

A man in a dark suit, white shirt, and dark tie is standing in a grocery store aisle. He is holding a silver pen in his right hand and a tablet in his left hand. The background shows shelves stocked with various products, including colorful bags of snacks. The lighting is warm and the scene is slightly blurred, focusing on the man and the text overlay.


# **FMCGs' Zero-Deforestation Challenges & Growing Exposure to Reputation Risk**

**19 November 2020**

**A Chain Reaction Research Webinar**

# Chain Reaction Research (CRR)







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# Run of Show

## Speakers

- **Gerard Rijk:** Equity Analyst, Profundo
- **Chris Wiggs:** Sustainable Sourcing Program Manager, Aidenvironment
- **Moderator: Matthew Piotrowski:** Director of Policy & Research, Climate Advisers

## Webinar Rules

1. All attendee lines will be muted
2. Please use the Q&A function to ask questions
3. A recording of the webinar and the slides will be distributed or made available to all registrants



# A recurring problem: The gap between policies and results



## Why this study? Two reasons:

- Ample examples that FMCGs with deforestation commitments are linked to palm oil-driven deforestation in Indonesia
- “Let’s start executing instead of talking” – a leading asset manager

## Context and background:

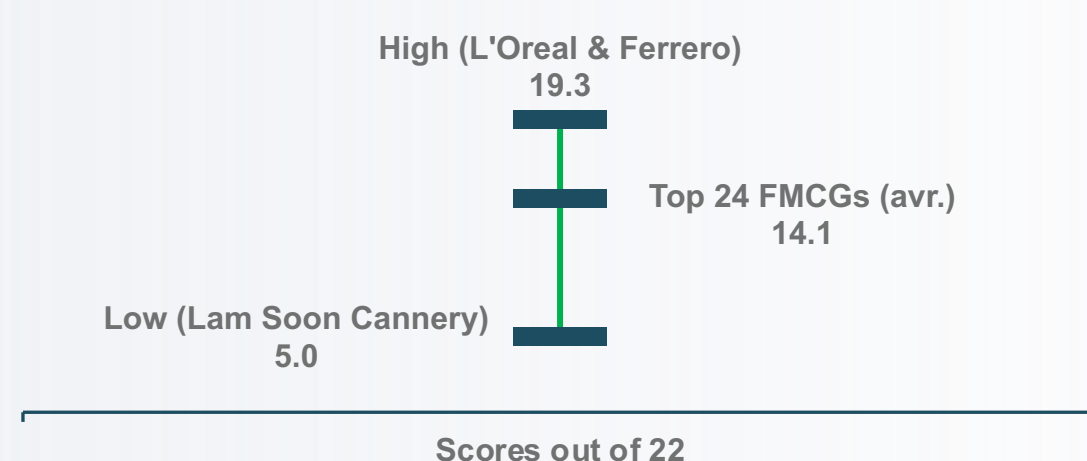
- FMCGs’ value chain position. Palm oil-related Brands of Top-25 use 9% of the global palm oil + earn USD 20-30 billion profit on palm oil- related products
- Smallholders are facing a huge USD 1.1 billion annual palm tree re-planting need = deforestation risk

## Studies emphasize leakage risk in FMCGs' supply chain - A 4<sup>th</sup> study by CDP: 70% is not replying to CDP Forest

