

The Green Lining

Seven Themes in COVID-19's Sustainability Proposition for Investors

COVID-19 may well have a “green” lining. The pandemic environment created, in ways, a more sustainable world. The elimination of many daily commutes and nonessential travel lowered CO₂ emissions, while lockdown orders prompted many to rely on local food sources more than ever before. What’s more, consumers’ appetite for more sustainable products and services not only endured through COVID-19 – in some cases, it actually accelerated.

These trends are converging and creating a re-energised, vibrant environment for sustainability. All require sweeping changes to how the world consumes energy, travels and thinks about wellness and well-being. In Baird’s view, these trends are accelerating the shift to more sustainable business models and creating compelling investment opportunities in key sectors.



Energy

The convergence of “greener” public policy and consumers’ increasing interest in sustainability is fueling a shift in the global energy mix. Climate-focused headlines and digital technologies are empowering consumers to monitor and manage their energy usage. Meanwhile, policy developments are becoming decidedly greener. Last year, Britain accelerated several “green” policy initiatives such as a ban on the sale of new petrol- and diesel-powered cars and a £12 billion plan to expand offshore wind, hydrogen and nuclear power. Infrastructure must evolve to support these trends. Companies with technologies and services that can support this transition will be poised for growth as this macro theme continues to unfold.

SMART GRID AND SMART METERS

The global energy mix is evolving in real time, and its dramatic, expedient transformation requires an equally dramatic investment in energy infrastructure. As our Baird Capital team has discussed, a demand for sustainability and the emergence of new, compelling technologies are driving change across the energy market.

One answer to the ever-increasing demand for

sustainable energy solutions is the smart grid – one that can respond quickly to changing electric demand, add resiliency and better integrate large-scale renewable energy systems with intermittent generation.

Andy Dyer, Director for Baird Capital, sees the driving forces around smart grids creating demand for an assortment of related technologies and services. “Controls, increased interconnections, battery storage, solutions that offer integration and automation of

communication between utilities and customers – these are the necessary ingredients for cities and communities powered by smart grids.”

Dyer says that the smart grids, in turn, will enable improved integration of customer-owned generation and storage systems – which could allow, for instance, households to sell solar energy back to the grid.

“Smart meters are an integral part of the smart grid revolution. Customers understand the

benefits of more mindful consumption and network operators need those customers to better manage energy supply and demand. It becomes a win-win."

A growing number of state and federal governments are implementing rules on smart meters. The U.K. government, for example, is requiring that energy suppliers roll-out smart meters to all homes by 2024. The mandate is driving demand and action on the part of business.

These developments will enable devices in smart buildings and smart cities. So called "Internet of Things" or "IoT" plays a big role here. IoT-enabled heating, ventilation and air conditioning (HVAC) systems can conserve energy and increase comfort, creating "smarter" buildings and generating energy savings for tenants and owners. Meanwhile, IoT enabled appliances, including LED lighting, window blinds, air conditioners and central heating systems, allows consumers to reduce energy consumption by turning off heat and lights when away from home. Wireless

sensors and networks allow buildings to be retrofitted at a lower cost and without damaging existing infrastructure, while small appliances such as smart power strips can automatically switch off office equipment at the end of the day. These applications represent a compelling, emerging use case for IoT-enabling technologies and sensors such as LoRa, developed by Semtech, and cellular IoT technologies such as CAT M and NB-IOT (Sequans).

LED lighting is a compelling case study in the potential impact of IoT-enabled appliances. It not only consumes less energy – when enabled with sensors, it can reduce energy waste in unused rooms. The LED lighting market is experiencing growth as a result of the transition from incandescent lighting to energy-efficient LED options. Baird Capital recently exited its investment in Collingwood Lighting, a leading designer and supplier of residential and commercial luminaires in the U.K. and France. The team invested in the business in 2018 as part of its energy efficiency investment

thesis. During the team's hold period, Collingwood grew at more than 11% CAGR and doubled its adjusted EBITDA.

AUTOMATION AND IOT TECHNOLOGIES

Now more than ever, businesses are recognising and incorporating automation and IoT into their processes. Not only do both afford potential operational efficiencies – they present unique sustainability opportunities.

