

Amazon fires, Global Deforestation and what we are doing about it



Stewart Investors
Sustainable Funds Group

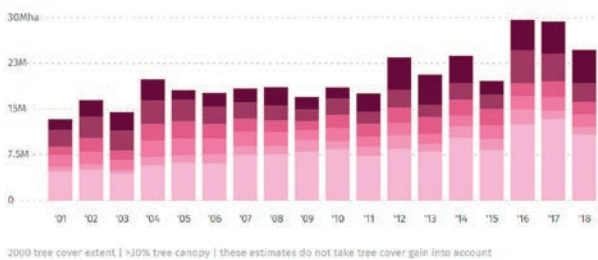
Background

The fires in the Amazon have rightfully captured a lot of attention given the global significance of the biome¹. However, it is important to recognise that deforestation is a global crisis. Countries like Cambodia, Malaysia and Paraguay have lost more than 10% of their forests in just six years. Globally, we have lost 9% of forest cover since 2000. There are many reasons for tree cover loss with the primary drivers of permanent deforestation being agriculture and urbanisation (agriculture is a 4,000 times larger contributor than urbanisation).

GLOBAL ANNUAL TREE COVER LOSS

SHOW ON MAP

From 2001 to 2018, there was a total of 361Mha of tree cover loss globally, equivalent to a 9.0% decrease in tree cover since 2000 and 98.7Gt of CO₂ emissions.



Source: Global Forest Watch. "Tree Cover Loss Globally". Accessed on 3rd October 2019 from www.globalforestwatch.org

Deforestation, like many issues today, is complex and often painted as competing with objectives of economic development and feeding a growing population.

However, the impact of deforestation on issues like the extinction crisis (with 75% of the terrestrial environment "severely altered" by human actions²) and climate change (around 13% of global emissions) makes this a Faustian bargain. Both economic development and food security are ultimately compromised if the causes of the climate and biodiversity crises are not addressed.

It doesn't need to be this way

Between 2000 and 2010 Brazil achieved a 70% reduction from the 1960-1999 average in deforestation. Looking only at tree cover loss it was closer to 50%. This was an extraordinary conservation success story with the success being attributed to many players: "The factors responsible for this accomplishment include government policies and enforcement actions by prosecutors, on both the federal and state levels; incentives created by Norway's pledge of up to \$1 billion in results-based compensation; the concerted pressure exerted by non-government organizations (NGOs) on the government and the soy and beef industries; and the positive response by those industries, resulting in the 2006 soy and 2009 beef moratoria."³

The role of companies

While governments are clearly very important, zero deforestation commitments and supporting actions from companies are critical for turning the issue around. Unfortunately, despite the seriousness of the issues linked to deforestation the New York Declaration on Forests (NYDF) assessment report found that corporate commitments had slowed.⁴

They also found that while "Commitments cover large shares of production in international palm oil markets (65%) as well as the largest paper and pulp players operating in tropical regions (70%), the shares are low in the global soy and beef markets."

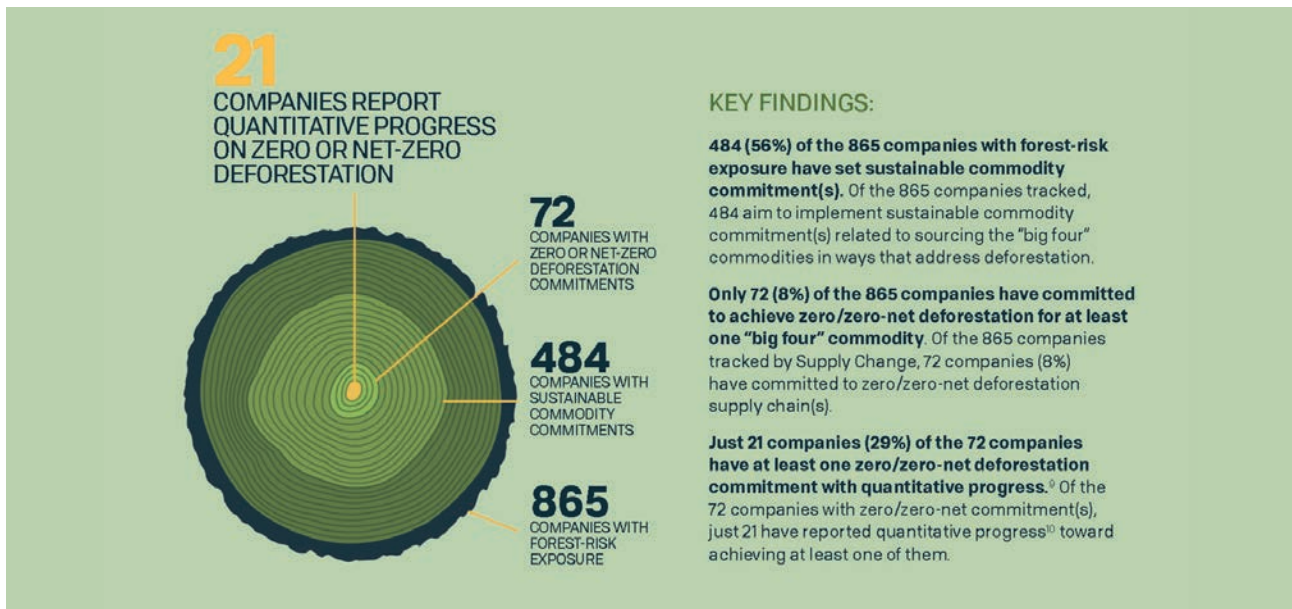
More important than commitments is action.