### 1 Global Canopy: Forest500 Report 2019 Out of 350 companies – 40% no commitments



### 2 WWF: Palm Oil Buyers Scorecard 2019 173 FMCGs: Top-24 had 14.1 average out of 22 points

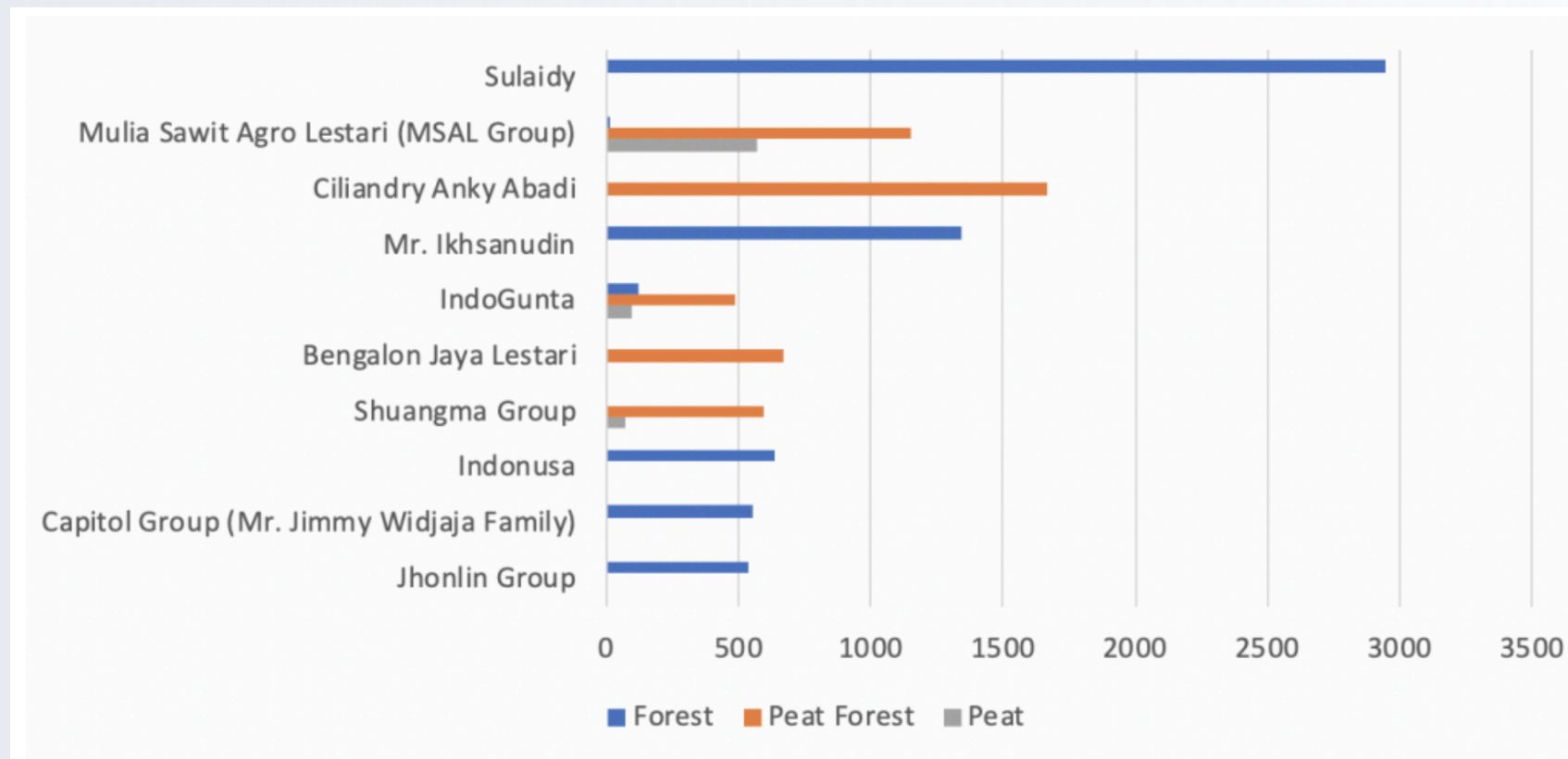


### 3 OECD Pilot Project on Responsible Agricultural Supply Chains in Southeast Asia: Baseline Report 2020 Out of 23 companies active in Southeast Asia – a weak supply chain due diligence in all 3 themes

