Hello and welcome to the latest episode of GSFM's Conversations podcast. This year we're going 'inside the vault' with our investment partners and today's conversation focuses on climate. With the decarbonisation of the planet described as a $50 trillion investment opportunity, Munro Partners' head of responsible investment, Mike Harut, joins our CEO Damien McIntyre at the microphone.

They will discuss the outlook for climate in our changing world and the sectors that excite the interest of team Munro.

Before I hand over, I need to read this important notice:

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Damo and Mike, it's over to you.

Damien McIntyre

Thank you, Tracey, and welcome to all our visitors joining us in the vault. Our conversations with our partners and portfolio managers and really the objective of these conversations is to get into the minds of what's occupying time of our partners and try and draw insights from them which are useful to you in your conversations with your clients that might make an issue clearer or at least gives you an anecdote to help in your discussions with clients. So that's our objective. I sincerely hope we're achieving it and we've certainly got a very interesting guest to discuss the issues of climate change here today with Mike Harut. Now Mike, you know your background far better than I do so perhaps it would be best if you talk through your background and your role here at Munro Partners.

Mike Harut

Sure, so I'm Munro Partners Responsible Investment Manager. What does that mean? I guess briefly, it means two things. First of all, I help us integrate issues like environmental issues or social issues or corporate governance issues into all of our investment decision-making. We think that these things are not just environmental topics or social challenges, et cetera, but they're actually important for the companies that we invest in in terms of their long-term financial performance. So, I help the team think about that and embed that in a systematic way into how we do things.

The second thing which I do, which I think we'll touch on today, is I work within the team in terms of our climate change leaders strategy. So, climate change is obviously an environmental issue. Next to that, we think it's an

opportunity in terms of a long-term investment opportunity. And so, I work with our team on our climate change leader strategy and help us think through what's going on in that strategy, but then also across really all of our funds where we invest in this particular theme or area of interest.

Damien McIntyre

And at the same time, you also work with students in their responsible investment studies. So, can you take us through what you do?

Mike Harut

Yeah, so yes, so I have a casual role. I suppose it's called as a lecturer at the University of Melbourne. With a industry colleague of mine, we run six weeks of the 12-week course. You know, we've got, we've had hundreds of students go through it so far. It's been running for five years. It's called sustainable investment. And really, it's about, I guess, educating the next generation on some of these topics, how they should think about it from a financial risk and investment risk and opportunity perspective. And we've found that it's been quite popular. And I think, you know, I get a lot out of it, I guess, giving back and then the students, I think, you know, we get some pretty good feedback in terms of this is something that they hadn't considered, perhaps even being relevant to their commerce degree, but you know, increasingly it is.

Damien McIntyre

Well, I mean, the other interesting way to look at that as well is that ESG is becoming an increasingly important component of investment process. And rather than be naive or cynical about how important ESG is and how it's applied in investment making decisions, it would be invaluable for a student to hear from someone who rather than a lecturer speaking in theory, a practitioner who's dealing with it on a daily basis, to bring those issues to life.

Mike Harut

Yeah, absolutely. And I think you sort of alluded to the fact that there's some cynicism or scepticism perhaps that's brewing in some of these areas. And really, you know, what I try to do in my role at Monroe Partners, and in what I'm doing in terms of the lecturing is really try to get move away from I suppose, these sort of headlines or ESG is good, ESG is bad. Well, it means a lot of different things. And it depends on your motivation of what you're trying to do by considering these things. But I think that underlying a lot of yeah, the sort of noise around this topic is issues that as we live really in our daily lives here at Monroe Partners, when we actually invest in some of these themes like climate change opportunities, it is a strong structural trend that we think is going to drive many, many years of investment opportunity.

