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# ESG AND THE FOOD SUPPLY CHAIN



Investment Week

Portfolio Advisor



LIFE CHANGING INVESTMENTS



## INTRODUCTION

Our focus at Alquity has been predominantly towards companies benefiting from domestic structural growth trends in Emerging Markets such as favourable demographics or increasing urbanisation levels. Consumers moving into the cities, shifting from an unorganised to an organised retail experience, and benefiting from rising income levels and purchasing power, results in attractive opportunities in sectors such as food production, supermarkets, and restaurants. We have invested in a number of such companies across the Emerging World - including currently in Peru, Indonesia, Egypt, China, India, Korea and Vietnam.

In our view, there are 3 main areas that responsible investors need to consider in relation to these sectors:

# 1

### PROTEIN PRODUCTION

- in the form of meat and livestock - carries significant risks primarily in terms of greenhouse gas emissions (GHG) and water usage but also deforestation and use of antibiotics.

# 2

### TRACEABILITY OF INGREDIENTS

- particularly the sustainable sourcing of products such as palm oil.

# 3

### HEALTHY EATING

- the influence products have on diet-related disease rates such as diabetes and their impact on those on lower incomes.

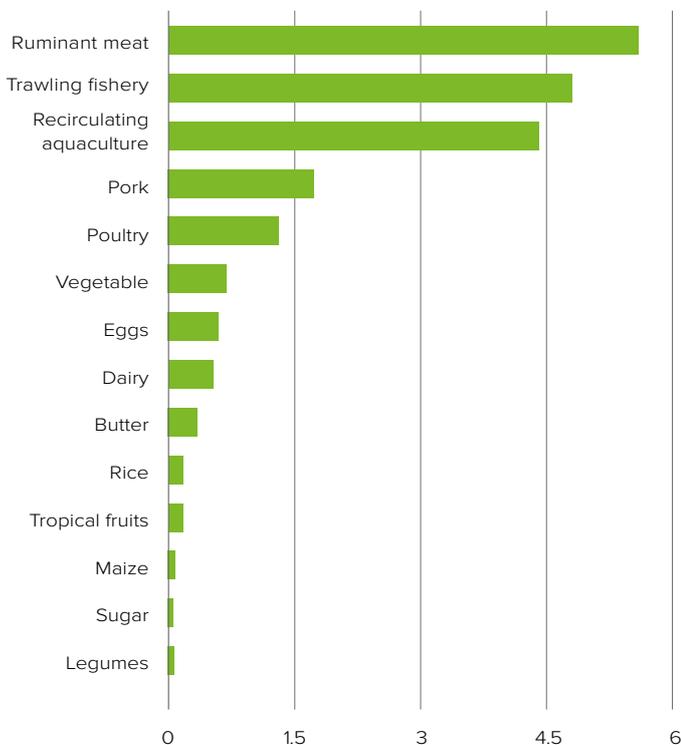


# 1. PROTEIN PRODUCTION

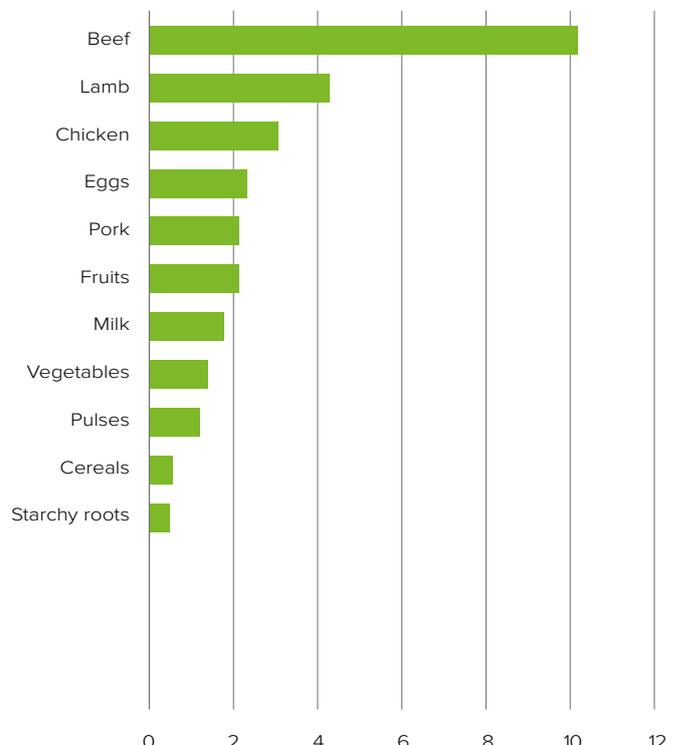
As shown in the charts below, the production of meat generates significantly higher GHG emissions than that of plant based protein, and requires significantly greater

water usage. These are both issues in the context of limiting global warming to 1.5 °C and water stress / droughts in many parts of the world.