	Internal audits	External audits	On-site investigation	Monitoring by third parties	Certifications	No verification + N/A
Environmental	54%	39%	50%	29%	25%	21%
Labour rights	54%	36%	32%	39%	14%	21%
Tenure rights	21%	18%	29%	18%	7%	57%

## Top 10 deforesters Q1-Q2 2020

- In the first six months of 2020, there was 19,894 ha of deforestation within known oil palm concessions in Indonesia, Malaysia, and Papua New Guinea.
- Just ten companies were responsible for 11,474 ha of that deforestation (57%)



## Top 10 deforesters supplying FMCGs



- Largest deforester, the Sualaidy-associated companies, doesn't have a mill, but one concession company supplies Fresh Fruit Bunches to PT Pundi Lahan Khatulistiwa. This company supplies to Avon, Danone, Kellogg's, L'Oréal, Mondelēz, Nestlé, PepsiCo, Reckitt Benckiser, and Unilever
- The second largest deforester, Mulia Sawit Agro Lestari, supplies to Avon, Danone, Kellogg's, Mondelēz, COFCO International, ITOCHU Corporation and Unilever
- The third, Ciliandry Angky Abadi, supplies to Avon, L'Oréal, ITOCHU Corporation and Hershey
- Other companies in the top 10 supply to Johnson & Johnson, General Mills, Mars, P&G, Friesland Campina, PZ Cussons, Upfield and several trader/ refiners

## Challenges for FMCGs

- Complex supply chains means many FMCGs companies don't know who they buy from and how they enter supply chains
- Supply is often indirect so FMCGs companies don't deal directly with the mill and rely (sometimes too much) on intermediary traders
- The use of palm kernel and the challenges of increasing sustainability in the kernel supply chain, where trader/ refiners often rely on comparatively few kernel crushers
- Lack of will in comparison to midstream players
- Out of date supply lists

## Four Important KPIs to reduce risk and protect reputation

Based on CRR interviews with investors/experts in NDPE execution in the palm oil chain, FMCGs and their investors - four KPIs to reduce leakage risk in their sourcing and investments respectively:

1. NDPE policy in place: Yes or No
2. Transparency of an up-to-date supplier/palm oil mill list and grievance list/process: Yes or No. A semiannually updated mill list would show positive behavior by FMCGs as traders update every quarter. In the case of materiality for FMCGs, due diligence of the suppliers is necessary – a grievance list is a proxy for this
3. **External auditing:** Yes or No. In the future, investors and FMCG customers could increasingly value the presence of an independent check or a "second opinion." A third-party auditor's instruments: regular site visits and landscape verification
4. **Non-financial reporting:** According to the TCFD (Task Force on Climate-related Financial Disclosures) process and/or up-to-date disclosure in an established format such as "CDP Forest." – "indicates that the process is embedded in the organization"

# KPIs: NDPE policy, up-to-date mill list and grievance list

## KPI Map

- 88% is lagging in NDPE execution, of the top-25 palm oil sourcing FMCGs = 9% of global palm oil production. Most are publicly-listed
- Of the 88%, many have a) low or no CDP Forest scores, b) weak external auditing processes, and/or c) no TCFD methodology

NDPE but weak Mill List/Grievance List							NDPE + Updated Mill List + Grievance List	
PepsiCo	Mondelez International	Colgate-Palmolive	Johnson & Johnson	General Mills	L'Oréal	Danone	Hershey	Unigra
Procter & Gamble	Ferrero	Friesland Campina	Mars	Vandemoortele			Unilever	
Nestlé	Reckitt Benckiser	Henkel	Kellogg	PZ Cussons		Upfield	Barry Callebaut	No NDPE
							Lam Soon Cannery	Yildiz Holding

