

Glanbia:

engagement commentary



Federated Hermes SDG Engagement Equity Fund
Q4 2020



ENGAGEMENT COMMENTARY: Glanbia

Glanbia is an international dairy, nutrition and ingredients company. While more than 80% of the company's revenues comes from America, the company operates primarily in Ireland, the UK and the US.

Investment case

The firm is positively exposed to structural growth trends within the functional food market, which are driven by more health-conscious and physically active consumers. Glanbia's Performance Nutrition division contains some of the leading brands within sports nutrition (Optimum Nutrition) and weight management (Slimfast), while its Nutritional division provides food ingredients. Glanbia is the number-one US producer of protein and is ranked second for vitamins and mineral premix¹.

Mergers and acquisitions have enabled Glanbia to expand its product portfolio and have created cross-selling benefits. We believe the business is undervalued and that its stock price will likely rise if it executes its strategy (of streamlining stock-keeping units and increasing efficiencies) to expand its profit margins.

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Principal theory of change (aligned to SDGs 2 (zero hunger), 3 (good health and well-being) and 13 (climate action))

Glanbia sources more than 8bn litres of milk a year from 5,000 suppliers, which accounts for nearly 90% of its total value-chain emissions. A single dairy cow generates about three tonnes of carbon-dioxide equivalent (CO₂e) every year in the form of manure and enteric (in other words, burped) methane.

While methane poses far higher potential for global warming than CO₂ – 28-36 times more according to the Environmental Protection Agency – it stays in the atmosphere for a fraction of the time.

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More pertinent is the way that methane converts into emissions. Fossil-fuel burning moves buried and dormant CO₂ into the atmosphere, exacerbating climate change (although some hope that carbon capture and storage might mitigate this).

By contrast, emissions from dairy cows are part of a natural cycle. Plants absorb CO₂ from the atmosphere, are eaten by the cows (and so are used for energy) and then are re-emitted back into the atmosphere.

The scale of methane emissions is clearly out of kilter with its natural equilibrium and methane is more potent than CO₂ in the short term. However, methane has a smaller cumulative effect on global warming.

Enteric methane emissions represent 30% of global methane emissions. Because methane is a short-lived climate pollutant, reducing emissions from enteric methane could help mitigate climate change within our lifetimes.

The amount of methane emitted per animal is far higher in North America than elsewhere, although the average milk yield per cow is also larger (see figure 1). This means that fewer cows are needed, and US dairy herds have declined from over 17m in the early 1960s to just over 9m today.

¹ 'Our equity story', published by Glanbia.

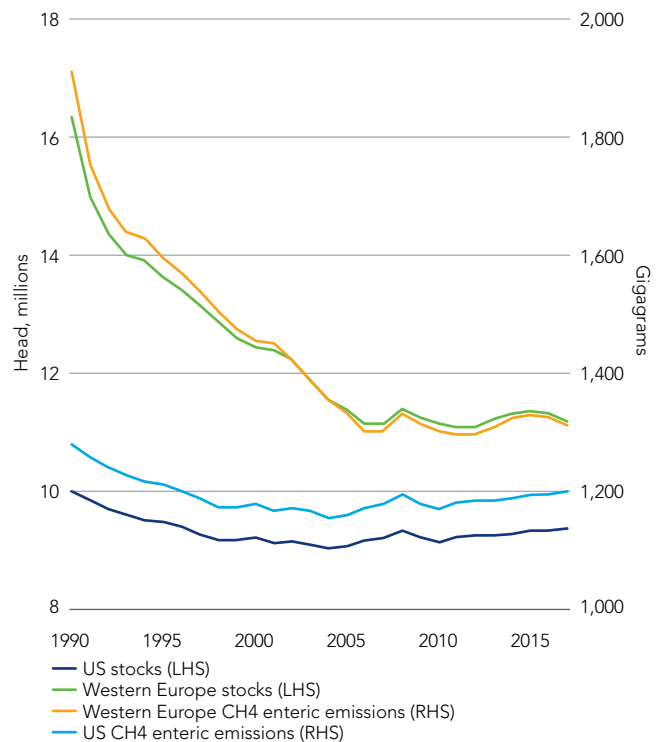


Figure 1. Emissions and milk yield per cow

Region	Kg of CH ₄ per animal per year		Average milk yield (kg per animal/year)	
	2005	2015	2005	2015
North America	111.0	116.6	8,899	9,867
Russia	64.2	71.8	3,000	4,146
Western Europe	76.3	80.9	6,287	6,957
Eastern Europe	71.2	81.7	3,921	5,005
West Asia and Northern Africa	68.2	72.8	1,240	1,830
East Asia	69.5	69.1	2,915	2,907
Oceania	72.3	71.4	4,274	4,659
South Asia	60.8	62.1	979	1,388
Central and South America	82.2	84.6	1,668	1,947
Sub-Saharan Africa	46.1	46.4	464	457

Source: Food and Agricultural Organisation of the United Nations, as at 2019.