Warehouses are a highly relevant example of these themes. Many of these facilities still rely heavily on manual solutions and physical labour, but the rapid rise of eCommerce during COVID-19 underscores the opportunity – and arguably, need – for automation technologies to help meet strong consumer demand and do more sustainable business. Automated facilities can be set up to reduce waste, be more energy efficient and leverage data analytics to inform future business decisions, thus having a positive environmental impact.

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Rob Mason
Senior Equity Research Analyst
Baird

Meanwhile, the proliferation of distributed, connected devices (such as IoT sensors and edge gateways) across the industrial domain (among others) is enlarging the digital surface area in which software (such as artificial intelligence or AI) can optimise and automate business processes. This convergence of IoT and AI is giving way to and catalysing “AloT.”

According to Erich Fritz, a senior investment banker in Baird’s Global Technology & Services Investment Banking group, it’s only recently that AloT has begun to transform businesses, optimise processes and create quantifiable economic value. “Looking back the past three, five, ten years, IoT was prematurely hyped to some extent. You had a pretty unstructured, fragmented marketplace, creating an abundance of data for monitoring and visualisation but without the ‘last mile’ of analytics, thus limiting business value. It’s only been in the last few years that we’ve seen tangible ROI in the form of process and yield optimisation, cost savings and a reduction of wasted materials in the manufacturing sector, for example. That’s what’s been so exciting to see: with the emergence of AI, IoT has evolved from a data collection to a value creation initiative with the ultimate use case expanding beyond the collection and storage to the application (e.g., digital twins, machine health)

and monetisation of captured data. I’m looking forward to seeing AloT’s increased impact to the sustainability movement in the years to come.”

Fritz notes that pent-up demand, a greater awareness among market participants (partly accelerated by COVID) and other market tailwinds all point to robust AloT investment and deal-making in the years to come.

The connectivity technologies underpinning all of these technologies is also rapidly evolving. In the industrial sector, companies are just beginning to leverage the benefits that new 5G- and WiFi 6-powered wireless networks provide by creating enhanced connectivity. While these new technologies are largely devoted to facilitating high-bandwidth communications and solutions today, Baird expects them to emerge in lower bandwidth applications, namely low-bandwidth IoT applications in the coming years – which will fuel the sustainability theme in the market.

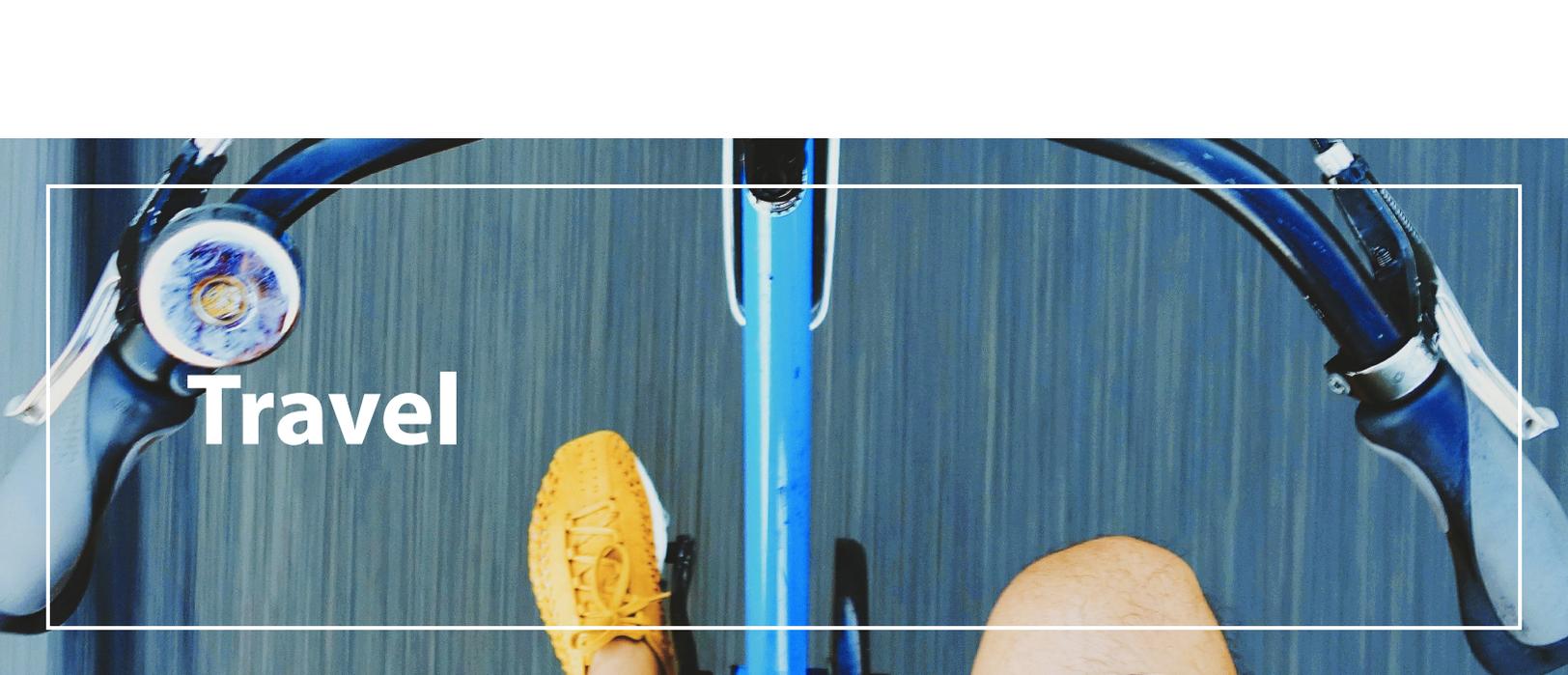
These new network capabilities are arriving precisely at a time when industrial companies are also increasing their focus and efforts to make operations more flexible, resilient, automated, productive and digitised. While wired industrial networks perform capably, legacy wireless networks have contained deficiencies in bandwidth,