# Financial costs for FMCGs of a strong NDPE policy execution

## Summary of a best-in-class expense analysis

**Costs for a good execution + monitoring/verification could cost in total tens of millions USD**

### Internal Auditing

Several Hundred Thousand USD



USD 10,000

### External Auditing

Several Hundred Thousand USD



USD 10,000

### Monitoring by Third Parties

One Million USD



Tens of Thousands

### On-site Investigation

Tens of Millions USD



### Blockchain & Other Tech

Reduction in Administration Costs



### RSPO-certified Palm Oil

Might cost  $\approx$  5% more

**USD 30 per MT**

## Cost of Response – Current Situation

Current expenditures by selected FMCGs on forest-risk related to palm oil  
**There are wide differences per company – excluding outlier L'Oréal USD 48/ton**

	Cost of response (USDm)	Tons of palm oil, KPO, derivatives	Cost per ton (USD)
Unilever	66.0	1,038,177	63.6
Reckitt	0.8	172,428	4.5
Colgate	9.0	138,490	65.2
Henkel	0.0	100,309	0.0
Mars	6.0	80,067	74.9
Kellogg	0.1	79,330	1.3
Barry Callebaut	0.0	71,853	0.0
L'Oréal	60.5	71,727	843.5
Danone	2.5	71,302	35.1
<b>Total</b>	<b>144.9</b>	<b>1,823,683</b>	<b>79.5</b>

- Outcomes not completely comparable and lack transparency
- Unilever's cost of response is the highest, USD 66 million annually – includes:
  - purchase of certified materials
  - its investments in programs throughout its supply chain
- Mars and L'Oréal spend more per ton but have other definitions. L'Oréal's cost of response includes the total cost of sustainable sourcing, but this could be double counting

## Best-in-Class - A Relatively Low Burden for FMCGs

If best-in-class execution cost amount to USD 65 per MT

Less than 1% of FMCGs EBITDA on palm oil-related products. Can be passed on via higher sale prices

2019	Palm oil, PKO, derivatives (tons)	Execution cost (USDm) at USD 65/ton	EBITDA (USD m)	Execution cost as % EBITDA	EBITDA palm oil related products (USDm)*	Execution costs as % of palm oil EBITDA
Unilever	1,038,177	67	13,354	0.5%	6,383	1.1%
Reckitt	172,428	11	4,760	0.2%	1,903	0.6%
Colgate	138,490	9	4,398	0.2%	1,437	0.6%
Henkel	100,309	7	4,450	0.1%	553	1.2%
Kellogg	79,330	5	2,381	0.2%	315	1.6%
Barry Callebaut	71,853	5	793	0.6%	139	3.4%
L'Oréal	71,727	5	8,616	0.1%	1,027	0.5%
Danone	71,302	5	5,858	0.1%	435	1.1%
<b>Total</b>	1,743,616	<b>113</b>	44,610	<b>0.3%</b>	12,139	<b>0.9%</b>

Source: Chain Reaction Research; \* based on calculation of palm oil cost X 25 = costs of palm oil related product (CoPOrP). This CoPOrP as % of total cost of sales X global EBITDA = EBITDA palm oil related products.

# Palm oil NDPE execution costs - a value chain analysis

Case study: Procter & Gamble – “20-40% of revenues is dependent on palm oil”  
0.12% of the value chain of the products containing palm oil (like shampoo, detergents)

	P&G	Palm oil related products	Palm oil only
Tons of palm oil, PKO, derivatives			463,295
Price per ton (USD)			600
Total palm oil purchase costs (USD m)			278
Benchmark palm oil execution costs per ton (USD)			65
Benchmark palm oil policy execution costs (USD m)			30
<b>Value chain (USD m):</b>			
Raw material costs (71% of CoS)	23,370	7,011	278
Cost of sales (CoS)	32,916	9,875	
CoS/net revenues (%)	48.6%	48.6%	
Gross profit	34,768	10,430	
Ratio net revenues/raw materials (X)	2.9	2.9	2.9
Total net revenues	67,684	20,305	805
Retail/supermarket value excluding VAT		25,382	1,006
Consumer prices including VAT		27,920	1,107
<b>Benchmark palm oil execution expenses:</b>			
as % of net revenues		0.15%	3.74%
as % of retail value		0.12%	2.99%
as % of consumer value		0.11%	2.72%



