



Client Update

Navigating the challenges and opportunities as China targets net zero

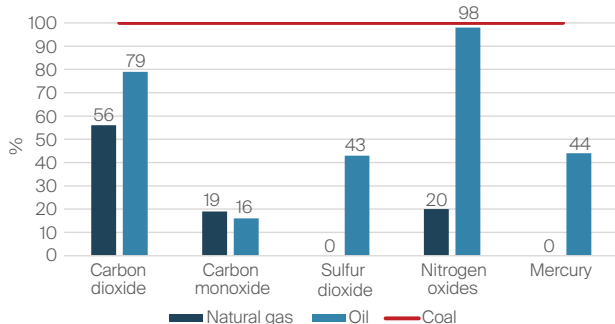
November 2021

China made headlines for watering down coal reduction targets during COP26¹, but we think the criticism is unfair. The nation's own targets set by President Xi Jinping last year – for peak emissions before 2030 and carbon neutrality by 2060 – are still ambitious and noteworthy considering China's faster economic growth compared to developed countries.

Much of China's carbon-intensive activities over the years, especially in manufacturing, had been outsourced from the West. This makes China's goals more impressive, considering the scale of change the country needs to make while retaining many of its core industries. And more domestic companies are taking steps to reduce emissions, which suggests the direction of travel is positive and still gathering steam.

China leads the world in use of renewable energies, but their adoption is constrained by recent subsidy cuts, lack of energy storage facilities, and sources of renewables such as solar and wind farms being far from urban consumption centres. Natural gas can play a key role in bridging the transition from fossil fuels to renewables, because it's much cleaner than coal and crude oil. However, gas has its drawbacks, such as methane leaks and other waste along the supply chain.

Emissions from combustion relative to coal



Source: EIA, Wood Mackenzie, 2019.

RISK FACTORS

This is a financial promotion for The First Sentier China Strategy. This information is for professional clients only in the EEA and elsewhere where lawful. Investing involves certain risks including:

- **The value of investments and any income from them may go down as well as up and are not guaranteed. Investors may get back significantly less than the original amount invested.**
- **Currency risk:** the Fund invests in assets which are denominated in other currencies; changes in exchange rates will affect the value of the Fund and could create losses. Currency control decisions made by governments could affect the value of the Fund's investments and could cause the Fund to defer or suspend redemptions of its shares.
- **Single country / specific region risk:** investing in a single country or specific region may be riskier than investing in a number of different countries or regions. Investing in a larger number of countries or regions helps spread risk.
- **China market Risk:** although China has seen rapid economic and structural development, investing there may still involve increased risks of political and governmental intervention, potentially limitations on the allocation of the Fund's capital, and legal, regulatory, economic and other risks including greater liquidity risk, restrictions on investment or transfer of assets, failed/delayed settlement and difficulties valuing securities.
- **Concentration risk:** the Fund invests in a relatively small number of companies which may be riskier than a fund that invests in a large number of companies.
- **Smaller companies risk:** Investments in smaller companies may be riskier and more difficult to buy and sell than investments in larger companies.

For details of the firms issuing this information and any funds referred to, please see Terms and Conditions and Important Information.

For a full description of the terms of investment and the risks please see the Prospectus and Key Investor Information Document for each Fund.

If you are in any doubt as to the suitability of our funds for your investment needs, please seek investment advice.

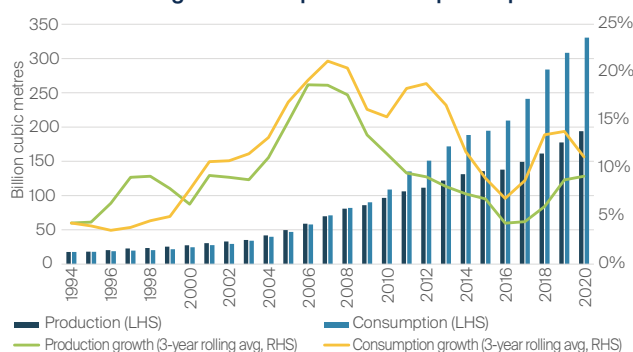
¹ 26th Conference of the Parties of the United Nations Framework Convention on Climate Change

China's policy targets include increasing natural gas in its energy mix, so gas volumes will continue to grow across power generation, heating and industrial applications as coal declines. Wood Mackenzie, an energy consultancy group, expects China's gas consumption to grow by an average of 5.5% a year between 2020 and 2030, before eventually peaking in the mid-2040s. More conservative estimates put the peak at around 15 years from now, which is still a decent runway in our view.

Evolving from gas distribution to integrated energy solutions

ENN Energy, a long-time holding in some of our China strategies, is a privately-owned gas distributor which offers a useful perspective on the country's energy transition. While no company is perfect, we believe ENN Energy sets a good example within the fossil fuels industry. The company is proactively reducing emissions, while its core business is positioned to benefit from both gas demand growth and the broader decarbonisation drive.