latency and the number of connections supported, which has hampered widespread adoption of industrial IoT and Industry 4.0.

New 5G and WiFi 6 wireless networks are not encumbered with these constraints and also offer the ability to cost effectively capture data from a wider variety of assets than wired networks. Baird expects this will drive increased data generation captured from the “shop floor” by facilitating more connected edge/IoT/mobile devices. Advanced analytics can be used to leverage this larger pool of data and offer deeper, broader and real-time operational insights for industrial users to achieve digital transformation goals.

“The demand for industrial IoT has really picked up coming out of the pandemic, and it’s helping to create a sense of urgency around digitising the shop floor,” said Rob Mason, Senior Equity Research Analyst at Baird. “We’re seeing a convergence of supply and demand. Connectivity technologies are becoming more widespread and commercially available, which then supports and strengthens the demand and investment case for that technology. This sort of synchrony is opportunistic, and we see it as a significant trend that will play out in the years ahead.”

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Travel

While global travel plummeted in 2020, the industry is beginning to stir once again – and there are signs that its sustainability movement endured through the pandemic. “This crisis is an opportunity to rethink the tourism sector and its contribution to the people and planet; an opportunity to build back better towards a more sustainable, inclusive and resilient tourism sector that ensure the benefits of tourism are enjoyed widely and fairly,” said Zurab Pololikashvili, Secretary-General of the UN World Tourism Organization. Companies with services and solutions focused on key trends will be positioned to capitalise on the evolving environment:

VIRTUAL MEETING PLATFORMS

While air passenger numbers and leisure travel bookings are on the rise, business travel remains quite restrained. As of the end of Q1 2021, corporate travel has yet to pick up in a significant way. Many large corporates continue to hold employee travel restrictions in place. A migration “back to the office” must take place before business travel can return to pre-pandemic levels.

Baird’s Equity Research team expects a broader resumption

of business travel to come in the second half of 2021, but some larger companies could be slower to lift restrictions on employee travel. The new normal of the virtual meeting, replacing the in-person meeting, has spurred further demand for certain technologies.

Tristan Gerra, Baird Senior Equity Research Analyst covering semiconductors, says: “Think about how many of our physical, face-to-face work meetings – typically accompanied by some type of travel – have now been

replaced by a video call. It’s transformed the way we work, and that genie is not going back in the bottle.

Gerra continued, “With that increased use in computer-related video calls comes a boost in demand for internet backbone semiconductor components, including PON optical components, servers (computing, switches, storage), and video sensors. Semiconductor investments pertaining to these technologies most notably

include Broadcom, Intel, AMD, Semtech, and Western Digital.

Baird believes these platforms have additional runway for growth as work-from-home arrangements persist and business travel remains subdued.