## Why spending so little? FMCGs own assessments of financial impacts is under-estimating the impact?

### Financial risk calculated by selected FMCGs in forest-risk related to palm oil - CDP

**FMCGs estimate the potential negative value impact of a weak NDPE policy execution – 0.4% of their sales**

	Financial Impact (USDm)	Tons of palm oil, KPO, derivatives	Impact per ton (USD)
Unilever	182	1,038,177	105
Reckitt	15	172,428	87
Colgate	1	138,490	4
Henkel	99	100,309	498
Mars	1,000	80,067	12,490
Kellogg	0	79,330	4
Barry Callebaut	73	71,853	1,010
L'Oréal	231	71,727	3,221
Danone	186	71,302	2,609
Total	1,786	1,823,683	979

- Also here, assessments by companies are not completely comparable
- These nine reporting companies: USD 1.8 billion risk, of which USD 1 billion from Mars. Excluding Mars USD 0.8 billion, or 0.4% of their total sales
- Mars foresees USD 1 billion market access risk: only based on Europe as “European consumers most sensitive to sustainability concerns”
- Unilever sees palm oil’s financial impact in the range of USD 109-182 million, based on assumption of losing 3-5% of sales – However, Unilever’s palm oil-related sales are much higher (CRR based on AR + P&G indication).
- USD 10 million of Reckitt Benckiser is based on its experience in one case that showed how regulatory costs related to land tenure rights can lead to higher raw material costs

## Misperception by FMCGs – Reputation Risk dominates

**Reputation risk** of palm oil-related deforestation might be USD 16-82 billion, **9-45X fold**  
**3-15% of current shareholders' value at risk**

As of 03-Jun-20	Reputation risk (30%)	Value-at-risk to low-end	Reputation risk palm oil related products	Reputation risk palm oil only
Unilever	42,495	4,249	2,031	81
Reckitt	18,836	13,813	5,522	221
Colgate	18,593	6,818	2,228	89
Henkel	11,664	3,888	483	19
Kellogg	6,810	3,859	510	20
Barry Callebaut	3,288	548	96	4
L'Oréal	50,965	40,772	4,859	194
Danone	14,485	7,725	573	23
<b>Total</b>	<b>167,135</b>	<b>81,672</b>	<b>16,302</b>	<b>652</b>
As of equity value	30%	14.7%	2.9%	0.1%

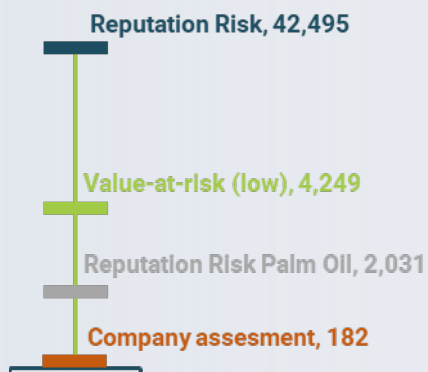
- First column: reputation risk refers to methodology in CRR report “Deforestation-Driven Reputation Risk Could Become Material for FMCGs”: weak ESG management might undermine value by 30%
- Second column: value-at-risk to low-end refers to relative price-earning (P/E) ratios decline to a 5-year low versus current valuation
- Columns 3 and 4 are refinements in this methodology to show the risk associated to palm oil-related products and to palm oil only
- USD 16 – 82 billion (or 3%-15% of current value) is the range from which palm oil reputation risk could escalate to company-wide reputation risk (USD 167 billion) through:
  - Attention from NGO + public + regulatory framework (EU) + retailers + investors