A recent CERES report found that while there were many commitments, there was less tangible action and progress, with only 21 companies out of more than 800 disclosing quantitative indicators of progress.⁵

A CDP report similarly found governance gaps and a lack of disclosure, with 70% of companies with a high impact on forests failing to disclose. Those that did disclose reported over US\$30bn in losses due to deforestation risks.⁶

Deforestation is a business issue

Deforestation creates business risks. The potential for regulatory and community changes threaten



Source: CERES. "Out on a limb: The State of Corporate No-Deforestation Commitments and Reporting Indicators that Count" (June 2019)

companies with compromised supply chains, including sudden cost increases, unavailability of key product inputs and delays. Reputational harm, particularly through consumer boycotts are a real threat in an age of rapidly transmitted social media controversies. We have seen some brands react quickly to cease purchases of leather from Brazil in response to the fires.

As investors, we are not forest experts and cannot claim to have the solutions, but we do try to understand risk. The deforestation trends suggest that the current approach is not working and something different needs to be done.

What does this mean for investing?

For the Sustainable Fund Group, sustainable sourcing and environmental stewardship are critical considerations in our company analysis. We have never owned livestock, big agricultural or trading companies due to the quality of franchise, quality of management and sustainability headwinds.⁷ However, the complexity and opacity of soft commodity⁸ supply chains make complete avoidance of deforestation very difficult, and near impossible for global food companies.

Global consumer companies such as Henkel, Unilever, Jeronimo Martins, Marico, Kikkoman and Vitasoy, all buy and use agricultural commodities. Due to the complexity and limited traceability in soft commodity markets, particularly for soy, it is likely Brazilian sourced soft commodities linked to deforestation exist in these companies' supply chains.

For example Jeronimo Martins, a Portuguese company operating in food distribution and specialised retail, notes that despite having a strong sustainable sourcing framework, 9,366 tonnes of soy, almost two thirds of the total purchased, came from

countries at risk of deforestation, with only 20% of this soy being certified sustainable. Most companies do not disclose this information nor have the sustainability ethos of Jeronimo Martins.

In various assessments including Forest 500, the CERES report mentioned above and our commissioned research, Henkel and Unilever are consistently amongst the best-rated companies globally for deforestation commitments and actions. Jeronimo Martins and Vitasoy have strong and evolving sustainable sourcing strategies which explicitly call out deforestation. Marico has a responsible sourcing programme which is focused on farming communities but does not explicitly highlight deforestation. While Marico does sell soy sauce in Indonesia, it is mostly exposed to coconuts and we expect total exposure to commodities linked to deforestation to be limited. Kikkoman provides limited disclosure on their sourcing practices.

Furthermore, companies such as Novozymes are producing microbes that help increase soft commodity yields and reduce the need for chemical herbicides and pesticides.

What are we doing from here?

Our plan in response to the most recent Amazon fires is to:

1. Join the PRI's (Principles of Responsible Investment) joint Investor statement on deforestation and forest fires in the Amazon.
2. Continue our support of CDP Forests.
3. Write to targeted companies we are invested with who have an exposure and potential influence on deforestation.
4. Include notes in our company engagement

system to prompt us to follow up on the issues in our future face-to-face meetings.