THE EVOLUTION OF BUSINESS AND LEISURE TRAVEL

After a year-plus of tight travel restrictions, many consumers are eager to book holidays away from home. In the U.S., consumers buoyed by strong savings and recent stimulus checks are spending more dollars, and as a result, consumer sales growth has been robust. Meanwhile, data from the U.S.'s Transportation Security Administration show that throughput volume continues to grow and many airlines are adding additional routes to new and existing leisure destinations. While international travel remained quite restricted in the U.K. at the

end of Q1, the recent easing of certain lockdown rules opened up the possibility of "staycations." The restrictions around foreign travel are slowly being lifted but remain under constant review by Downing Street.

According to Michael Bellisario, Senior Equity Research Analyst covering global hotel brands and hotel REITs, the pandemic didn't quell calls for more sustainable travel options – in fact, it may have accelerated the sustainable travel movement. "Corporate ESG efforts (and related disclosures) are on the rise, and we're seeing hotel brand companies, property owners and investors increasingly lean into the sustainable travel movement."

Bellisario points to one notable example: a particularly robust ESG program from Host Hotels & Resorts (HST), the largest publicly traded hotel REIT. According to Host's 2020 Corporate

Responsibility Report, it has invested more than \$45 million in distributed energy systems, such as co-generation, since 2015 to decrease its portfolio's reliance on district utilities and increase its energy resiliency. The company is pursuing a number of ambitious 2025 environmental targets in its portfolio and is on track to achieve a 55% reduction in greenhouse intensity per square foot, a 25% reduction in energy intensity per square foot, and a 25% reduction in water consumption in occupied hotel rooms. Host is also pursuing a meaningful increase in the use of renewable energy for its properties' energy needs.

Bellisario also noted actions by several airlines pursuing a number of eco-friendly initiatives of their own, including a push for greener fuels and working toward achieving a carbon-neutral footprint.

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Michael Bellisario
Senior Equity Research Analyst
Baird

“Industry players that lean into this broader sustainability trend stand to write strong growth stories as the industry emerges from this pandemic environment. We expect industry leaders to be on the forefront of offering more innovative itineraries, including fewer port-to-port options, embracing near-term demand for domestic travel like staycations while foreign travel remains restricted and introducing new options for sustainability-minded travelers, such as an option to purchase carbon offsets for air travel.”

Travel providers will likely need to retool their customer acquisition strategies in a post-pandemic world. Tour operators and travel agents in particular may need to rethink their strategies. According to our analysis of data from CapitalIQ and Bloomberg, these companies could take up to 60 months to fully recover to their 2019 revenue levels. Cruise lines and airlines are a close second at 59 months, while hotels are expected to recover to pre-pandemic revenues in 33 months.

A growing body of third-party service providers offer vital assistance around marketing, digital presence and related channels to help travel companies acquire new customers and drive much-needed bookings to

help offset the pandemic’s low hotel occupancy levels and partially empty flights. Service providers with strong offerings – particularly those with a comprehensive platform of services – are poised to gain market share post-COVID.

OUTDOOR RECREATION

Running parallel to these shifts in leisure travel is the trend of consumers turning to nature for recreation. With COVID severely limiting many types of trips, large numbers of consumers rented caravans or recreational vehicles (RVs) and booked campsites to spend time with family and socially distance in the great outdoors. Campers flooded national parks and long-time caravan owners connected with first timers looking to give life on the road a shot – and many of them loved it.

According to Thor’s 2020 U.S. RV Rental Study, as many as 73% of RV renters would strongly consider making a permanent lifestyle change by purchasing an RV. Meanwhile, online platforms such as Outdoorsy, which links caravan/RV owners with people who would like to rent one, saw major upticks in demand during the pandemic. Outdoorsy alone saw bookings skyrocket 4,500% during COVID-19, and 90% of its 2020 renters were first-time bookers.

Craig Kennison, Baird’s Senior Equity Research Analyst covering consumer and automotive services said, “We expect sustained interest in the outdoors, forcing retailers to scramble for inventory. In a recent Baird poll of caravan retailers, over 90% reported extreme shortages, an all-time record.”

Manufacturers are trying to catch up, but new caravans are sold as soon as they arrive in showrooms – causing massive order backlogs. According to SEC filings, Thor’s European caravan/RV backlog increased 132% from January 2020 to January 2021 – and many expect production to remain strong well into next year. “With surging wealth, unprecedented stimulus, and flexible work schedules, we expect demand to stay stronger for longer,” added Kennison.