Damien McIntyre

Well, let's turn the conversation now to present. And if we start with the election of President Trump, it's probably fair to say that President Trump wasn't the best advocate for responsible and green investment for one of a better description with his big, beautiful bill. And in fact, there was a point in recent times where he referred to rebates to individuals for driving EVs, for example, as the big green scam. So, he wasn't exactly helpful in setting up an investment climate. So, a couple of questions. How did you sort of think about that? Is that evolved? And then second, where are we? Well, what's happened? What's changed?

Mike Harut

Yes. Well, this is something that's been really occupying us for the better part of 18 months or more. So, all through last year, if you remember, there was that risk, I suppose, in terms of Donald Trump being re-elected. And you know, when he was first president, he pulled the US out of the Paris agreement. And so really, the question that we were asking ourselves in 18 months ago was, well, what happens to the Inflation Reduction Act, which is Joe Biden's sort of signature climate set of subsidies and incentives? What happens to that if Donald Trump gets in?

And so really, we for a very long period of time, you know, since that time have positioned our portfolio and how we think about where the best opportunities are around what are the more bipartisan or really kind of policy free, not policy reliant elements of this opportunity. And so it's, you know, I guess you can ask yourself the question and the other way around, which is what is most at risk, we already knew from the first time around that probably electric vehicles would be something that will be at risk, we knew that offshore wind is something that Donald Trump has a particular sort of personal is very concerned about the birds, is very concerned about the birds and the views from his golf course, or whatever else it is, I'll leave others to dig into all of that.

So, we really, you know, in terms of our positioning, it was a matter of focusing on the areas which we think are more bipartisan, for example, nuclear energy. And actually, just to throw one statistic at you, you know, in 2014, the year when Trump was due to be potentially re-elected, one of the best performing stocks in the S&P 500 was a clean energy stock, which was constellation energy, the largest owner of the nuclear fleet, the US, which provides base flowed carbon free power. So that was really our strategy to sort of stay out of the more partisan elements and think about what are the parts of this opportunity that don't rely on essentially government support.

So, what's happened? Well, actually, in the last couple of weeks, we've seen the passage of the 'One Big, Beautiful Bill', which was Donald Trump's and the Trump administration's effort to really remove a lot of what they thought were objectionable parts of the Biden era policy support. Overall, I think it's fair to say yes, some of the things have been removed. But we felt that again, these more bipartisan elements such as nuclear energy would be kept. And I think it's important to also just phrase it as the investment markets don't like uncertainty. And now that this law has come in about uncertainty has been removed. So really, you know, the things that we think retain a lot of policy support, nuclear energy, energy storage, manufacturing of, you know, for example, solar panels in the US, a lot of that stuff has actually remained intact.

Even for renewables developers, we think it's a workable outcome in terms of them being able to effectively plan ahead. And really, those negative elements are what I already mentioned. So EVs, residential solar, so sort of rooftop solar, as opposed to for a solar farm, that sort of stuff, I think, has been much more strongly curtailed. And yeah, offshore wind, as I mentioned as well earlier, perhaps it's interesting to kind of reflect on, okay, somebody who calls climate change a scam, you know, or the subsidies, whatever this green use scam, why did any of it survive, they probably if you sort of heal back, again, move away from the headlines, it's really US jobs, sort of onshore domestic manufacturing capability. And the fact that the US is in a very tight electrical energy supply situation, you know, you have AI, you've got electrification, all these things, US wanting to be an energy champion, you need to support new energy generation, even if part of it is wind or solar.

Damien McIntyre

Well, we're experiencing that live here in Victoria. The Victorian government is committed to removing coal-fired power stations, which puts pressure on the grid for one of a bit of description. So, investment in other power generation forms really is vital. Yeah, because you talk about data centres, but equally with EVs. For every EV that's produced and sold, it requires electricity. So, in this bizarre way, whilst at the same time we're cutting supply, demand is increasing. Yes. So, we just have to invest in these other forms of power generation just to stand still.