**Figure 1: Grams of GHG emissions per kilocalorie of food product (g/kcal)**



**Figure 2: Water footprint for calories generated (litre/kcal)**



Source: FAIRR

Whilst the decision to consume meat or to pursue a vegetarian diet is a personal choice, there are however significant environmental implications of that choice.

It is for this reason that we include animal agriculture in our definition of 'high risk' industries, along with extractives, heavy industry, aviation and shipping. Thus we hold these companies to a higher, global standard when determining our in-house ESG rating of A,B,C or FAIL.

However, the risks in this sector are not confined to just emissions or water usage, but also include over-use of anti-biotics, poor working conditions and the use of forced labour, animal welfare, treatment of waste, food safety and deforestation.



*If global animal agriculture were a country, it would be the world's second highest emitter of greenhouse gases and the sector produces three times more greenhouse gases than the aviation sector.*

**We have always monitored these risks. Working conditions, water usage and disclosure of waste and GHG generation comprise part of our 13 key progress indicators (KPI) for all investee companies that we monitor and report progress to clients.**

Nevertheless, we have devised 7 sector specific topics, incorporating and extending our existing KPIs, to ensure even greater engagement in 2021. We will discuss the following with each company:

- 1. GHG disclosure:** including scope 3. Potential membership of Carbon Disclosure Project. Policies to reduce GHG, including through feed additives. Reporting in line with Task Force on Climate-related Financial Disclosures (TCFD) framework.
- 2. Labour rights:** Details on loss time injury rates ; policies relating to health and safety / working conditions and ensuring zero forced, bonded, or child labour on farms and fishing boats. What are the (third party) verification procedures in place for these.

- 3. Water scarcity:** Disclosure on water sources and usage, wastewater and solid waste treatment (e.g. drying systems to ensure zero discharge); managing the impact of noise and smell on local communities.
- 4. Antimicrobial resistance:** Anti-biotics usage policies. Commitment to eliminate routine, non-therapeutic use.
- 5. Deforestation:** Measuring deforestation risks and targeting zero impact in this area, including traceability and sourcing of animal feed. Policies to manage biodiversity.
- 6. Animal welfare:** clear policies; e.g. cage free chickens, minimal confinement of animals, slaughtering policies (following of RSPCA, Compassion in World Farming, or Five Freedoms of Animals standards).
- 7. Contagious Disease:** prevention process and methods/contingency plans for dealing with any outbreaks.