Figure 2. Dairy stock and emissions



Source: FAOSTAT, as at 21 August 2020.

Data also suggest that emissions from dairy cows in western Europe have fallen steadily since 1990 (see figure 2). In developed economies like Europe and the US, the emissions intensity of dairy production is relatively low but the volume of production – and therefore total amount of emissions – is high. This means that lowering emissions intensity can still result in a large aggregate reduction in emissions.

Emerging feed supplements can help mitigate the effects of climate change. For example, red seaweed could reduce enteric methane by 80%.³ DSM, a nutrition company, claims that its feed supplement lets farmers reduce greenhouse-gas emissions by cutting enteric methane by 30%. Improved farm operations and energy use also help reduce emissions.

Meanwhile, climate change and environmental concerns have driven rising interest in health and wellbeing, prompting an increase in demand for alternative proteins. Demand for alternative dairy has risen by 23% over the past four years.⁴

We believe that emissions can be reduced, degraded land restored, and biodiversity enhanced by working with farm suppliers and partners across the value chain. Glanbia has the ability to invest in research and development and marketing in order to diversify its product portfolio, which will help it continue to grow while also reducing both the industry’s and its own environmental impact.

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³ Journal of Dairy Science, Volume 102, Supplement 1’, published in January 2019.

⁴ ‘5 charts that show how milk sales changed and made it tough for Dean Foods to avert bankruptcy’, published by CNBC on 13 November 2019.

Engagement objectives

Reduce total carbon footprint (Milestone 4) – SDG 7 and 13:

Reporting in line with the Taskforce for Climate-related Financial Disclosures (an initiative to develop a set of recommendations for climate-related financial risk) is now required for UK-listed firms. Given the high emissions associated with Glanbia's farming supply chain, we hope it will commit to adopting entire value-chain emissions-reduction targets that are aligned with the Paris Agreement (an agreement to limit global warming to well below 1.5°C).

Responsible nutrition strategy (Milestone 3) – SDG 2 and 13:

Given the rising interest in non-dairy alternatives, we want Glanbia to articulate more clearly its alternative-protein strategy. Within this, we want to understand the link between its planned product-segment growth and the firm's intended reduction in total value-chain carbon emissions.

Decent employment (Milestone 4) – SDG 1, 5 and 8:

Covid-19 has clearly brought greater salience to this agenda. In our discussions with firms, we have been encouraging them to emphasise diversity and inclusion efforts and identify opportunities to promote economic, physical and mental wellbeing.

Packaging audit (Milestone 4) – SDG 12:

Regulatory requirements and consumer preferences surrounding packaging continue to grow. We want the company to undertake a packaging audit, which would enhance its disclosures around the recyclability of existing packaging and intensity of package use (in other words, the amount spent per unit of sales).

International partnerships (Milestone 2) – SDG 3 and 17:

While Glanbia continues to grapple with the challenge of getting its products in front of and to its target customers in key international markets, there is a clear opportunity to support and promote healthy living. We wish to see the firm develop in-country partnerships with relevant organisations and bodies to collaboratively address the needs of populations – including those related to infant health or obesity – for the mutual benefit of all.

Executive pay (Milestone 3):

Glanbia has been developing and establishing its sustainability targets in recent years. Our objective is for the company to include performance against its sustainability targets in the CEO's annual incentive scorecard.

Milestone 1 Initiate dialogue

Milestone 2 Issue validated

Milestone 3 Plan developed

Milestone 4 Plan implemented

The story so far

Glanbia published its first sustainability report in 2016. We also began to broaden our dialogue with the firm that year and discuss its approach towards sustainability. Since then, we have had numerous interactions with the company's board, management and with others below these levels.

In 2016, Glanbia commissioned the Carbon Trust to help it develop its approach to carbon. This partnership remains critical as Glanbia deliberates whether to establish science-based targets or equivalent ones.

The company agreed a series of initial targets in 2015 and 2016. Glanbia came to the end of its first five-year sustainability plan in 2020 and is currently reviewing its progress and is setting new targets for the next decade and beyond.


Carbon

In 2019, the company worked with the Carbon Trust to map its total value-chain emissions. Perhaps unsurprisingly, the analysis identified that 89% of the group's total emissions came from its purchased milk. The most material issue for Glanbia – and indeed for the whole dairy industry – is to mitigate emissions at the farm level.

The risks associated with these emissions are emphasised by the following points:

- a) A new California law enacted in September 2019 requires the state's livestock industry to cut methane emissions to 40% of 2013 levels by 2030. Three quarters of this reduction should come from the state's dairies.
- b) It is reported that half of all Americans consume non-dairy milk, due to concerns about heart health and weight loss. While whey dominates the supplements market, plant sources such as pea protein are expected to record the fastest growth. In this vein, we were heartened to see the Innovation Centre for US Dairy – an organisation founded by dairy farmers to bring leadership across the dairy value chain together to align social responsibility priorities – commit to become carbon neutral or better by 2050 at its 2020 spring conference.

