



Tottiford Reservoir,  
Exeter, UK  
Photo: Unsplash

# Weather extremes and microplastics: do water sector challenges hold an opportunity for investors?

Climate change and environmental pollution pose enormous challenges for water companies. At the same time, the billions of investments needed to secure a more sustainable, future-proof water supply offer opportunities for investors.

Globally, heat and drought records are being broken every summer. Meanwhile, we increasingly witnessing disastrous floods in the news, often triggered by unprecedented heavy rainfall.

## **EXTREME WEATHER, MICROPLASTICS, PFAS**

The extremes of drought and flooding place enormous pressure on water companies. Increasing drought frequency and intensity increases the importance of utility companies ability to ensure the supply of clean drinking water. Increasing rainfall intensity and flooding places enormous pressure on outdated combined sewerage systems, impacting the capacity of utility companies to effectively deal with and safely discharge wastewater.

Environmental pollution also makes water management more challenging than ever. More and more is becoming clear about the harmful effects of microplastics and PFAS, the ‘forever chemicals’ that make pans and rainwear water and dirt repellent, among other things. The potential costs to human health are downright worrying: one study estimated the health costs associated with PFAS at €52 - €84 billion per year, in Europe alone.

### SELECTION OF PUBLICLY TRADED WATER COMPANIES

Currently, around a third of the assets of the ASN Milieu & Waterfonds are invested in companies that provide solutions, products and services in the field of water infrastructure and treatment. These also include the utilities themselves, including well-known names such as American Water Works, the market leader in the US, and the British Severn Trent Water. It’s a select group since not all water utilities worldwide are publicly traded.



*A worker at American Water Works*

### MARKET-DRIVEN INVESTMENTS

The water sector will need to make huge investments in the coming years to become climate resilient. In the UK, this includes investments in ageing infrastructure as well as new purification methods and technology to monitor water quality. In countries where water management has been privatised, such investments are regulated but generally not funded by



*Severn Trent -  
Clywedog Reservoir*

*Veolia water purification*

the government. This requires significant support from the capital markets, especially when the need for capital expenditure and infrastructure improvement is increasing. The fund has significant exposure to those water infrastructure and technology providers as well as the water and wastewater companies that manage this precious resource.

#### **WATER AND THE ENVIRONMENT: INEXTRICABLY LINKED**

Water management is no random theme for the ASN Milieu & Water Fund. Access to clean water is one of the UN's Sustainable Development Goals and an essential part of the sustainable future SN Impact Investors aims to create. Moreover, water is deeply interconnected with natural ecosystems and biodiversity.

"It's an important complement because the environment, water, and climate are inextricably linked," says Milan Schut, fund manager of the ASN Milieu & Water Fund. Schut takes pride in this segment of his portfolio. "We invest in promising companies that offer technologies and systems providing solutions to global challenges in water, resources, and energy. These companies are active in diverse sectors: renewable energy, recycling, and sustainable management of waste, food, and agriculture."



"When we started our strategy in 2001, environmental technology was still a relatively new and volatile market for investors. That's why it made perfect sense to balance it with a defensive position in a more mature sector—water treatment—that also aligned with the fund's environmental mission."

#### **THE UPSIDE OF WATER: PREDICTABLE REVENUES**

Regulated water utilities have traditionally been viewed as defensive investments with stable earnings. While this may be true, there is significant upside potential for these companies due to the increased level of investment required to mitigate the risks of supply constraints and infrastructure improvements. In addition to the utilities themselves, companies that provide water infrastructure and treatment solutions and related services will also benefit from the challenge of providing sufficient clean and safe water.



With specific reference to the UK water utilities, capital programs are pitched to and adjusted by the regulator ahead of each five-year regulatory period. This expenditure allows each company to grow their regulated asset base, upon which an allowed return is applied. Companies outperform or underperform against their allowed returns based on performance against many metrics including but not limited to environmental performance.

### SUSTAINABLE INVESTMENT UNIVERSE

At ASN Impact Investors, every investment is carefully selected for its contribution to sustainability, human rights, and good governance. Schut explains: “When a water utility passes our rigorous screening process and is admitted into our sustainable investment universe, you can be confident that it ranks among the most sustainable and well-governed in its sector.”

“For instance, if a utility is involved in both water and gas supply, we exclude it because we don’t invest in fossil fuels. However, if water treatment produces biogas, we certainly welcome that.”

Behind the apparent simplicity of water lies a complex world that has been dramatically reshaped in recent decades by major environmental and climate challenges.

### BRITISH PIONEER IN SUSTAINABLE ASSET MANAGEMENT

For the Milieu & Water Fund, ASN Impact Investors has been working with the British asset manager Impax, itself a pioneer in sustainable investment with a long track record, since its inception. Justin Winter is Schut’s counterpart there. He has a deep knowledge of the investment opportunities of the water sector.