Mike Harut

And, you know, really was something that we've noticed in the last sort of two years and really what underlies a lot of the investments that we're making is, as you said, this inflection of electricity demand. So, for example, in the US for the last 20 years, all the new demand that has come in has been basically offset with energy efficiency. So, it's basically flatlined for 20 years. But now for those factors that you mentioned, so people electrifying their cars or getting electric heating and cooling, artificial intelligence, or this whole effort in the US to bring back manufacturing, bring back in industries, all of that adds up to electricity demand. And, you know, with coal closing down and other opportunities being more difficult or taking longer to add to the grid, like gas or nuclear, sure, they're viable, but takes many years to add new capacity there. What fills the gap? It is these renewables, storage, those sorts of things.

Damien McIntyre

Yeah, can you just sort of remind us of what those three tailwinds are and what signals you can glean from the two tailwinds outside of government?

Mike Harut

Yeah, so the way that we like to think about it is yeah, there's government policy, which we've already touched on, but we also think that it's separate from that corporates that set net zero targets independently of governments, and then also investors push policymakers or push companies to set these targets. So, what we noticed when we started to think more deeply about this entire opportunity is that it's not just policy support that is driving this tailwind, but it's also corporates and investors. So, I'd like to just maybe illustrate one of these other tailwinds, which is the corporates. So, in the past 18 months or so, again, with this surging energy demand from AI, what we've seen is corporates like Microsoft, like Meta, which owns Facebook, like Amazon that have very ambitious targets around decarbonizing their own operations, really kind of leaning into providing support for carbon free power. What that's primarily manifested in is them signing, you know, for example, Amazon signing a deal with a company called Talon

Energy to secure its nuclear power station for I think it's 15 years, something that they recently effectively doubled up on by increasing their potential of how much energy they're going to extract. We've also seen Microsoft sign a deal with Constellation Energy to say, you know, we Microsoft again have this ambitious climate change target. We want to have carbon free power, but we want to power our data centres. And so, they are working with Constellation to effectively restart a nuclear power station and they're willing to pay a big premium over the prevailing power price for that same thing with Meta, which also recently signed another deal.

So, I guess it's to say that these big companies driven by their needs around electricity and driven by their needs around having ambition around climate change targets are really driving opportunities, investment opportunities that we are trying to. And we have captured, for example, this constellation energy, which is one of these big, well, the biggest nuclear power generator in the US, which is, you know, again, as I said, one of the best performers in the S&P 500 last year.

Damien McIntyre

I'll ask you two questions. Firstly, or the observation I'd make is that regardless of government support, when a listed company states it has climate objectives or carbon reduction objectives, it's almost like a binding contract. It's in their annual report. Investors in the firm or shareholders expect that those stated objectives will be met. So, it's almost like if the government doesn't get us there, the corporate world will. Is that a fair way to think about it and state it?

Mike Harut

Yeah, I think we have to be a little bit careful because there have been some companies perhaps that weren't really that serious in the first place, to be honest, when the US administration changed. They've either sort of stepped back from some of their commitments or I think equally just stopped talking about them, maybe being a little bit more sort of politically afraid to talk about what their ambition actually is. But I think leaving that aside, for these really big companies like Microsoft, and we actually, we're active managers, we actively engage with these companies.

So, we literally have had Microsoft in our office and probe them on these questions, under the Trump administration, what do you do now? Do you just abandon your climate change goals? And really the reflection that they had was absolutely not, we're very serious about these targets. As you said, it is something that their shareholders clearly want and we convey that message. I think it's also something that really is expected of them in the communities, sort of more like the US states, for example, that they operate in, that these companies are gonna contribute to that country or that state or that municipality, reaching its own objectives. And so, I think we have to be, to some degree, wary of companies putting out targets that they're not really serious about meeting. But I think in the last sort of five years, that is starting to really sort of wash out. The sort of less serious commitments just sort of aren't being made as much, I think is probably a bit of a generalisation, but I think it's something that's probably true.

