Impax Asset Management

Newsletter Q4 2010

Overview

Many will remember 2010 as a year marked by economic and financial uncertainty; however the year was a very satisfying one for Impax, with strong asset flows and sustained outperformance across both our Listed and Private Equity divisions. We enjoyed a particularly successful final quarter, as institutional investors from around the globe continued to allocate to the environmental sector and many chose Impax as their investment manager.

In November we announced that Lønmodtagernes Dyrtidsfond Pension Fund of Denmark had appointed us to manage €75 million in a segregated account following our Environmental Leaders strategy. We also attracted further commitments to our second private equity infrastructure fund, Impax New Energy Investors II, a pan-European fund investing in power generation infrastructure assets and growth companies in the renewable energy sector.

Accordingly, we reported on 10 January that assets under management had risen to £2,251 million as of 31 December 2010 and that FY 2010 revenues were up 48% to £15.3 million (2009: £10.4 million), with a profit before tax of £5.2 million (2009: £2.5 million).

We continue to see strong investment performance as a top priority, and our Listed Equity team's long term track record of out-performance of the peer group continued throughout 2010. Whilst European sovereign debt concerns and proposed cuts to feed-in tariffs undermined the valuations of some environmental markets stocks, companies exposed to Asian environmental markets continued to develop rapidly throughout the year, and strong performance from the energy efficiency and waste sectors, combined with increasing corporate activity, lifted overall performance in the latter half.

Our Private Equity Infrastructure team completed the investment programme for their first fund, Impax New Energy Investors I, and made the first investment from Impax New Energy Investors II, through a purchase from the German company Conergy AG.

At the start of 2011, prospects for equity markets continue to improve, and there are tangible catalysts for strong performance of environmental sector investments. Notwithstanding concerns over potential stagflation in developed economies and overheating in emerging markets, a broad economic recovery appears to be underway and investors are currently increasing their exposure to equities. Against this backdrop, we expect that continued disbursement of stimulus spending, rising commitment to energy efficiency as a response to rising oil prices, and further commitment from Asian governments to measures that reduce pollution will drive performance in our portfolios.

Ian Simm
Chief Executive

Listed Equities

Investment Performance

The general performance of the environmental markets sector continued to improve in the fourth quarter of 2010 as macro concerns receded and equity markets showed further signs of stabilisation. Concerns over cuts to feed-in tariffs in continental Europe persisted in hampering the renewable energy sector, but stocks in the energy efficiency, recycling and water sectors outperformed. An increasing number of M&A transactions, escalating IPO activity and strong third quarter results enhanced the performance of all strategies.

Sub-Sector Analysis

Alternative Energy and Energy Efficiency

2010's ongoing theme of a strong energy efficiency sector and a weak renewable energy sector was sustained during the fourth quarter of the year.

Some capex-intensive late cycle companies driven by capital expenditure in the energy efficiency sector continued to perform well as new order inventory data indicated an ongoing industrial-led recovery in the global economy. In Asia, business technology capital expenditure in data centres led to strong performance from energy efficiency companies Delta Electronics (Taiwan) and Murata (Japan). Murata was also supported by a weakening of the Japanese Yen and greater visibility on the outlook for the capacitor market.

Significant corporate activity further boosted the energy efficiency sector, with a number of Impax portfolio companies involved in mergers and acquisitions. For example, Invensys (energy efficiency, UK) outperformed following takeover speculation relating to a Chinese rail partner.

Weakness in the renewable energy sector persisted due to sovereign risk in Europe, concerns over interest rate increases in China, feed-in tariff (subsidy) reductions in key markets, low power prices and structural industry overcapacity. Weak performers were EDP Renovaveis (wind IPP, Portugal) on sovereign debt concerns and Sunpower (solar, US), on concerns over feed-in tariff reductions.

Valuations in this sector have derated substantially but we are waiting for more evidence of recovery before increasing our exposure to renewables.

Water Treatment and Pollution Control

The water treatment and pollution control sectors performed well in the final quarter of 2010, buoyed by positive US industrial data and M&A activity in the environmental testing and sensing market.

US stocks Pall Corporation (filtration) and Thermo Fisher Scientific (environmental monitoring and testing) were strong performers, the former on perceived takeover interest and the latter following its proposed takeover of competitor Dionex.

In Japan the weakened Yen and an improving outlook for the technology and semiconductor sectors supported the performance of Horiba (pollution monitoring and testing) and Kurita (water treatment).

Water utilities lagged the broader 'industrials' outperformance during the period with relative underperformance from California Water (US) and Veolia Environnement (France). Regional economic and financial concerns weighed on Indian companies IVRCL Infrastructure and Jain Irrigation (both water infrastructure).

Waste Technologies and Environmental Support Services

The waste technology and environmental support services sectors performed well due to increasing commodity prices, growing comfort on economic growth prospects, relatively cheap valuations and an increase in M&A activity. For example, Stericycle (clinical waste management, US) rose on solid core business growth, small acquisitions and price increasing opportunities.