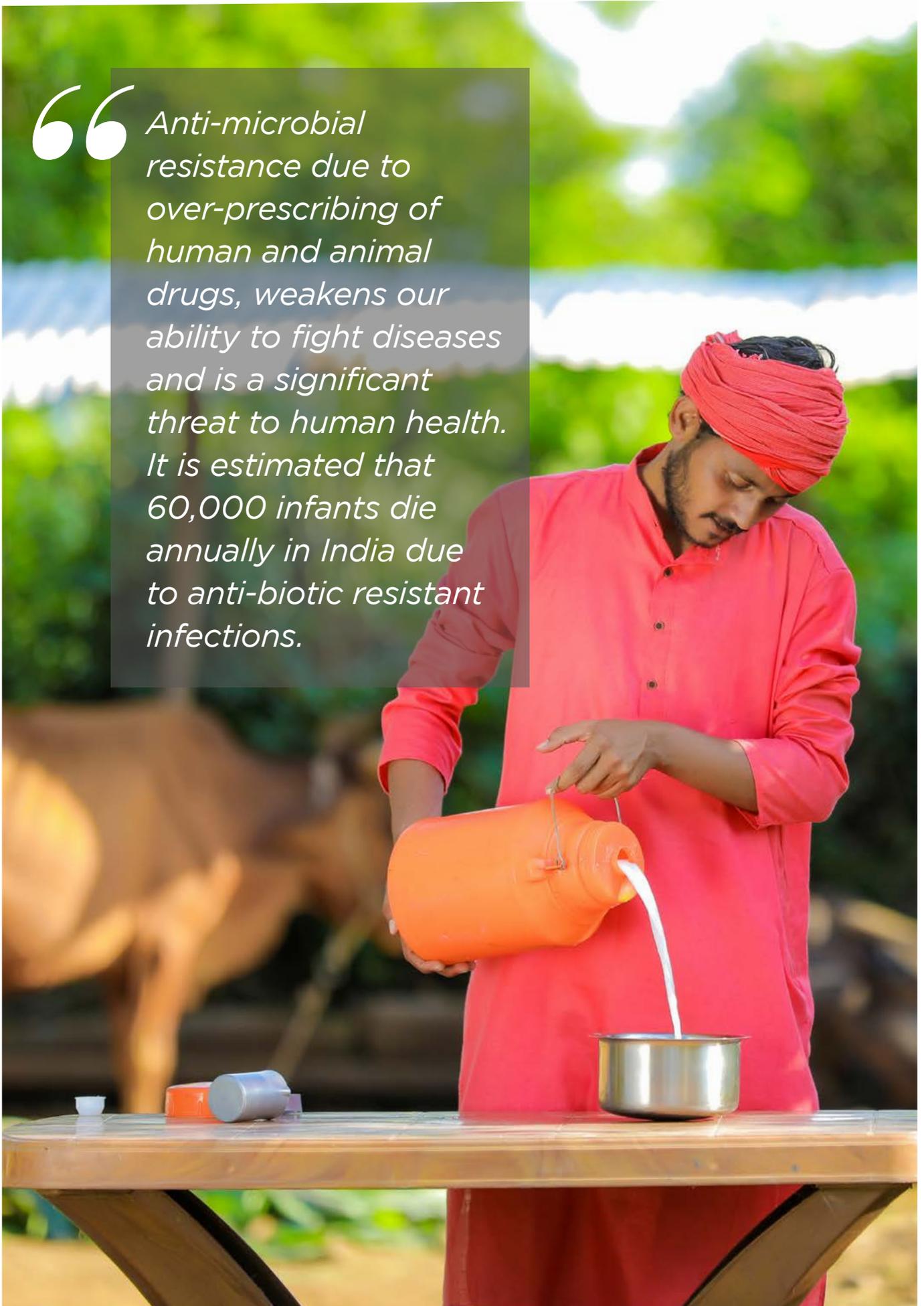
transformation

# FIVE FREEDOMS OF ANIMAL WELFARE



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*Anti-microbial resistance due to over-prescribing of human and animal drugs, weakens our ability to fight diseases and is a significant threat to human health. It is estimated that 60,000 infants die annually in India due to anti-biotic resistant infections.*



## 2. TRACEABILITY OF INGREDIENTS

**T**raceability issues apply not just to protein producers as mentioned above, but also to their customers more widely. Supermarkets and restaurant chains are more sensitive to changing customer preferences and can exert their substantial purchasing power on their supply chains. Furthermore, traceability also applies to non-meat protein, and can contribute to improved food safety more generally.

Food safety has been a major issue in Emerging

Markets, due to repeated scandals. For example, the 2008 tainted milk scandal in China resulted in 300,000 hospitalisations, and tainted meat sold by Yum! Brands in China in 2014 resulted in significant reputational damage. Taiwan suffered from a food scandal in 2013 due to the adulteration of cooking oil with illegal colouring agents and cheaper vegetable oils, which was repeated again in 2014 with the so-called 'gutter oil' scandal where recycled waste oil was added to cooking oil.

A key part of our process is to understand the supply chain for all food producers, retailers and restaurants to ensure that food safety standards are maintained throughout. In addition to discussing the aforementioned questions from the previous section in regard to their meat suppliers, we also look for the following:

- 1. Full traceability of key ingredients back to the producer, and ultimately the farm, including auditing of the supply chain**
- 2. Robust testing procedures to ensure compliance with hygiene and quality standards, and to ensure products are not adulterated**
- 3. Third party certification of procedures (eg ISO 22000) and membership of relevant industry bodies such as Roundtables on Sustainable Beef, Soy, Poultry, Palm oil or Dairy Sustainability Alliance to provide quality assurance**

## CASE STUDY



### **Atacadao** (Carrefour, Brazil)

We recently upgraded our ESG rating for Atacadao, the Brazilian hypermarket operator, to A following the release of their new sustainability report which provides significant disclosure in a variety of areas and provides illustrations of best practice in Emerging Markets. For example, they have extended their social audits to all manufacturers of their private label products, rather than just textile suppliers. This is supplemented by 'risk maps' detailing the history of labour conditions in the producing region. Two supplier relationships were subsequently terminated in 2019 for refusing to share traceability information and suspected labour law violations respectively.