Damien McIntyre

Now on one level it seems counter intuitive that climate change leaders fund would invest in nuclear energy, but I think that people confuse the issues. Nuclear energy as you say is the most carbon free source of power and I think it's confused with other environmental or emotional impulses or thoughts. How do you reconcile?

Mike Harut

That's a really good question and it's probably something that I should have addressed in the very beginning but the way that we think about this particular fund is companies that will benefit from efforts to decarbonize the planet and yes it's true, nuclear has many questions asked about it around safety, around nuclear waste, is it contributing to the proliferation of nuclear weapons and I can address those but the you know the fact is that nuclear energy is carbon-free when it's generated and it's also I think one advantage that it has which is very attractive to these AI data centre hyperscaler sort of companies is that it's baseload power so obviously as the sun is going down slowly behind me the solar panels that powering part of this conversation will stop to work but a nuclear power plant is effectively always on so that's what's attractive about it. So, the way that we think about it is you know that is the only I suppose sort of screen criteria that we have this particular fund and so we made a decision you know very early on that nuclear does have these attributes so we're going to include it. It's not to say that we don't think about nuclear safety or nuclear waste, in fact we have engaged with companies like Constellation Energy specifically on this topic.

I think on the safety question probably the most important one that probably comes up in terms of our discussions this company is acutely aware of nuclear safety being a risk. You know you can think back to Fukushima, Chernobyl over the many, many decades past those sorts of things have completely stalled this industry and so these companies I think are hyper aware of their obligations to run a safe operation and in fact when we talked to them I actually learned something which was quite interesting which is that when they do their safety work they not only look at one power plant I guess cross-checking another one that they own but they actually look beyond their own fleet. It's like a whole country-wide effort of them kind of cross-checking each other not to mention obviously the regulatory oversight by the NRC in the US. So, I guess what I'm trying to say is that we really try to analyse these issues around nuclear safety. We don't we do think it's important but as I said the fact is that this is baseload carbon-free power which is very attractive in a world of A. wanting to decarbonize and B. wanting to minimise that intermittency.

Damien McIntyre

I said from the outset, it's an emotional issue. People confuse those issues from practical side to safety issues and the impacts on society. And I don't want to trivialise those, but they are very different.

Mike Harut

Yeah. And I think probably just one other thing, which I say is that what I'm really talking about here is very different to the political conversation that was had in Australia recently. So, this is about companies like Constellation Energy that have been running nuclear power stations for 50 plus years successfully, which I think is a very different conversation that we've had or are having in Australia around. Should we start a nuclear energy industry in Australia, which I think is something that we as global investors probably spend less time, honestly, thinking of.

Damien McIntyre

Well, it's not on the table in Australia, so there's no point. No, it's not. Until it is, it's not a conversation, is it? That's right, that's right. So, let's look at the Munro Climate Change Leaders Fund. Munro talks about space being a $50 trillion investment op, which is an enormous number. And then Munro divides that into four sub-areas. What are they?

Mike Harut

Yeah, so we do, as you said, think of it as a 50 trillion-dollar investment opportunity. You know, there are some others out there like Bloomberg that put a hundred trillion plus on that number. And the way that we think about it is, okay, that is what it's got to cost to decarbonise the planet. So that is the revenue opportunity. That is the opportunity, financial opportunity for the companies that actually enable that to happen. The four, I guess, buckets that we generally think about are clean energy, clean transport, energy efficiency, and the circular economy. So clean energy, as I said, encompasses nuclear energy, but obviously also renewables, the electricity grid, because you can't, you know, just rely on generating the stuff, but not plugging it into every where it's needed. Clean transport is electric vehicles and the supply chain. So, batteries, those sorts of things. Energy efficiency, I think, is a very sometimes overlooked area because, you know, it's one thing to decarbonize your electricity, but perhaps the simpler thing to do is to just use less electricity. And so, there are companies, for example, in HVAC or insulation, that help manage electricity use. And the final area is the circular economy. So, it's companies in the waste space or treating and managing the water supply chains and those sorts of things as well. But those are the four areas that we generally bucket our opportunities into.