# FMCGs Financial Risk Overview: Reputation Risk Underestimated

## Summary of Financial Risk Analysis

Significant difference between companies' reported risk assessment and CRR studies (all values in million US Dollars)

### Unilever



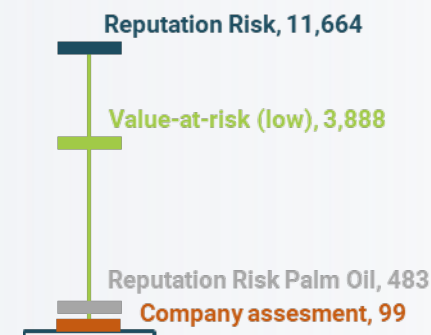
### Reckitt



### Colgate



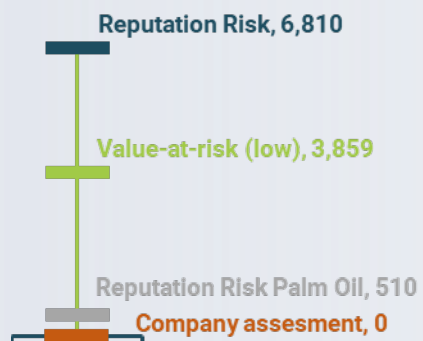
### Henkel



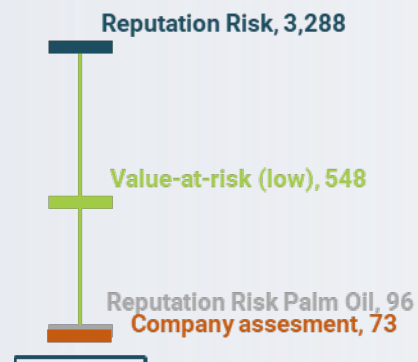
### Total



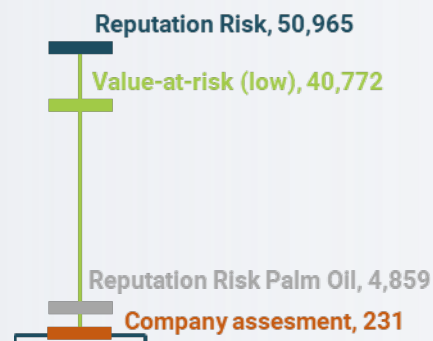
### Kellogg



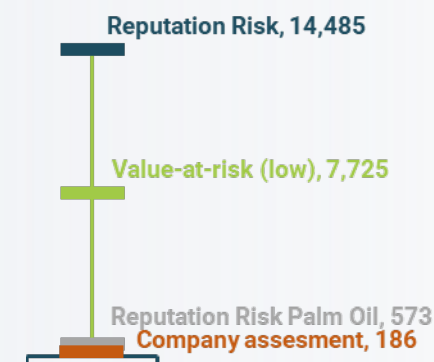
### Barry Callebaut



### L'Oréal



### Danone



## FMCGs could solve the smallholders problem? Probably!

- **Best-in-class execution and reputation risk outcomes applied to top-25 FMCGs**
  - Best-in-class NDPE execution spending = USD 339 million per year, with a DCF value of USD 3.4 billion
  - The reputation risk related to products containing palm oil (using 3X) = USD 49 billion to USD 245 billion
  - The palm oil-related EBITDA could be valued at USD 20-30 billion
- **Context: smallholders face upcoming re-planting costs = a deforestation risk**
  - CRR Report “Future Smallholder Deforestation: Possible Palm Oil Risk,”: palm tree renewal cost for the coming 25 years = USD 1.1 billion per year and USD 28 billion for the period of 25 years
  - Currently, costs for a solution of this dilemma are born by smallholders, the governments, large plantation companies as well as externalized through deforestation.....while FMCGs occasionally participate in a project – Zoom 5x5
  - The annual USD 1.1 billion replanting costs would amount to 3.7-5.5% of the top25 FMCG palm oil-related EBITDA...versus 3-15%...and even 30% equity value risk due to reputation loss

