White Paper
Fundamental Growth and Core Equity

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Investing in Sustainable Growth

Q4 Newsletter

STATE STREET GLOBAL ADVISORS

Contents

Recession is Coming: Stay With Quality

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In the wake of three consecutive quarterly declines, global equity markets rebounded in the fourth quarter to provide a positive footnote to the volatility narrative that played out through 2022. In a year marked by persistently high inflation, equities experienced volatility as central banks intervened with an intensive program of quantitative tightening, reversing the monetary policy that had encouraged loose financial conditions for over a decade.

Economic uncertainty had a negative impact on market multiples in 2022. While we expect more monetary policy tightening early in 2023, focus will eventually pivot towards timing the rate cycle peak. In a soft landing scenario, equities will ultimately benefit from lower inflation and an expectation of easier monetary conditions as economic conditions worsen and recession takes hold.

As we prepare for a volatile year in financial markets, our philosophical alignment with Quality will be a key defensive element for our Strategies. High quality businesses demonstrate pricing power, leading market positions, strong balance sheets, and a sustainable growth profile. Holdings that exhibit strong quality metrics may reflect sustainable margins, better control over their supply chains and better financial resiliency should a hard landing scenario unfold.

While the backdrop for 2023 may be volatile, we continue to identify opportunities in the current environment that satisfy our investment criteria and should support the generation of alpha over the long term. In our first article, we explore the investment potential in businesses that disclose Scope 4 Emissions and enable the net-zero[1] economy. Our second article takes a closer look at how a specific company, Experian, has been executing on an innovation strategy to transform their operating model and what the impact is on its growth outlook.

Avoided Emissions: Enablers to a Net-Zero Economy

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Research Analyst

The Paris Agreement set an ambitious target to limit the increase in global temperature to well below 2 degrees and to pursue efforts for a 1.5 degree temperature increase by the end of the century. However, as per the latest reports from the Intergovernmental Panel on Climate change (IPCC),[2] human activities have been estimated to have caused a 1 degree rise in temperature already.

This rise in temperatures is alarming as climate scientists believe that achieving Paris Agreement goals is the last resort to protect the world from climate catastrophe. To achieve this target, an approach beyond business-as-usual will be required; we cannot solely rely on existing businesses reducing their emissions. Instead it will require innovative and disruptive offerings by companies that do not just reduce their own emissions, but also help other businesses lower their overall emissions. Such innovative products or service offerings, by virtue of their usage or performance, help reduce and/or avoid emissions that would have otherwise been produced.

Avoided emissions are emission reductions that occur outside a product's life cycle or value chain but result from the use of that product. Other terms used to describe avoided emissions include climate positive, net-positive accounting, and scope 4.[3] It gives organizations a pathway to report on more efficient products (goods and services) replacing less efficient alternatives.

The Importance of Avoided Emissions for Companies

Avoided emissions have become important for an organization in assessing their overall environmental footprint, which enables them to identify and develop better sustainability strategies. Companies that have an understanding of their scope 4 emissions are better placed to make informed investment decisions in sustainable projects and hence have a better assessment of profitability from such investments. In order to best manage their environmental footprint, companies are typically either redesigning their existing products or services, or creating newer innovative ones.

An estimate of avoided emissions is particularly useful in the product design phase where actual modifications can be done to reduce the overall footprint of the products that will be manufactured. Such estimations will make companies more competitive in the supply chain and lead to development of low-carbon or carbon-free product lines.

As climate emergency becomes more imminent, there will be increasing pressure on businesses to reduce their emissions drastically in a short period of time. Relying on increasing efficiency of existing products alone will not be sufficient to bring about deep emissions reductions. Companies will not only have to develop products that are themselves emissions free, but also help other companies reduce the overall footprint of their products. Estimating the avoided emissions from these innovative products will give an better picture of the level of decarbonization achievable in the future.

Examples: Companies Disclosing Avoided Emissions

Air Products and Chemicals Inc.

Air Products and Chemicals Inc., an American provider of essential gases and chemicals for industrial use, discloses avoided emissions based on the emissions reduction caused by usage of its products at the customers' end. It enables its customers to be more productive and efficient, to make more with less while reducing the overall environmental impact. According to the company, its primary and secondary customers combined were able to avoid the equivalent of 82 million metric tons[4] of carbon dioxide emissions in 2021. This is around three times more than the total direct and indirect emissions of Air Products itself.

14%	82 Million	56%
Increase in CO_2e Emissions Avoided by Customers	Metric Tons of CO_2e Avoided Due to Company Products	Of Revenues From Sustainable Offerings

Source: Air Products, 2022 Sustainability Report.