Damien McIntyre

And given those areas, where's the main focus today and what companies do you like in those areas?

Mike Harut

Yeah. So, of the four, I'd probably put it in the order of clean energy, energy efficiency, then the circular economy, and then finally clean transport. The first two of clean energy and energy efficiency we like, because it really sort of feeds into this dynamic that we touched on earlier, which is for, and again, here I'm talking about the US, for about 20 years they've had a situation where electricity demand has been essentially flat because all the new demand is sort of offset by energy efficiency. Now we're seeing a few dynamics really driving up that electricity demand. So, one of those is electrification. So yes, while under Donald Trump, there's less policy support for EVs, they are still penetrating perhaps at a slower rate, penetrating the US auto market. So, if you have, you know, a couple of EVs, that means your household electricity use goes up maybe twice, for example, next to that electric electrification is

also think of things like, you know, heating and cooling and those sorts of things. Another one is obviously if, you know, if the US wants to re-shore that manufacturing, that means you need more electricity demand on shore in the US. And the third one, which we've sort of only sort of touched on, I guess tangentially so far is AI. So, you know, we've heard that, and we know because we invest in these companies that AI is a very power-hungry new demand. So, we think that basically we're going to go from a flat electricity demand growth to 2% per annum electricity demand growth. That might not seem like a lot, but when you think about all of the kit that needs to be added on and then replaced and replaced more quickly, it is a large increase in demand. And so, the areas within clean energy that we like, as I said, uh, you clear energy, we do like renewables. Although again, for these reasons that we've discussed, you have to be quite selective. The electricity grid is something that we think has very durable tailwinds because not only is there this increasing demand, but then also the electricity grid is something that is itself susceptible to physical weather events and climate events and needs to be hardened and made more resilient. So those are things that we like, and then within the energy efficiency space as well, like in this environment, I guess it pays to be more energy efficient. And so, there are companies in HVAC, like Johnson Controls, companies in insulation like Kingspan that have been within the fund.

Damien McIntyre

So, we've talked about what we like. Yeah. Conversely, what areas aren't of interest or are less attractive?

Mike Harut

Yeah, at the moment, we tactically are less invested in the clean transport space, so electric vehicles and the whole supply chain. Part of that is to do with, you know, perhaps waning policy support, as we discussed. But honestly, I think probably a bigger part of that is just around competition. So, we've seen in the electric vehicle space, a lot of competition and the incumbents, you know, particularly Tesla, yes, while they there's so many potential opportunities around robo taxis and autonomous vehicles and autonomous robots and all the rest of it. Their actual underlying electric vehicle business has been challenged by competition, particularly from Chinese companies like BYD. I know, I think it's quite interesting that there's another one, which is Xiaomi, which was a company that was making mobile phones five years ago. And now they're making EVs that look like Ferraris, if you ask me, and quite amazing. So that is an area that I think we've found challenging. So that sort of increasing competition, driving more competition in terms of pricing, which hurts their margins, which hurts their profit abilities. Although I should say that, you know, this is an area that we do fundamentally think this, you know, this is part of the transition that we think is going to happen in a bumpy way for various reasons. But we do think that there's going to be a higher EV penetration over time. And we have been thinking about other ways rather than directly buying into the OEMs, the actual car makers to, I guess, capture that opportunity. One way that we are recently, we did invest in a company called CATL, which is the world's largest battery maker, they've got just under 40%, I think market share or for EV batteries. So, Tesla uses them, you know, I think effectively nine out of the top 10 EV makers use CATL batteries. And so, we think that is a place where you can have a more durable technology driven mode or edge, which enables you to have a more stable profitability and margins. So that is a company that we, yes, well, they recently listed in Hong Kong. And we participated in that. And that is a name that we have recently invested in.

