

Sustainable Investment

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Postcard from the US – a look over the water

I arrived in a cold and windy Chicago in the American Midwest last week to attend a conference focusing on industrial technology companies, with a key focus on water infrastructure.

Under our “Improving the management of water” theme we focus on technologies that help to conserve and efficiently manage water as a resource. Water is a vital resource and is essential for life. It is also unique in that it can’t be transported from an area of abundance to an area of scarcity, as with some forms of energy. Water usage from an investment perspective tends to split across industrial uses, such as semi-conductors and industrial boilers, and municipal customers, that represent residential water users. We focus on all these areas, with three of our holdings under this theme; Veralto, Ecolab and Ferguson. I met the chief executives and management teams of all three of these holdings while in Chicago and had some interesting conversations about the uses of water in the global economy.

The first company I met is also the most recent addition to our portfolio. Veralto has recently spun out of Danaher, and we started a position at the end of October 2023. Veralto is split into two key areas, the largest being the water quality business. This business tests, treats and protects the global water supply. Its technologies reduce the environmental impact of industrial wastewater and replenish and purify vital water sources. Veralto is also a leader in the detection of PFAS, a nasty ‘forever’ chemical which can contaminate drinking water across the world. We feel technology innovations in this space could be crucial to ensure we aren’t contaminating our food and water systems with this chemical, and Veralto is on the cutting edge here. From an overall business fundamental perspective, the management of Veralto were keen to point out that it forms part of its customers operating expense budget, rather capital expenditure – “opex rather than capex”, so the cash flow is far more defensive. In Veralto we are confident we have found a defensive, compound business that is on the cutting edge of ensuring the water we drink is pure.

Ecolab has been in the portfolio since 2009 and has been a core holding under the “Improving the management of water” theme. Ecolab calculates that over this year alone, its products have helped save more than 772 million litres of water. The chief executive was upbeat as it continues to use its technologies to help customers save on energy and water costs. The move to digitalisation for the company’s customers, from industrial water boilers to commercial kitchens, ensures they can identify, track and monitor improvements in the water they use and the energy they are saving. The business is expected to benefit from a period of falling raw material costs, while pricing it took during the “great inflation” era of 2022 is likely to stick, ensuring margins improve over

2024 despite a slowing global economy. Ecolab's defensive attributes could well help the portfolio if we do experience a slowdown in 2024.

I also met the CEO of Ferguson, a new position over the first half of 2023. Ferguson owns a business called Waterworks, which supplies everything from water meters and automation equipment to pipes, valves and fittings. It sells into municipal customers in the US, to ensure the water infrastructure is maintained and runs as efficiently as possible. Ferguson is also the dominant player in supplies to plumbers. The business is multiples bigger than its nearest competitor and can offer a significantly wider range of products when a replacement part is needed. Its value proposition is clear – given the cost of this replacement part tends to be small relative to the cost of the labour for the end customer, ensuring the part is available is key. Ferguson's value proposition is also about ensuring the salesperson in each branch is knowledgeable. This is a key differentiator, ensuring the correct part is supplied, and the repair job is finished correctly. In a digital world where physical retail sales have become less important, Ferguson has a niche offering which is highly valuable to its customers. From a sustainability perspective, by repairing existing plumbing and extending its useful life, you can reduce the resources needed. From a fundamental perspective, the Ferguson business is notably more defensive than the residential and commercial property markets the business services, given repair and maintenance tends not to be cyclical, especially for plumbing.

Collectively Ecolab, Ferguson and Varelto are the core of our holdings related to the "Improving the management of water" theme. These companies are some of the most important providers of technologies and resources to effectively manage water as a resource. They are also high quality, defensive businesses that can deliver and compound cash flow in both good and bad economic times.

For a comprehensive list of common financial words and terms, see our glossary at:
<https://www.liontrust.co.uk/benefits-of-investing/guide-financial-words-terms>

Key Risks

Past performance does not predict future returns. You may get back less than you originally invested. We recommend this fund is held long term (minimum period of 5 years). We recommend that you hold this fund as part of a diversified portfolio of investments.

The Funds managed by the Sustainable Future Team:

Are expected to conform to our social and environmental criteria.

May hold overseas investments that may carry a higher currency risk. They are valued by reference to their local currency which may move up or down when compared to the currency of a Fund.

May hold Bonds. Bonds are affected by changes in interest rates and their value and the income they generate can rise or fall as a result; The creditworthiness of a bond issuer may also affect that bond's value. Bonds that produce a higher level of income usually also carry greater risk as such bond issuers may have difficulty in paying their debts. The value of a bond would be significantly affected if the issuer either refused to pay or was unable to pay.

May encounter liquidity constraints from time to time. The spread between the price you buy and sell shares will reflect the less liquid nature of the underlying holdings.

May invest in companies listed on the Alternative Investment Market (AIM) which is primarily for emerging or smaller companies. The rules are less demanding than those of the official List of the London Stock Exchange and therefore companies listed on AIM may carry a greater risk than a company with a full listing.

May invest in smaller companies and may invest a small proportion (less than 10%) of the Fund in unlisted securities. There may be liquidity constraints in these securities from time to time, i.e. in certain circumstances, the fund may not be able to sell a position for full value or at all in the short term. This may affect performance and could cause the fund to defer or suspend redemptions of its shares.

May, under certain circumstances, invest in derivatives, but it is not intended that their use will materially affect volatility. Derivatives are used to protect against currencies, credit and interest rate moves or for investment purposes. There is a risk that losses could be made on derivative positions or that the counterparties could fail to complete on transactions. The use of derivatives may create leverage or gearing resulting in potentially greater volatility or fluctuations in the net asset value of the Fund. A relatively small movement in the value of a derivative's underlying investment may have a larger impact, positive or negative, on the value of a fund than if the underlying investment was held instead. The use of derivative contracts may help us to control Fund volatility in both up and down markets by hedging against the general market.

The use of derivative instruments that may result in higher cash levels. Cash may be deposited with several credit counterparties (e.g. international banks) or in short-dated bonds. A credit risk arises should one or more of these counterparties be unable to return the deposited cash.

Outside of normal conditions, may hold higher levels of cash which may be deposited with several credit counterparties (e.g. international banks). A credit risk arises should one or more of these counterparties be unable to return the deposited cash.

May be exposed to Counterparty Risk: any derivative contract, including FX hedging, may be at risk if the counterparty fails.

Do not guarantee a level of income.

The risks detailed above are reflective of the full range of Funds managed by the Sustainable Future Team and not all of the risks listed are applicable to each individual Fund. For the risks associated with an individual Fund, please refer to its Key Investor Information Document (KIID)/PRIIP KID.

The issue of units/shares in Liontrust Funds may be subject to an initial charge, which will have an impact on the realisable value of the investment, particularly in the short term. Investments should always be considered as long term.

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