Saint-Gobain

Saint-Gobain, a French multinational corporation, is a global leader in light and sustainable construction; it designs, manufactures, and distributes materials and services for the construction and industrial markets. The company's offerings of integrated solutions for the renovation of public and private buildings, light construction and the decarbonization of construction and industry are developed through continuous innovation that provides sustainability and performance.

In 2020 alone, the company reported around 1300 Mt of carbon dioxide solutions reductions through the use of products sold.

Trane Technologies

A similar example is Trane Technologies, a company focused on the manufacturing of heating, ventilation, and air conditioning and refrigeration systems. The company seeks to develop solutions that are better for the environment and their customers. Trane believes that customer use of its products is the largest opportunity for it to reduce emissions. To capitalize on this opportunity, the company has set a Gigaton challenge[5] — a first-of-its-kind climate commitment related to customer product use by any business-to-business (B2B) company. The company has set a goal to reduce one billion metric tons of greenhouse gas (GHG) emissions from their customers' carbon footprints by 2030. This magnitude of emissions reduction is equivalent to around 2% of the world's annual emissions.

50M	197K	100%
$MtCO_2e$ Contributed to the Gigaton Challenge Since 2019	$MtCO_2e$ Refrigerant Recovered in 2021	Of Trane Technologies' Strategic Businesses are Participatng in the Gigaton Challenge

Source: Trane Technologies, 2021 ESG Report.

The Importance to Investors

The scope 4 emissions represents a particularly interesting metric for investors. As more and more investors try to capitalize on climate change as an opportunity for investment in innovative companies, scope 4 emissions will provide investors with an estimate of the impact that companies can make towards decarbonization. The impact created by companies is not just due to its own operation but also across the value chain. Thus, from an investor point of view, this category of emissions points towards an opportunity for higher returns compared to companies with traditional business models.

A major concern for investors analyzing this metric is the lack of a standard guidance on measurement and reporting of avoided emissions. This presents the potential for 'greenwashing' by businesses. Scope 4 is not an official category of the GHG protocol and is a theoretical calculation that is measured through a reference scenario. This usually involves comparing products to the average market solution, an existing solution, and/or a previous generation of a product. As more companies attempt to measure the overall impact of their products and services, a need will likely arise for a standard like the GHG protocol developed for measuring and reporting emission scopes 1, 2, and 3.

Through our climate transition strategy, the Fundamental Growth and Core (FGC) equity team at State Street Global Advisors tries to identify companies with innovative business models that can contribute to transitioning to a low-carbon economy. Companies that disclose the avoided emissions of their products are frontrunners for decarbonization as they act as enablers for other companies to transition. The FGC team has developed a proprietary scoring mechanism to identify such innovative business models for its climate transition strategy.

Experian: Growing Beyond Traditional Bureau Business Through Innovation

Ramsai Neelam
Research Analyst

Credit scores play an increasingly important role in our personal lives. The use of credit scores is not limited to decision-making in consumer credit (mortgage loan, auto loans, credit cards, interest rates etc.), but also extends to decisions on eligibility for rental housing, homeowner insurance, and in the job-hiring process.

Experian, TransUnion, and Equifax (known as the Big 3) are responsible for collecting and maintaining credit information on consumers in the United States. These three bureaus sell credit data and analytics to financial institutions and other lenders that use the information to make credit decisions; the Big 3 also sell credit reports, lead generation products, and premium services to consumers directly or through B2B partnerships.

