

Artisan Partners' Yockey looks to global cleanup theme amid urbanisation

Mark Yockey, portfolio manager on the Artisan Partners Global Equity Team, says the environmental challenges linked to increasing urbanisation globally are opening up a broad range of investment opportunities

The world is experiencing a massive wave of urbanisation, ushering in repercussions both good and bad. Cities can act as powerful engines of economic growth, thanks to their ability to encourage the development and diversification of commercial activities, create jobs, foster social mobility and leverage efficient economies of scale.

However, the resulting growth in industry and consumption comes

along with negative environmental consequences.

Although there are several ways in which urbanisation impacts the environment, the broader discussion often centres on greenhouse gases, which can serve as a useful tool for contextualising the negative effects. The world's cities, while occupying only 2% of the land, manage to generate the bulk of these harmful gases. Culprits include industrial

activities, transportation and the combustion of fossil fuels for electricity.

As urbanisation continues to meaningfully impact populations around the globe, countries are being forced to address the serious accompanying environmental consequences. Three specific pockets where meaningful action is being taken include: cleaner energy and provision of improved water services in China, and on a global scale, the reduction in emissions from cars and trucks.

CLEANER ENERGY

Environmental issues are of particular importance in China, the number one emitter of greenhouse gases in 2012. The Chinese government is advancing its environmental cleanup efforts on several fronts by rolling out initiatives to create and enforce stricter emissions standards.

Part of its focus is on cleaner energy substitution, whereby coal would be partly replaced with natural gas. Chinese gas demand is expected to be broad-based, ranging from needs for residential heating, to use as a transportation fuel. Supply is an equally important part of the picture. In its twelfth five-year plan, which addresses 2011-2015, the Chinese government outlined targets to build out the national gas grid by 50%.

Beijing Enterprises Holdings (BEH) and China Oil & Gas Group

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are positioned to benefit from rising investment in China's natural gas sector. For the past several years, BEH has been aggressively developing its natural gas pipeline distribution business beyond its Beijing base. China Oil & Gas is a smaller player focused on city gas and gas pipeline transmission, with many of its projects in second- or third-tier cities. The company could see additional earnings growth over the coming years as the natural gas penetration rate rises in areas in which it operates.

WATER SERVICES

Water pollution in China is also extreme-nearly 60% of ground water and 30% of surface water is of poor quality. Furthermore, China's renewable freshwater resources are among the lowest in the world while its freshwater demands are among the highest in the world. Sources of water pollution include overuse of fertilizers and untreated industrial discharge.

The Chinese government has implemented several key water-related targets as part of its most recent five-year plan. About \$60 billion was pledged to improve urban wastewater systems. As a result, water treatment capacity is expected to increase more than 60% vs 2010 and the sewage pipeline network is expected to double. China Everbright and Beijing Enterprises Water Group are at the forefront of the government's efforts to clean up the water and waste systems. These companies are positioned to benefit as the fragmented water services landscape becomes more consolidated. Industry consolidation lends itself to pricing power, economies of scale and distribution leverage, all of which can help pave the way for sustainable earnings growth.

CLEANER CARS AND TRUCKS

Emissions from cars and trucks heavily impact human health and the well-being of the planet as a whole, especially in urban settings. Ever-stricter emissions regulations are being rolled out around the globe as countries are forced to address the problem of vehicle pollution.

Demand for more fuel-efficient and cleaner burning autos is being reflected in demand for turbochargers, catalytic converters and other engine products.

Turbochargers are increasingly being used as a means for automakers to substitute a smaller, more fuel-efficient engine for a bigger one, without losing any power output. IHI is a heavy machinery company which generates a meaningful portion of its profits from the manufacture and sale of turbochargers.

The company, which enjoys a 20% market share in the turbocharger segment, is benefiting from steady growth in utilization of turbochargers as a means to combat air pollution.

Catalytic converters are tasked with the job of converting harmful pollutants into less harmful emissions before they leave an automobile's exhaust system. Johnson Matthey and NGK Insulators are focused on the manufacture of catalytic converters.

While each benefits from its own company-specific growth drivers, both are key players in a consolidated market, lending them pricing power, which can be a meaningful competitive advantage.

In conclusion, there are several pockets of attractive opportunities exposed to the long-term trend of environmental clean-up that have the potential to generate sustainable earnings growth in the years to come. ■

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