5. Write to our clients to ask them to join with us in these activities.

We have also commissioned our own research on Palm Oil and Soy, to understand better the issues faced and shape our engagement on these soft commodities.

What we are asking of companies

In our letter we refer to the CERES report, “Out On a Limb: The State of Corporate No-Deforestation Commitments & Reporting Indicators that Count”, which recommends three measures from the CDP Forest questionnaire investors should be asking companies to disclose in support of their commitments:

- Percent of total production/ consumption covered by commitment.
- Percent of total production/ consumption volume traceable; point to which commodity is traceable.
- Whether the company specify any sustainable production/procurement standards for its disclosed commodity(ies), other than third-party certification? And to indicate the percentage of production/ consumption covered and if it monitors supplier compliance with these standards.

In addition, we ask companies to show greater ambition in terms of deforestation, engage with the large trading companies who dominate deforestation-linked soft commodities, and to review industry group memberships to ensure alignment on deforestation commitments.

Conclusion

Like many of the sustainability challenges we face, deforestation is complex, interconnected with other issues and not something any organisation can solve on their own. However, the 70% reduction in land use change achieved in Brazil in the early 2000s shows what is possible with concerted effort. The backward steps since then shows more needs to be done and different approaches will be needed. Investors have a key role to play. For our part, we will continue to encourage the companies we invest in, our clients and the broader industry to join the movement for a zero-deforestation future.

-
- ¹ A biome is a community of plants and animals that have common attributes adapted for the environment they live in.
 - ² Source: Sustainable Development Goals. UN Report: Nature’s Dangerous Decline ‘Unprecedented’; Species Extinction Rates ‘Accelerating’ (May 2019)
 - ³ Source: Boucher, D. How Brazil has dramatically reduced tropical deforestation. (March 2014)
 - ⁴ Source: <https://forestdeclaration.org/goals/goal-2/>
 - ⁵ Source: CERES. “Out on a Limb: The State of Corporate No-Deforestation Commitments and Reporting Indicators that Count” (June 2019)
 - ⁶ Source: CDP. The Money Trees: The role of corporate action in the fight against deforestation (2019)
 - ⁷ Sustainability headwinds are conditions which can slow company growth.
 - ⁸ A soft commodity is a commodity such as sugar, corn, soy, wheat. They are grown rather than mined.

Source for company information: Stewart Investors investment team and company data. For illustrative purposes only. Reference to the names of each company in this communication is merely for explaining the investment strategy, and should not be construed as investment advice or investment recommendation of those companies. Companies mentioned herein may or may not form part of the holdings of Stewart Investors.

Important information

This document has been prepared for general information purposes only and is intended to provide a summary of the subject matter covered. It does not purport to be comprehensive or to give advice. The views expressed are the views of the writer at the time of issue and may change over time. This is not an offer document, and does not constitute an offer, invitation, investment recommendation or inducement to distribute or purchase securities, shares, units or other interests or to enter into an investment agreement. No person should rely on the content and/or act on the basis of any matter contained in this document.

This document is confidential and must not be copied, reproduced, circulated or transmitted, in whole or in part, and in any form or by any means without our prior written consent. The information contained within this document has been obtained from sources that we believe to be reliable and accurate at the time of issue but no representation or warranty, express or implied, is made as to the fairness, accuracy or completeness of the information. We do not accept any liability for any loss arising whether directly or indirectly from any use of this document.

References to “we” or “us” are references to Stewart Investors. Stewart Investors is a trading name of First Sentier Investors (UK) Funds Limited, First Sentier Investors International IM Limited and First Sentier Investors (Ireland) Limited. First Sentier Investors entities referred to in this document are part of First Sentier Investors, a member of MUFG, a global financial group. First Sentier Investors includes a number of entities in different jurisdictions. MUFG and its subsidiaries do not guarantee the performance of any investment or entity referred to in this document or the repayment of capital. Any investments referred to are not deposits or other liabilities of MUFG or its subsidiaries, and are subject to investment risk including loss of income and capital invested.

Past performance is not a reliable indicator of future results.

Reference to specific securities (if any) is included for the purpose of illustration only and should not be construed as a recommendation to buy or sell. Reference to the names of any company is merely to explain the investment strategy and should not be construed as investment advice or a recommendation to invest in any of those companies.