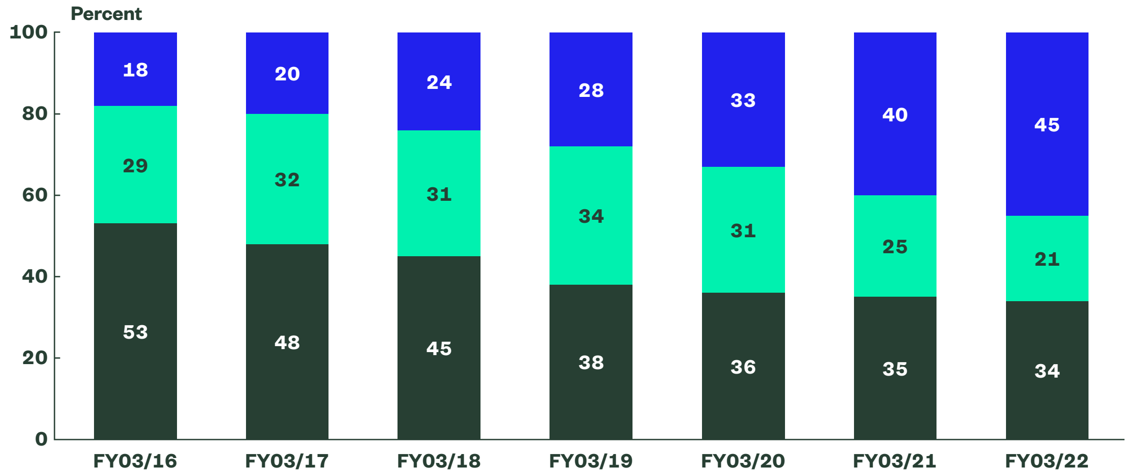
The Company

Experian is the world's leading multinational consumer credit reporting company with 44% revenue share, followed by Equifax at 35%, and TransUnion at 21% through 2021. Experian operates in three business lines: Data, which accounts for 53% of revenue (B2B division), Decisioning (21% of revenue — B2B), and Consumer Service (26% of revenue — B2C), in the full year to March 2022. It operates in four regions: North America, which accounted for 65% of revenue, United Kingdom and Ireland (14%), Latin America (13%), and Asia Pacific (8%). Experian is a market leader in North America, Brazil and UK.

Pushing Boundaries Through Innovation

Experian has been growing beyond traditional bureau business, reducing its dependency on historical core profiles (credit cards, personal loans, auto loans etc.) from 42% in FY03/16 to 25% in FY03/22. At the same time, it has increased exposure to new data assets and value-added services through industry-leading innovation. Investment in new products has increased from 18% of capital expenditure (capex) in FY03/16 to 45% of capex in FY03/22 (Figure 1) as it seeks to exploit untapped market opportunities.

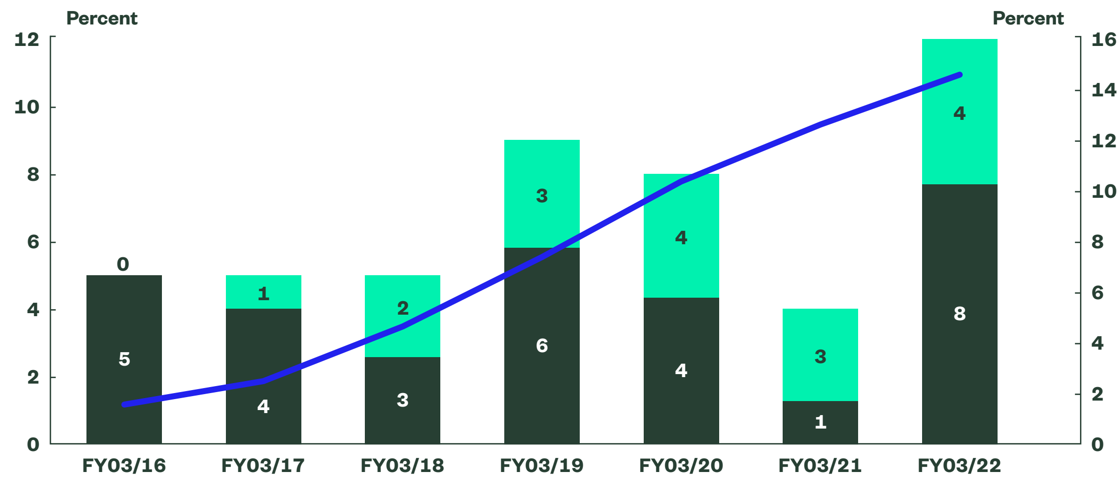
Figure 1
Increased Focus on Product Innovation and Development



Source: Experian as of 31 March 2022.

Since 2016, Experian has launched new products that in FY03/22 generated $909 million of revenue, equivalent to 15% of total revenue. Over the last four years, new products contributed between 3% to 4% of organic growth on top of market growth. (Figure 2).

Figure 2
New Product Innovation Key to Organic Growth



Source: Experian, State Street Global Advisors as of 31 March 2022.

In 2018, Experian introduced its Ascend big data platform in the B2B space. The cumulative total contract value (TCV) of Ascend products has grown from $46m and eight clients in 2018 to $432 million and 70 clients by June 2022.[6] The rapid growth has been driven by innovation and the introduction of new modules on the platform. We expect TCV of the Ascend platform to approach $500–$600 million, with annual revenues to exceed $180 million in three years.