## Conclusions



- **88 percent of the top-25 FMCGs are lagging in NDPE execution**
- **Four Key Performance Indicators (KPIs) can help measure leakage risk**
- **For FMCGs, best-in-class NDPE execution is a low-cost burden....** the expenses would be 0.9 percent of EBITDA and 0.1 percent of palm oil-related product revenues
- **FMCGs' misperception of deforestation's financial impact might be a factor behind low execution spending.** The leading eight FMCGs anticipate a value loss of USD 1.8 billion, but the reputation value-at-risk is 9X to 45X higher at USD 16 billion-82 billion, or 3-15 percent of equity values
- **Investors appear to have ample financial reason to engage with FMCGs to help halt deforestation.** FMCGs' high reputation risk + their profitable palm oil-related businesses could initiate more collaboration in upcoming smallholders' tree renewal programs

# Questions

FOR MORE INFORMATION, PLEASE  
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A special thanks to Barbara Kuepper of Profundo and Okita Miraningrum of Aidenvironment for their support in developing the report *FMCGs' Lagging Efforts in NDPE Execution Lead to Deforestation, USD 16-82B Reputation Risk*

SEE CHAT FOR REPORT LINK:



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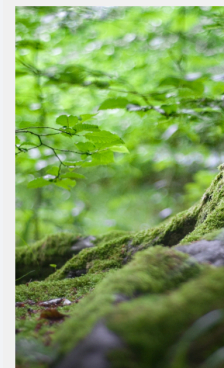
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## FMCGs' Lagging Efforts in NDPE Execution Lead to Deforestation, USD 16-82B Reputation Risk

**July 2, 2020**

Fast Moving Consumer Good (FMCG) companies have increasingly developed zero-deforestation or NDPE policies. Still, deforestation continues to show up in the supply chain of various FMCGs for which palm oil and its derivatives are a material input. Weak monitoring and verification mechanisms at times allow leakage of deforestation-linked palm oil into supply chains and consequently impact the reputation of individual companies. This report analyses the key performance indicators needed to reduce risks and positively impact the reputational value for FMCGs sourcing palm oil and its derivatives. The report estimates the potential costs and, mainly reputational, benefits of a best-in-class approach.

### Key Findings:

- **Four Key Performance Indicators (KPIs) can help measure leakage risk.** The FMCG industry is lagging in deforestation policies and even more in execution. Key KPIs to help reduce leakage are: 1) Presence of an NDPE policy; 2) Up-to-date list of palm oil mills and grievance list; 3) External auditing; and 4) TCFD process and/or CDP Forest disclosure.
- **88 percent of the top-25 FMCGs is lagging in NDPE execution.** Eight percent of companies are lagging in all KPIs, while 80 percent have an NDPE policy but are lagging in a semi-annual update of the mill list and/or lack of a grievance list. These include publicly listed companies such as Henkel, Procter & Gamble, Reckitt Benckiser, Kellogg's, Mondelez International, General Mills, PZ Cussons and BASF.
- **There is large variation in spending on NDPE execution between various FMCGs. Best-in-class execution is a low-cost burden.** The cost would be 0.3-0.9 percent of EBITDA and 0.1 percent of palm oil-related product revenues. Moreover, higher costs can be passed on to consumers.
- **FMCGs' misperception of deforestation's financial impact might be a factor behind low execution spending.** The leading eight FMCGs anticipate a value loss based on discounted cash flow of USD 1.8 billion, but the reputation value-at-risk is 9X to 45X higher at USD 16 billion-82 billion, or 3-15 percent of equity values.
- **Investors appear to have ample financial reason to engage with FMCGs to help halt deforestation.** FMCGs' high U.S. dollar exposure to reputation risk combined with their profitable palm oil-related businesses could initiate more collaboration in smallholders' tree renewal programs.