China's natural gas consumption has outpaced production



Source: BP Statistical Review of World Energy, 2021.

Our investment case for ENN is supported by its track record of strong execution and operational outperformance vs. peers such as CR Gas and Towngas China; consistent profit growth driven by its core gas distribution business, with 15% annual growth expected over the medium term; and consistent increases in dividend payouts. From 2001 to 2020, revenue, earnings per share (EPS) and book value per share (BVPS) have compounded at average rates of 35%, 21% and 21% respectively.

We also like the company's improving business mix. Two decades ago, it had just a handful of projects while 80% of revenue came from connection fees, which are one-off sales. More recently this segment has decreased to less than 10% of the total, outpaced by other segments with more sustainable earnings such as retail gas sales and the Integrated Energy Business.

Perhaps most significant is senior management's willingness to listen to our suggestions and discuss issues openly. We've been engaging with the company for many years, having met them more than 50 times since the early 2000s, and have been a shareholder for at least a decade. Some of the suggestions we've made include reducing their related party transactions, improving data disclosure, setting firm ESG targets, and increasing the diversity of its employees and managers to include more women in the workforce. They have made some improvements but more needs to be done.

ENN seems well aware of the need to transform their business, as natural gas use may peak in the next 15 or so years. Given our long investment horizon, we also need to pay attention to what happens beyond this. The company recently published a multi-faceted plan that can be broadly categorised into defensive and offensive measures – in other words, reducing their own emissions and other waste, and providing customers with low-carbon solutions to become more environmentally-friendly and compliant with tightening global and local regulations.

Some of the measurable goals they have announced include reducing combined Scope 1 and 2 greenhouse gas emissions, lowering the methane from natural gas production, and switching their transportation fleet to only use clean fuel vehicles. Certain tools ENN employs such as software for efficient routing of their deliveries and alerts for methane leakages in their pipelines can also become revenue-generating offerings.

In recent years the company has positioned itself as an energy solutions provider, and the nascent Integrated Energy Business should expand from 10% to 20% of revenue by 2025. The major areas of focus include energy storage, carbon capture, hydrogen energy, geothermal energy, and converting biomass waste into fuels. By allocating capital and innovating across these emerging fields, ENN is aligning with increasing demands to better cope with the negative impacts of climate change.

Reducing emissions in our investment portfolios

Looking at the big picture, we are engaging more with our companies to reduce their emissions, but this is still in the early stages. The task is complex with plenty of grey areas and room for debate on how to move forward. While ESG has always been a focus for us, we are mindful of greenwashing and following the letter rather than the spirit of new regulations and industry standards.

As active, benchmark-agnostic investors, we seek to make a positive contribution to climate change action by engaging with our portfolio companies to lower their emissions over

time, rather than simply selling off high-carbon contributors within our portfolios. Our philosophy is to assess the net effect of a company's environmental impact alongside its broader sustainability, and to engage heavily on the improvements that can be achieved.

Developed countries may need to mature in their thinking and face the reality that blame will not solve the problem – engagement and support will. It is easy to sit back and criticise Asia, but as investors on the ground, we are able to consider the many nuances and interests at stake. How can the world balance economic development and improvement

in quality of life with the need to decarbonise? We believe the pragmatic approach we have taken with ENN is one pathway to this goal.

Natural gas is a medium-term bridge to net zero emissions as renewables cannot become the entire energy mix overnight. The company's core business is well positioned for the transition years ahead, while its projects under development suggest it's evolving in the right direction. We believe our long-term relationship with ENN demonstrates our engagement philosophy – to travel well, rather than arrive.

Source: Company data retrieved from company annual reports or other such investor reports. Financial metrics and valuations are from FactSet and Bloomberg. As at 31 October 2021 or otherwise noted.

Important Information

This material is for general information purposes only. It does not constitute investment or financial advice and does not take into account any specific investment objectives, financial situation or needs. This is not an offer to provide asset management services, is not a recommendation or an offer or solicitation to buy, hold or sell any security or to execute any agreement for portfolio management or investment advisory services and this material has not been prepared in connection with any such offer. Before making any investment decision you should conduct your own due diligence and consider your individual investment needs, objectives and financial situation and read the relevant offering documents for details including the risk factors disclosure. Any person who acts upon, or changes their investment position in reliance on, the information contained in these materials does so entirely at their own risk.

We have taken reasonable care to ensure that this material is accurate, current, and complete and fit for its intended purpose and audience as at the date of publication but the information contained in the material may be subject to change thereafter without notice. No assurance is given or liability accepted regarding the accuracy, validity or completeness of this material.