[CONTINUE TO WELLNESS INSIGHTS ►](#)

A close-up photograph of a person's eye, looking slightly to the right. The eye is brown and has dark, well-defined eyelashes. The skin around the eye is fair with some freckles. A bright orange, textured substance, likely face paint or a cosmetic product, is applied to the skin around the eye and on the cheek. The word "Wellness" is overlaid in white, bold, sans-serif font on the left side of the image.

Wellness

COVID-19 prompted consumers to re-evaluate certain values in their buying decisions – for example, safety, hygiene, wellness and a desire for quality time with loved ones – and this reconsideration is likely to cause a longer-term shift in spending priorities. Boris Partin, senior investment banker from Baird’s Global Consumer team, completely underscored this sentiment, noting, “A CEO of a large international business just said to us in a meeting the other day, ‘Our firm won’t even consider an acquisition if the target isn’t sustainable.’” Indeed, companies that understand the permanence of this shift in the consumer’s mindset will be well-positioned in the post-pandemic environment.

CYCLING

The shift in consumer mindset also elevated the profile of self-care, mental health and well-being, and preventative health. Cycling has emerged as a fast-growing sector that is increasingly popular with consumers. The pandemic accelerated a number of structural market trends that underpin the cycling space, including sustainability, consumers’ increased focus on fitness, and the growing interest in micro mobility vehicles such

as bicycles, electronic (“e”) bikes and scooters. While the cycling market will likely benefit from this increased popularity for some time, companies that are structured to compete in an eCommerce world stand to emerge as winners.

Our Global Investment Banking team recently advised Canyon on its sale to GBL in December 2020 – a transaction that illustrates these dynamics. Most cycling manufacturers employ a traditional indirect selling model to get bikes

to consumers, with product moving from manufacturer > importer/distributor > bike shop > consumer. Canyon completely disrupted the industry by going direct-to-consumer via its own website, and has now grown into the largest, fast growing DTC operator worldwide.

Senior investment banker Boris Partin, who worked on the Canyon deal, further emphasises this hot spot in the market. “Consumers have really embraced cycling over the past year and will continue to do

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Boris Partin

Investment Banker – Director
Baird

so going forward. People will continue to take part in activities that are good for them, are close to home and that can be done individually versus in a team sport or group environment where there might be an infection risk. Coupled with the broader sustainability and micro mobility trends, it is easy to see why cycling has become a very attractive category for investors.”

BEAUTY & WELLNESS

The shift in consumer mindset is also fueling a number of long-term trends in the beauty and wellness space. Pre-pandemic, there was a growing demand from consumers – particularly millennials and Gen Z – for more sustainable product offerings, reduced waste in beauty packaging and enhanced use of water-optimising formulas. While COVID-19 drove near-term demand for hygiene-driven features such as disposable or single-use packaging, Baird is now seeing a renewed focus

on sustainable packaging and reducing the overall carbon footprint in the manufacturing process for beauty products.

Similar to trends in the food & beverage space, Baird expects the beauty & wellness market’s focus on “clean” to continue post-COVID. Lauren Leibrandt, a senior investment banker leading Baird’s coverage of the beauty and wellness sector says, “In many ways, the sector is moving from ‘clean’ to ‘conscious’. Consumers are increasingly focused on products that are good for me, my community and the planet. This shift was underway prior to the pandemic. One might think that COVID would slow or suppress that evolution, but it hasn’t at all.”

Leibrandt is also quick to note that consumers are much more sophisticated today. Safety, ethical sourcing and transparency of ingredients are highly sought-after attributes. While “clean” (and natural, vegan, cruelty-free and/or organic)

products still command significant mindshare, there is an increasing understanding that just because an ingredient is synthetic does not mean it’s harmful, and just because an ingredient is natural does not mean it’s “good.”

“Products with science-backed ingredients, clinical trials proving efficacy and an association with a doctor / dermatologist are gaining significant traction,” says Leibrandt. Consumers expect more from the beauty and wellness products they purchase, and the companies that understand the implications of consumers’ heightened expectations and incorporate it into their product development, manufacturing and marketing practices stand to capture market share as the global economy emerges from COVID-19.

To discuss these themes, their implications for your business or other topics, email sustainability@rwbaird.com.

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