In addition, Atacadao has policies regarding zero deforestation and animal welfare. Regarding the former, Atacadao has engaged with meat suppliers to explain their requirements but has supplemented this by mapping the locations of their farms and using satellite imaging to ensure deforestation is not occurring. In terms of animal welfare, Atacadao encourages suppliers to follow the five freedoms of the Farm Animal Welfare Council, as well as specific policies for pig rearing and ensuring all eggs are from cage-free chickens by 2025.



### 3. HEALTHY EATING

**A**lthough restaurant chains such as McDonalds have very strong traceability policies embedded in their supply chains, they do suffer from concerns about healthy eating.

In developed markets, we see the societal damage in terms of health impact, often amongst low-income groups influenced by sale of low priced, high sugar, processed foods and fizzy drinks – both in restaurants and supermarkets. In emerging markets, this phenomenon is less pronounced but is an area of engagement for us to ensure that the product offering of both food manufacturers and retailers includes affordable, healthier alternatives. Where we do not see tangible progress in product range, these companies will be reviewed against our ratings criteria and we will exit the holding if necessary.

Although this is an area that suffers from particularly low levels of disclosure, we do see evidence of progress. For example, Atacadao has created ‘Healthy Space’ corridors in 82 hypermarkets thus increasing the variety and availability of healthy foodstuffs. In terms of food producers, Unilever has committed to double globally the proportion of its products that meet globally recognised nutrition standards, and 46% of the products of their separately listed Indian subsidiary (Hindustan Unilever) met this standard already in 2018. The company intends to continue to reduce salt, saturated fat and sugar across the product range.

There is also progress in the lower income Emerging markets such as Egypt, Peru and India. Edita, the leading Egyptian baked goods company, is introducing healthier

options into their product range although greater granularity on their future plans is still required and is an engagement topic for us. Alicorp, the leading Peruvian consumer goods company, announced in 2015 a target to reduce salt and sugar by 10% in the next 6 years, which was actually surpassed by as early as 2017.

In terms of restaurant chains, it is firstly important to note that companies are treating their consumers similarly regardless of their geographical location, and Emerging consumers are not being provided with an inferior product. For example, an Indian Egg & Cheese McMuffin has virtually identical nutritional information to the UK. This data can be downloaded from the Indian website so that customers can make informed choices, as well as using the customisation options to replace fried chicken with grilled chicken etc. In addition, in April 2018 healthier options were introduced by McDonalds India - such as replacing refined flour in wraps with whole grain flour and reducing sodium content in fries by 20%.



*10% of urban Chinese are classified as obese which is projected to rise to 25% by 2030. Unchecked, China could follow the path of the USA where 40% of all adults are obese.*

# CASE STUDY



## Westlife India (McDonalds franchise in South & West India)

The Indian restaurant industry is highly fragmented and unorganised companies comprise 65% of the sector. Thus the safe sourcing of quality products is a challenge. Westlife has created its own supply and cold chain, so that 98% of products are sourced locally and 100% are from within the company’s own supply ecosystem. The company pioneered large scale lettuce cultivation in India to ensure product quality and availability, for which the planning started 6 years before the first customer entered a restaurant. All palm oil is certified by the

Roundtable on Sustainable Palm Oil. In addition, Westlife has introduced FSC (Forest Stewardship Council) certified recyclable packaging (as well as eliminating single use plastics).

The company now serves 200mn customers a year, which will only rise rapidly with the exponential growth in on-line delivery options. Thus Westlife can utilise its purchasing power for good, to ensure full traceability of ingredients and thus providing a safe and sustainable product to their customers.

# CONCLUSION

The food chain involves major Environmental and Social issues that need to be closely managed and tracked. We recognise that emerging markets are at a different stage of development to Developed markets and the issues are similar but not identical. Protein production,

traceability and healthy eating are the key areas in our view that require investors’ focus and these are areas that we intend to engage further with our investee companies over 2021.

Sources: Atacadao 2019 Sustainability Report, Westlife India, FAIRR, McKinsey, US CDC

# CONTACT INFORMATION

EUROPE	ASIA	UNITED KINGDOM	LATIN AMERICA	NORTH AMERICA
<b>Benoit Ribaud</b> +44(0) 7702 257 865 benoit.ribaud@alquity.com	<b>Suresh Mistry</b> +44 (0) 7973 309687 suresh.mistry@alquity.com	<b>Alex Boggis</b> +44(0) 7702 257866 alex.boggis@alquity.com	<b>Cyn Cano</b> +44(0) 207 5577 871 cyn.cano@alquity.com	<b>Renee Arnold</b> +1 215 350 9063 renee.arnold@alquity.com

## FOR MORE INFORMATION ON ALQUITY, PLEASE CONTACT:

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