Hong Kong and Singapore

In Hong Kong, this document is issued by First Sentier Investors (Hong Kong) Limited and has not been reviewed by the Securities & Futures Commission in Hong Kong. In Singapore, this document is issued by First Sentier Investors (Singapore) whose company registration number is 196900420D. This advertisement or publication has not been reviewed by the Monetary Authority of Singapore. Stewart Investors is a business name of First Sentier Investors (Hong Kong) Limited. Stewart Investors (registration number 53310114W) is a business division of First Sentier Investors (Singapore).

Australia

In Australia, this document is issued by First Sentier Investors (Australia) IM Limited AFSL 289017 ABN 89 114 194 311 (FSI AIM). Stewart Investors is a trading name of FSI AIM.

United Kingdom

This document is not a financial promotion. In the United Kingdom, this document is issued by First Sentier Investors (UK) Funds Limited which is authorised and regulated in the UK by the Financial Conduct Authority (registration number 143359). Registered office: Finsbury Circus House, 15 Finsbury Circus, London, EC2M 7EB, number 2294743.

European Economic Area (“EEA”)

In the EEA, this document is issued by First Sentier Investors (Ireland) Limited which is authorised and regulated in Ireland by the Central Bank of Ireland (registered number C182306) in connection with the activity of receiving and transmitting orders. Registered office: 70 Sir John Rogerson’s Quay, Dublin 2, Ireland, number 629188.

Middle East

In certain jurisdictions the distribution of this material may be restricted. The recipient is required to inform themselves about any such restrictions and observe them. By having requested this document and by not deleting this email and attachment, you warrant and represent that you qualify under any applicable financial promotion rules that may be applicable to you to receive and consider this document, failing which you should return and delete this e-mail and all attachments pertaining thereto.

In the Middle East, this material is communicated by First Sentier Investors (Singapore).

Kuwait

If in doubt, you are recommended to consult a party licensed by the Capital Markets Authority ("CMA") pursuant to Law No. 7/2010 and the Executive Regulations to give you the appropriate advice. Neither this document nor any of the information contained herein is intended to and shall not lead to the conclusion of any contract whatsoever within Kuwait.

UAE - Dubai International Financial Centre (DIFC)

Within the DIFC this material is directed solely at Professional Clients as defined by the DFSA's COB Rulebook.

UAE (ex-DIFC)

By having requested this document and / or by not deleting this email and attachment, you warrant and represent that you qualify under the exemptions contained in Article 2 of the Emirates Securities and Commodities Authority Board Resolution No 37 of 2012, as amended by decision No 13 of 2012 (the "Mutual Fund Regulations"). By receiving this material you acknowledge and confirm that you fall within one or more of the exemptions contained in Article 2 of the Mutual Fund Regulations.

United States of America

In the United States, this document is issued by First Sentier Investors International IM Limited, as SEC registered investment adviser. Stewart Investors is the trading name of First Sentier Investors International IM Limited. This material is solely for the attention of institutional, professional, qualified or sophisticated investors and distributors who qualify as qualified purchasers under the Investment Company Act of 1940 (hereafter the "1940 Act"), as accredited investors under Rule 501 of SEC Regulation D under the US Securities Act of 1933 ("1933 Act), and as qualified eligible persons as defined under CFTC Regulation 4.7. It is not to be distributed to the general public, private customers or retail investors.

Other jurisdictions

In other jurisdictions where this document may lawfully be issued, this document is issued by First Sentier Investors International IM Limited which is authorised and regulated in the UK by the Financial Conduct Authority (registration number 122512). Registered office 23 St. Andrew Square, Edinburgh, EH2 1BB number SC079063.

Contact details

Edinburgh

23 St Andrew Square
Edinburgh EH2 1BB
United Kingdom
t. +44 (0) 131 473 2900

London

Finsbury Circus
House
15 Finsbury Circus
London EC2M 7EB
United Kingdom
t. +44 (0) 207 332 6500

Singapore

58 Duxton Road
2nd & 3rd Floor
Singapore 089522
t. +65 680 59670

Sydney

Suite 10, Level 3
13 Hickson Road
Dawes Point
Sydney NSW 2000
t. +61 2 8274 8000

info@stewartinvestors.com
stewartinvestors.com