Damien McIntyre

Yeah, well, it's interesting when you look at EVs just as a segment, and let's just turn the conversation to Australia for one moment. The government here, through novated leases, made it an attractive opportunity to buy an EV if you can package it up as part of your salary. And then the government, at a whoopsie moment, just sort of said, well, we forecast X hundreds of million dollars of tax rebates. And of course, once you create a tax advantage, it's stupid to think that people won't take advantage of it, and now they've realised that actually what it's costing them is far greater than.

So, these hybrids were the first one to get scaled back, and EVs are the last. So, I suppose that's one issue. But regardless of whether or not you get a tax break, it doesn't change in the mind of the climate-conscious person that that's what they want to achieve. And in their own way, that's their contribution. I drive a Tesla, and I don't get a tax break on it, but I feel good about it. My family, there are at least five hybrid vehicles within my nieces, nephews, et cetera, et cetera. And each of us in our own way, it's our expression of what we're doing tangibly. So, I don't think that necessarily changes. But at the same time, you've got mass producers like BYD and others who are driving the cost of the vehicles down, which is only making it easier for consumers to make that expression. So, the game's not over. It might not look good for Musk, but Tesla wasn't going to own the space on their own forever anyway. That's right. They were always subject to the competitors catching up, which is where we are today.

Mike Harut

Yeah, yeah. And if you listen to Elon, I mean, I think, you know, at one point, I think I do remember him saying things like, you know, he wanted to sort of kickstart the entire industry, not for Tesla to be like the forever dominant manufacturer. In fact, I don't know if that's how true that is. But you know, to your point, it's interesting in the in the US, previously, you could get seven and a half thousand-dollar rebate effectively, if you bought an electric vehicle. Now, in the US, it's a bit more of a more nuanced because they've got tariffs and other barriers effectively to Chinese competition. But effectively, in this space, like what's bad for the shareholder is ultimately kind of good for the consumer, right? So, prices coming down is bad for margins and profitability, and therefore for the shareholder, but it does actually mean that you have cheaper vehicles that maybe don't need subsidies. And in many cases, they're much cheaper on a global level, you can definitely find examples where they're cheaper than their combustion engine counterparts.

So, for us, it's that doesn't necessarily mean that those EV manufacturers are the investment that we want to pursue. But if you sort of think through the logic of all of that, a grid operator would be a great investment because it means they're an indirect bit of beneficiary. And so companies like Schneider Electric, like Eaton, that make the kind of componentry that sort of high voltage componentry that goes into the electricity grid or the cable companies or whatever else it is, or the people that make the make all of that infrastructure, those are some of the less obvious beneficiaries of this transition that we're talking about.

Damien McIntyre

This is what we're talking about, in essence, isn't it? So, when we look at what Munro are trying to do, this is an ESG fund where there are strict rules about this, that, and the other thing. This is really looking at the financial opportunity of climate change. And we've run with a $50 trillion number. Even a $25 trillion number is still a very big number. So, the opportunity financially to benefit from climate change is massive. It's got long tailwinds. And our focus really is to invest in those companies that make climate change happen. Is that the right summation?

Mike Harut

Yeah, absolutely. You know, we don't think of this as an ESG fund, but we do, as I said, for reasons of trying to make better investments, integrate issues like safety at a nuclear power generator or human rights at a battery maker or whatever else is. We integrate all of that into our decision making, but the motivation and the purpose and what we're trying to do is to find the winners from this 50 trillion, according to some hundred trillion investment opportunity and invest in profitable companies who are benefiting from this structural change.

Damien McIntyre

Yes. Well, congratulations. the fund's been very successful in both in terms of investment returns, it's just gone through its three-year track record, it's going very well. We've just launched a sister fund in New Zealand so congratulations to Munro, the message is getting through, the funds are building. Best of luck with reporting season as it's kicked off last week and thanks very much for your time, Mike.

Mike Harut

It's been my pleasure, Damo. Always really fun talking to you. Appreciate it.