To the extent this material contains any expression of opinion or forward-looking statements, such opinions and statements are based on assumptions, matters and sources believed to be true and reliable at the time of publication only. This material reflects the views of the individual writers only. Those views may change, may not prove to be valid and may not reflect the views of everyone at First Sentier Investors.

Past performance is not indicative of future performance. All investment involves risks and the value of investments and the income from them may go down as well as up and you may not get back your original investment. Actual outcomes or results may differ materially from those discussed. Readers must not place undue reliance on forward-looking statements as there is no certainty that conditions current at the time of publication will continue.

References to specific securities (if any) are included for the purpose of illustration only and should not be construed as a recommendation to buy or sell the same. Any securities referenced may or may not form part of the holdings of First Sentier Investors' portfolios at a certain point in time, and the holdings may change over time.

References to comparative benchmarks or indices (if any) are for illustrative and comparison purposes only, may not be available for direct investment, are unmanaged, assume reinvestment of income, and have limitations when used for comparison or other purposes because they may have volatility, credit, or other material characteristics (such as number and types of securities) that are different from the funds managed by First Sentier Investors.

Selling restrictions

Not all First Sentier Investors products are available in all jurisdictions.

This material is neither directed at nor intended to be accessed by persons resident in, or citizens of any country, or types or categories of individual where to allow such access would be unlawful or where it would require any registration, filing, application for any licence or approval or other steps to be taken by First Sentier Investors in order to comply with local laws or regulatory requirements in such country. This material is intended for 'professional clients' (as defined by the UK Financial Conduct Authority, or under MiFID II), 'wholesale clients' (as defined under the Corporations Act 2001 (Cth) or Financial Markets Conduct Act 2013 (New Zealand) and 'professional' and 'institutional' investors as may be defined in the jurisdiction in which the material is received, including Hong Kong, Singapore and the United States, and should not be relied upon by or be passed to other persons.

The First Sentier Investors funds referenced in these materials are not registered for sale in the United States and this document is not an offer for sale of funds to US persons (as such term is used in Regulation S promulgated under the 1933 Act). Fund-specific information has been provided to illustrate First Sentier Investors' expertise in the strategy. Differences between fund-specific constraints or fees and those of a similarly managed mandate would affect performance results.

About First Sentier Investors

References to 'we', 'us' or 'our' are references to First Sentier Investors, a global asset management business which is ultimately owned by Mitsubishi UFJ Financial Group (**MUFG**). Certain of our investment teams operate under the trading names FSSA Investment Managers, Stewart Investors and Realindex Investments, all of which are part of the First Sentier Investors group.

This material may not be copied or reproduced in whole or in part, and in any form or by any means circulated without the prior written consent of First Sentier Investors.

We communicate and conduct business through different legal entities in different locations. This material is communicated in:²

- **Australia and New Zealand** by First Sentier Investors (Australia) IM Limited, authorised and regulated in Australia by the Australian Securities and Investments Commission (AFSL 289017; ABN 89 114 194311)
- **European Economic Area** by First Sentier Investors (Ireland) Limited, authorised and regulated in Ireland by the Central Bank of Ireland (CBI reg no. C182306; reg office 70 Sir John Rogerson's Quay, Dublin 2, Ireland; reg company no. 629188)
- **Hong Kong** by First Sentier Investors (Hong Kong) Limited and has not been reviewed by the Securities & Futures Commission in Hong Kong
- **Singapore** by First Sentier Investors (Singapore) (reg company no. 196900420D) and has not been reviewed by the Monetary Authority of Singapore. First Sentier Investors (registration number 53236800B) is a business division of First Sentier Investors (Singapore).
- **Japan** by First Sentier Investors (Japan) Limited, authorised and regulated by the Financial Service Agency (Director of Kanto Local Finance Bureau (Registered Financial Institutions) No.2611)
- **United Kingdom** by First Sentier Investors (UK) Funds Limited, authorised and regulated by the Financial Conduct Authority (reg. no. 2294743; reg office Finsbury Circus House, 15 Finsbury Circus, London EC2M 7EB)
- **United States** by First Sentier Investors (US) LLC, authorised and regulated by the Securities Exchange Commission (RIA 801-93167).
- **Other jurisdictions**, where this document may lawfully be issued, by First Sentier Investors International IM Limited, authorised and regulated in the UK by the Financial Conduct Authority (registration number 122512; registered office 23 St. Andrew Square, Edinburgh, EH2 1BB number SC079063).

To the extent permitted by law, MUFG and its subsidiaries are not liable for any loss or damage as a result of reliance on any statement or information contained in this document. Neither MUFG nor any of its subsidiaries guarantee the performance of any investment products referred to in this document or the repayment of capital. Any investments referred to are not deposits or other liabilities of MUFG or its subsidiaries, and are subject to investment risk, including loss of income and capital invested.

© First Sentier Investors Group

² If the materials will be made available in other locations, seek advice from Regulatory Compliance.