Recycling companies were particularly strong performers, as demand from emerging markets strengthened scrap metal prices. Sims Group (metals recycling, Australia) outperformed on robust scrap metal pricing derived from increasing demand in China for iron ore.

Nevertheless, there were pockets of weakness - Republic Services (general waste management, US) underperformed due to uncertainty about volume recovery and Lee & Man (paper recycling, China) suffered from price cuts relating to the sovereign debt crisis in Europe.

Bruce Jenkyn-Jones
Managing Director, Listed Equities

Focus on Energy Efficiency

Reducing energy use by investing in more efficient products and processes is highly attractive to corporate customers and governments, both of whom are keen to minimise the energy costs without making significant changes to established systems.

The energy efficiency sector performed strongly throughout 2010, as rising markets strengthened corporate balance sheets and provided the upfront capex cost of installing products and systems to improve energy efficiency. As the world economy and financial markets continue to recover in 2011, we believe the sector is poised for continued outperformance, with particularly compelling opportunities in the power network efficiency, industrial energy efficiency, buildings energy efficiency and power electronics sub-sectors.

Power network efficiency is most advanced in the US, where utilities follow a fully integrated distribution model which incentivises them to install smart grids to improve supply and provide better tariffs. For example, Itron (US), the world's leading provider of intelligent metering and data collection solutions, recently announced record nine-month revenues of $1.6 billion and quarterly bookings of $528 million. In Europe, overloading of the renewables grid is propelling renewed investment in upgrades, whilst countries in the Asia-Pacific region are integrating smart grids and meters into initial power grid roll out – thereby 'leapfrogging' developed economies which need to integrate them into an older infrastructure. The industrial energy efficiency sector in the Asia-Pacific region is set for sustained strong performance, led by companies such as China High Precision Automation, which provides materials for the automation of industrial processes.

A recovery in the construction cycle (anticipated in the second half of 2011) is likely to generate improved performance from the insulation and heating system sector, which lagged other energy efficiency sub-sectors in 2010. The light emitting diode (LED) market is set to account for 80% of the total lighting market by 2020, with companies such as SemiLEDs, a Taiwanese company specialising in the development and manufacturing of metal alloy vertical LED chips, a potential long term outperformer.

With little or no dependence on government subsidies, huge economic advantages and a diverse range of sub-sectors, energy efficiency is expected to remain a favoured investment area across Impax's investment strategies.

Lee CLements
Investment Manager, Listed Equities

Private Equity

Market Update

The renewable energy sectors in Europe, particularly onshore wind and solar, continue to grow rapidly. As these markets mature, investors in downstream power generation are benefiting from declining wind turbine and solar panel prices and the economies of scale of larger projects. The Impax private equity infrastructure team seeks to take advantage of this significant market opportunity.

The renewable energy sector is also enjoying an active financing market and the Impax team continues to receive indications of financing on attractive terms. Funding costs for new investments are estimated to be roughly the same as (or lower than) in 2008, as long term swap rates have declined while lender's margins have increased.

Impax New Energy Investors I LP

"NEF I"

Launched in 2005, the €125 million NEF I Fund invests in onshore wind, solar PV and solar thermal projects across Europe.

The Fund is actively managing investments, with only an Italian solar programme to be completed. We consider Italy to be an attractive market for solar, and, during August, NEF I acquired an Italian project company with the right to build 9MW in the Lazio region, which will begin construction this summer. In addition, in November, NEF I invested in a solar company developing 10.9MW in Puglia. These commitments have provided the portfolio with further diversification.

In parallel, during calendar year 2010, NEF I's portfolio of Spanish solar projects again beat its budget and produced an attractive cash yield. At the time of writing, we are analysing the implications for NEF I of a new Royal Decree passed in Spain on 23 December 2010, and ratified by the Spanish parliament on 26 January 2011, to cap the subsidies to solar power generators. Meanwhile, we expect to complete Final Acceptance Testing for these assets during the first half of 2011.

Impax New Energy Investors II LP

"NEF II"

The Impax private equity infrastructure team is now investing from Impax's second private equity fund, NEF II. The Fund is currently capitalised at €275 million having had its most recent close in December.

The Fund will invest in independent power companies and projects in Europe, applying the same investment strategy as NEF I but on a larger scale, taking advantage of the significant increase in opportunities and project size as the market has developed.

In December the team completed the first investment for NEF II through the purchase of 23MW of operating wind farms from the German company Conergy AG, as well as a business with a development pipeline of 93MW in Germany and 285MW in France, some of which we expect to be ready for construction in 2011. We expect to use the business as a platform for growth in these markets.

Peter Rossbach
Managing Director, Private Equity

Contact Information clientservices@impax.co.uk | +44 (0) 207 434 1122 | www.impax.co.uk