Experian Boost is another key innovation that lifted the company's strategy from passive to active consumer engagement in the B2C space. Boost aims to help members instantly improve their credit score through data such as utility bill payments, Netflix subscription, etc. Experian Boost (known as Serasa in Brazil) received an overwhelming response in the US, UK, and Brazil following its launch, with about 149 million free users as of December 2022.[7] Two-thirds of Boost customers in the US experienced improvements in their credit score, with 34% of those previously not scoreable getting a score.[8] Experian Boost's 'freemium' model efficiently monetizes its customer base by offering a range of premium services such as lead generation, credit score monitoring services, identity theft protection services, and an expanded product ecosystem.

Figure 3
Experian's Key Product Launches Since 2016

2016	2017	2018	2019	2020	2021	2022
Cross-Core (US)	Identity Works (US)	Ascend analytical Sandbox	Exeperian Boost (US)	Sure Profile	Ascend India	The Buy Now, Pay Later
		Credit 3D launch (UK)	Ascend account review	New Ascend module	CrossCore 2.0	RentBureau
		Lead generation	Ascend marketing	PowerCurve 2.0	Ascend Market Insights	ExperianGo
				Serasa Turbo (Brazil)		Lift Premium
				Experian Boost (UK)		Brazil agri-risk management
				Ascend data services		Ascend Ops

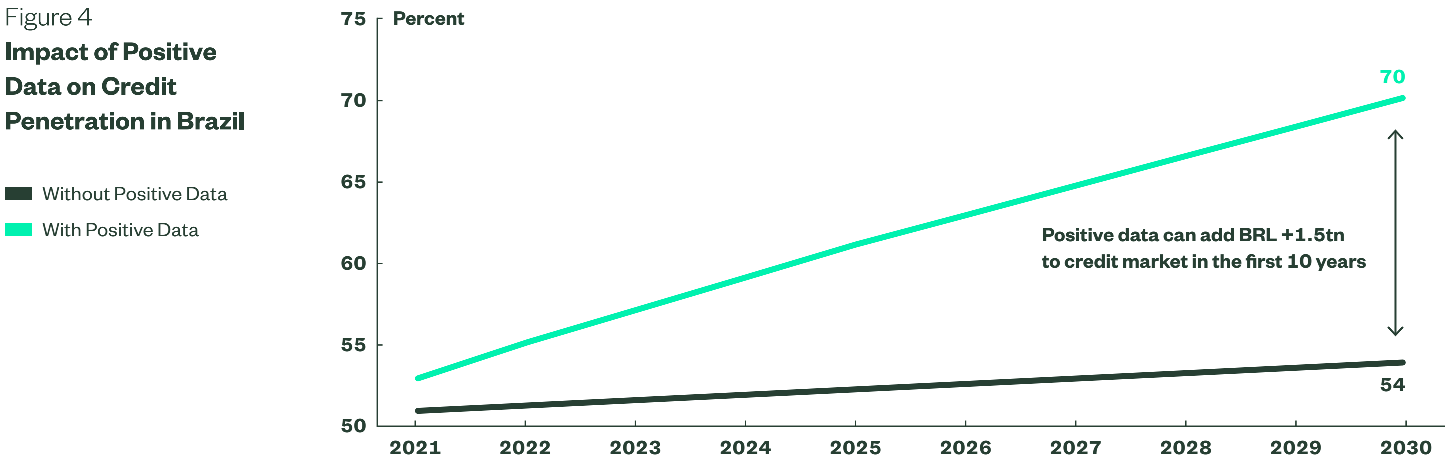
Source: Experian as of 31 December 2022.

Experian has recorded strong demand for its new products, not only from the financial industry but also from high growth areas such as the rental verification industry, Buy Now Pay Later (BNPL), the Fintech sector, and employer verification services. Historically, one-third of Experian's growth has come from innovation. We are confident that its innovation capabilities and expanded use opportunities for its data should enable it to continue widening its addressable market and revenue growth potential.

Adoption of Positive Data in Brazil

In 2019, Brazil legislated to allow for the use of automatic positive data. Positive data coupled with negative data provides a more comprehensive view of consumers' financial situations. The adoption of positive data allows lenders to offer lower interest rates and faster loan approvals to borrowers with positive credit histories. According to Experian, 22.6 million Brazilians who are currently outside the credit market could get access; it estimates that 88% of Brazil's adult population could benefit from the adoption of positive bureau data. Experian estimates that credit penetration could grow from an average of 50% of GDP to about 70% of GDP in the 10 years from 2021 (Figure 4).

Figure 4
Impact of Positive Data on Credit Penetration in Brazil



Source: Experian as of 7 September 2022.