Winter: “It’s actually quite simple: the earth is getting warmer, and warm air can hold more water. When that water condenses, it rains harder. Here in England, we’ve just experienced the wettest winter in decades, with sewers occasionally overflowing into surface water. Naturally, as a water utility, you want to avoid these kinds of spills or, at the very least, minimize them as much as possible and our companies are at the forefront of the push to reduce them. For example, Severn Trent are pushing to go beyond the UK Government’s imposed targets on this issue, striving towards halving its usage of storm overflows by 2030.”



### SENSOR TECHNOLOGY, DATA-DRIVEN MANAGEMENT

“The innovations required to purify water and prevent leakage among consumers and business customers also demand significant attention. Think of smart water meters and sensor technology that allows you to monitor water quality and where leaks occur in real time. As with other industries, the leaders in the water world are increasingly managing their networks through data-driven approaches, and recently, through the use of “digital twins”. If AI can help you better predict heavy rainfall, you can prepare and respond accordingly.”

### REDUCING CO<sub>2</sub> EMISSIONS

“As with all investments, we also pay close attention to the CO<sub>2</sub> emissions of the water companies and whether they are able to reduce them at a pace fast enough to meet the Paris Agreement climate goals. Bear in mind that treating and transporting water will always consume energy, so reducing CO<sub>2</sub> emissions is a top priority of the water companies we select. With the biogas from their own purification plant they can generate electricity, if they remove substances such as phosphates from the water and market them, this also contributes to CO<sub>2</sub> reduction. The British sector for instance has the ambition to operate net zero by 2030.”

### THE OPPORTUNITY OF PFAS

A rapid increase in spending to clean up PFAS pollution and reduce levels in drinking water is now expected in major developed economies. As more money flows from governments and polluters to tackle PFAS in the coming decades, many opportunities will arise for companies that offer solutions. As alternatives to the forever chemicals are developed, the need to reduce PFAS levels in water and soil will only become more urgent. Impax’s water experts believe this creates an opportunity for investors to focus on leading companies in water testing and treatment, and on innovations that will make PFAS problems a thing of the past.



*Severn Trent - Upper Derwent Valley*

## PARTICIPATING IN AN INDISPENSABLE SECTOR

For investors, the sector's capital needs create new opportunities to share in the returns of the essential water sector of the future. Publicly listed players are issuing new shares and also raising debt to finance these investments. "For the British companies, this means adhering to the balance sheet requirements set by regulators. Regulated water utilities offer more certainty regarding demand and investment needs compared to other sectors such as energy that are experiencing disruption in the energy mix. This can make water utilities an attractive investment for investors looking for stable returns, such as pension funds, provided there is regulatory certainty."

## LONG-TERM INVOLVEMENT AS A SUSTAINABLE INVESTOR

Despite some concerns regarding the ability of the sector in general to raise the necessary means to increase investments in the upcoming regulatory cycle, the highest quality companies retain significant interest from the capital markets. For example, Severn Trent Water's most recent share issuance of over £1 billion was heavily oversubscribed last autumn, Winter explains. "This allowed ASN Impact Investors to maintain its position. It helps when you've been involved in the sector for such a long time as a sustainable investor."

Winter: "In general, we look for companies with strong governance and excellent management. These are the right parties to invest in a climate-resilient future in which water remains accessible, safe and affordable for everyone."

## £104 BILLION INVESTMENT AGENDA

British water companies face a monumental challenge in the coming years: ensuring safe drinking water and cleaner rivers and coastlines. This requires addressing aging infrastructure and upgrading sewer systems to cope with a wetter climate, which comes at a significant cost. The investment agenda for British water utilities is set in consultation with regulator Ofwat for five-year periods. For the upcoming period, starting in April 2025, Ofwat has confirmed that £104 billion will be spent on increasing water supply, upgrading wastewater systems, tackling emerging contaminants and updating aging infrastructure. Justin Winter from Impax sums it up. "Fortunately, there's no debate over one fundamental issue: every person wants clean, safe drinking water, and everyone has a right to it."

This fund is a subfund of the investment company with variable capital ASN Beleggingsfondsen UCITS N.V.. The manager is ASN Beleggingsinstellingen Beheer B.V., which holds a licence as referred to in Section 2:69b of the Financial Supervision Act (Wft). ASN Beleggingsinstellingen Beheer B.V. and ASN Beleggingsfondsen UCITS N.V. are entered in the register of the Netherlands Authority for the Financial Markets. The Key Information Document (KID) and the prospectus for this fund, together with more information about the fund, the costs and the risks, can be obtained free of charge from [www.asnimpactinvestors.com](http://www.asnimpactinvestors.com). Read the prospectus and KID before you decide to invest in this fund. This statement should not be regarded as an offer or investment advice. The returns stated relate to past results. The value of your investment may fluctuate. Past performance is no guarantee for the future. The information in this publication has been derived from sources that we consider reliable. No rights can be derived from this information. The manager is not liable for damage of any kind resulting from incorrect or incomplete information. Morningstar Rating: ©2024 Morningstar. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers, (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results. For more detailed information about the Morningstar Rating, including its methodology, please go to [www.morningstar.com](http://www.morningstar.com)