year, rendering the generation of renewable electricity intermittent. Using batteries to store electricity could offer a scalable solution to this problem, but increases the overall cost. Battery storage is also more suited to daily short-term balancing rather than long term (i.e., seasonal). While a commercially viable solution to long-term storage has not yet been found, many are betting on green hydrogen that is produced via renewable energies.

Geopolitics is another disrupter. Asia, and especially China, command the dominant share of existing capacity and the lowest cost supply chain. The US and Europe are not comfortable with that reliance. Efforts to keep Chinese renewable products out of their markets have led to inferior products, higher costs and slower adoption.[7]

For investors, these challenges mean not overestimating the rate of renewable growth, especially after the explosive pace of progress in the last few years. On the other hand, investors should not lose heart by periods of slowdown either. Advances in technology and a wider push to mitigate climate change are driving a global push towards renewables. As a result, we believe that renewables will offer significant opportunities for many decades to come.

[5] Comgest forecast, assuming solar generated electricity increases from ~1% of global energy consumption to ~5%, with average annual utilisation remaining flat at ~1300 hours.
[6] Comgest forecast, assuming global passenger vehicle sales increase from ~80M in 2022 to ~90M in 2030, EV penetration increases from ~15% to ~45%.
[7] Dempsey, Harry and White, Edward. 'Simply good' Chinese electric cars power ahead of inferior US rivals. *Financial Times*, 3-Mar-2024 (subscription).

IDENTIFYING THE RIGHT POWER PLAYS

Since renewable industries are massive and growing, finding winners is not easy. The value chains are long and there are a lot of sub-segments, many of which suffer from sharp price deflation, rapid technology disruptions, intense competition and sharp boom-bust cycles. Players from China may suffer from geopolitical fallout, while players from other regions must cope with intense competitive pressure from China.

Comgest has done deep on-the-ground research in renewables and identified the sectors that are more attractive to our long term, quality growth investment approach.

Within the solar sector, solar glass is less deflationary, experiences less technological disruptions and is less geopolitically exposed than other sectors. Solar glass represents a small fraction of total solar module cost and its production process is mature, with limited room for cost reduction. In addition, the US and European governments have less of an urge to achieve self-sufficiency in solar glass than other more critical parts. This is why our research led us to invest in **Xinyi Solar** (China), the largest solar glass manufacturer in the world. The company has a strong cost advantage versus peers in terms of scale, efficiency and managerial expertise.

Inverters for solar, wind and battery storage are another sector that is less deflationary and technologically disrupted as well as less cyclical. For example, **Sungrow** (China) is the leading player globally in the utility-scale solar farm market, where cost, reliability and functionality are the winning criteria. In contrast, **Enphase** (US) is the developed markets' leading player in residential distributed energy resources, where conversion efficiency, brand and sales channel are paramount.

Figure 3. Global Market Share of EV Batteries

MANUFACTURER	CAPACITY H1 2022 (GWH)	MARKET SHARE (%)	RANK
CATL	70.9	34.8	1
LG ENERGY SOLUTION	26.2	14.4	2
BYD	24.0	11.8	3
PANASONIC	19.5	9.6	4
SK ON	13.2	6.5	5

Source: As of H1 2022, Electrive.com.

Within the EV battery value chain, the battery itself is less commoditised and less cyclical than most other components. EV battery makers wield significant bargaining power vis-à-vis suppliers. They are also less susceptible to technological disruptions if they have broad technology coverage. **CATL** (China) and **LG Energy Solution** (Korea), in which we're invested,[8] are the two largest battery makers globally (see *figure* 3), with cost advantage, broad technology coverage and a global footprint.

Electric vehicle OEM[9] pure-plays can also be rewarding investments, as Tesla has already attested to in the US. However, in Asia and especially in China, the industry is intensely competitive with dozens of EV start-ups. We have been very selective and have only invested in **Li Auto**, the top premium EV OEM in China, due to its savvy management and smart market positioning that have helped it generate good margins and returns. In Q4 2023, Li Auto generated a 23% gross profit margin and a 7% operating profit margin.[10]

Onsite visit by Comgest analysts; photo of CATL's battery swap station for electric trucks.

There are also opportunities in more adjacent, niche areas. For example, we have invested in **Sinbon**, a Taiwanese cable supplier for EV charging stations, wind turbines and rooftop solar installations. While cables are a small cost component, they are vital in terms of end-product durability and reliability.

[8] Comgest's exposure to LG Energy Solutions is via our holding in its parent entity, LG Chemical.
[9] OEM refers to original equipment manufacturer, an organisation that makes devices from component parts bought from other organisations.
[10] Source: Company report.

CONCLUSION

The road ahead for renewables will be long and winding in terms of cost, technology and geopolitics. As a result, market conviction in the sector is likely to continue waxing and waning, just as it has in the past. Given these factors, many industry participants are unlikely to become long-term winners as they engage in a high-stakes competition in which only the strongest companies with sustainable business models and advanced technologies will survive.

At Comgest, one of our aims as long-term investors is to filter out the noise and attention-grabbing headlines. Our approach focuses on bottom-up, on-the-ground research to identify long-term industry trends and select quality growth companies that can sustainably generate value over an extended period of time. From our vantage point, therefore, we see that the shift towards renewables is accelerating. In its World Energy Outlook 2023, the International Energy Agency noted that "global fossil fuel use could peak as early as the mid-2020s". This would be great for our environment – and for discerning long-term investors seeking emerging investment opportunities in renewables.

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MAIN RISKS

- Investing involves risk including possible loss of principal
- The value of all investments and the income derived therefrom can decrease as well as increase
- Changes in exchange rates can negatively impact both the value of your investment and the level of income received
- Emerging markets may be more volatile and less liquid than more developed markets and therefore may involve greater risks

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