Experian holds over 65% share of the Brazilian credit score market and has a clear competitive advantage to address the evolving credit space. The structural changes open up multiple opportunities in the consumer credit market, digital banking, analytical data services, credit expansion in the small and medium enterprises (SME) market and FinTech sectors. Brazil accounts for roughly 12% of group revenue and achieved 17% organic growth in FY03/22. We expect the Brazil segment of the business to grow significantly (percentage growth in a range of high single digits to mid-teens) over the long term.

Regulatory Environment

Credit bureau operations are heavily regulated in the markets where Experian operates. In the wake of Equifax's data breach in 2017 and amid increased regulatory supervision of sensitive consumer data, the credit bureau industry invested heavily in data security technology (multi-layered approach) to address the cybersecurity threat.

Some policymakers believe there is need for a Public Credit Registry as the current credit scoring system is still failing consumers at the lower end of the socio-economic spectrum. However, credit bureaus have been able to reduce errors in credit data and help many consumers to access credit more easily and cheaply, and arguably serve a positive social purpose. Experian has addressed the data issues in the industry by sourcing accurate and high quality data, engaging in continuous monitoring, and implementing rigorous internal procedures. It said it achieved scoring of 99.9% (versus 98.6% in 2016) in the USA and would continue to focus on further improvement.

Our Confidence Quotient Assessment

Experian scores well in our proprietary Confidence Quotient (CQ) framework. The company operates in an industry with secular growth and their scale advantage provides them with a strong competitive position that drives a high score for their Market Position CQ. We also score the Management CQ highly as Experian is led by a team of executives with a strong track record of industry-leading innovation capabilities, such as the use of alternative data to help consumers improve their credit scores. Experian has reduced its dependency on the credit cycle and, despite rising interest rates and more challenging macro conditions, the company's Fundamental Momentum CQ score remains favorable.

Experian also scores well on the ESG CQ given its focus on 'improving financial health for all' through its core products and social innovation. Experian products directly help consumers to get better access to the credit system, lower borrowing costs, and to make better financial decisions.

We believe that Experian is a quality company with sustainable growth underpinned by strong fundamentals. Recent market moves have brought the stock valuation to more reasonable levels, adding to the relative attractiveness of the company as an investment opportunity.

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Endnotes

1 Net zero means that the total greenhouse gas (GHG) emissions being emitted should be lower than or equal to the total GHG emissions being removed or absorbed (i.e. no positive emissions). On a net basis, no additional emissions should be released into the Earth's atmosphere.

2 Source: IPCC, 2018: Summary for Policymakers. In: Global Warming of 1.5°C. An IPCC Special Report on the impacts of global warming of 1.5°C above pre-industrial levels and related global greenhouse gas emission pathways, in the context of strengthening the global response to the threat of climate change, sustainable development, and efforts to eradicate poverty [Masson-Delmotte, V., P. Zhai, H.-O. Pörtner, D. Roberts, J. Skea, P.R. Shukla, A. Pirani, W. Moufouma-Okia, C. Péan, R. Pidcock, S. Connors, J.B.R. Matthews, Y. Chen, X. Zhou, M.I. Gomis, E. Lonnoy, T. Maycock, M. Tignor, and T. Waterfield (eds.)]. Cambridge University Press, Cambridge, UK and New York, NY, USA, pp. 3-24, https://doi.org/10.1017/9781009157940.001.

3 Source: *Do We Need a Standard to Calculate Avoided Emissions?* by Laura Draucker, 11/05/2013, World Resource Institute. https://wri.org/insights/do-we-need-standard-calculate-avoided-emissions.

4 Source: Air Products 2022 Sustainability Report. https://airproducts.com/company/sustainability/sustainability-report.

5 Source: Trane Technologies 2021 ESG Report. https://tranetechnologies.com/en/index/sustainability/sustainability-reports/esg-report.html.

6 Source: Experian half-year results presentation, 16 November 2022.

7 Source: Experian ESG Presentation, January 2023.

8 Source: Experian Company Accounts June 2021.

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- Start with rigor
- Build from breadth
- Invest as stewards
- Invent the future

For four decades, these principles have helped us be the quiet power in a tumultuous investing world. Helping millions of people secure their financial futures. This takes each of our employees in 29 offices around the world, and a firm-wide conviction that we can always do it better. As a result, we are the world's fourth-largest asset manager* with US $3.48 trillion† under our care.

* Pensions & Investments Research Center, as of December 31, 2021.
† This figure is presented as of December 31, 2022 and includes approximately $58.60 billion USD of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.

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Marketing communication

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