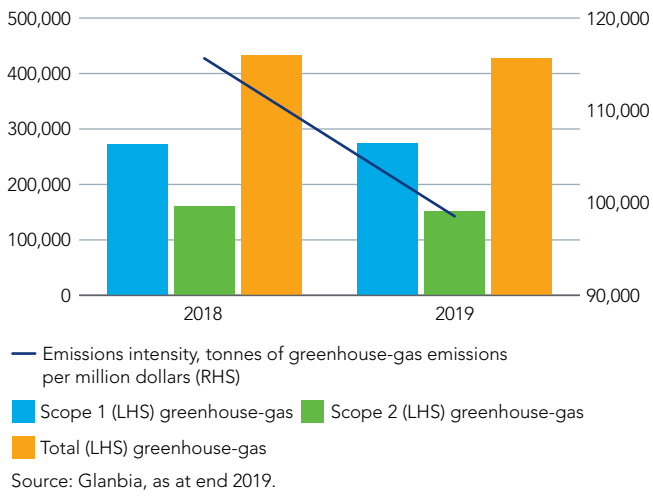
This 2050 goal comes after the Innovation Centre of a Stewardship Commitment was set up in 2018. Glanbia Nutritionals was involved in developing this commitment and adopted it in 2019, agreeing to follow a rigorous set of standards to demonstrate positive impact.



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Progress against each of the US Dairy Innovation Centre's 2050 environmental stewardship goals will be reported every five years, beginning in 2025. In the meantime, we hope that companies involved in the dairy value chain will establish their own emissions-reductions targets to ensure that momentum is maintained and accelerated.

Figure 3. Glanbia's operational emissions



Plant-based protein

Glanbia launched its plant-based business by acquiring the company Amazing Grass in 2017, which had a portfolio of organic and non-genetically-modified-organism brands that produced plant-based nutrition, green and superfood products. Glanbia also acquired Thinkthin – now rebranded as Think – in 2015 and launched a plant-based high protein bar in 2017.

The firm has launched plant-based innovations across its Performance Nutrition portfolio, and we tasted some of its Optimum Nutrition pea-based protein products during a visit to the company's Chicago offices in 2018. Today, these pea-based products represent about 5% of the Performance Nutrition division's revenue and compare favourably with whey protein.

Similarly, Glanbia's Nutritionals business has steadily deepened its relationships with key customers by providing them with plant-based solutions. These plant-based protein, flaxseed, chia, quinoa and oat ingredients all offer improved safety, nutrition and flavour to the customer's end products.

Decent work

Glanbia employed 7,385 people across 34 countries during the 2019 financial year, principally across the US, UK and Ireland.

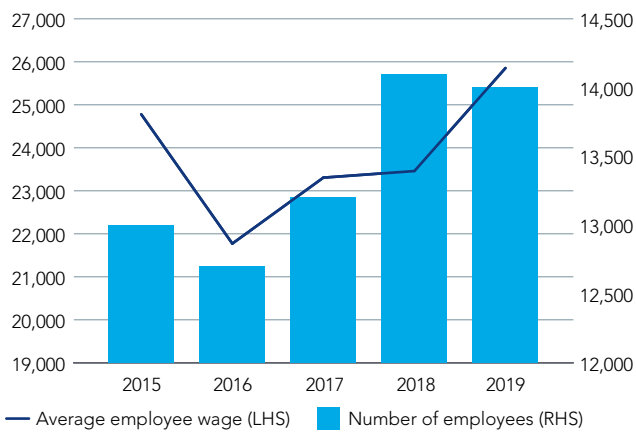
The firm launched its first global employee engagement survey in 2015, which has been repeated every year. In 2018, the Performance Development Programme was restructured to include an assessment for 'living the Glanbia values'.

While diversity levels are not poor, they deteriorate markedly at senior-management levels. Glassdoor ratings and employee turnover levels are also on a par with the industry, although this masks the spectrum of performance across the group.

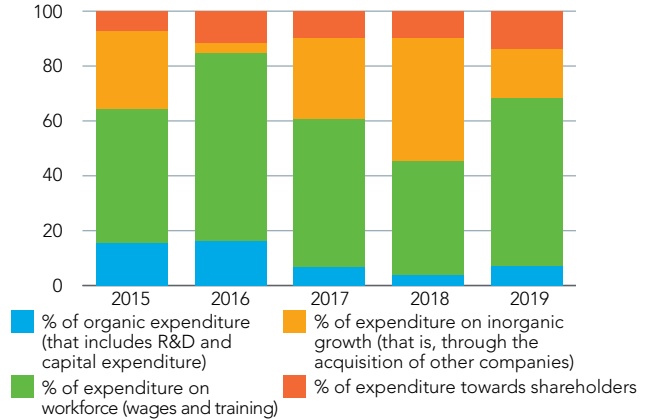
This suggests that Glanbia could improve how it attracts, retains and promotes talent. In turn, the group's sustainability credentials are of increasing importance to the younger employees it wishes to attract and retain.

Figure 4. Glanbia's employment practices

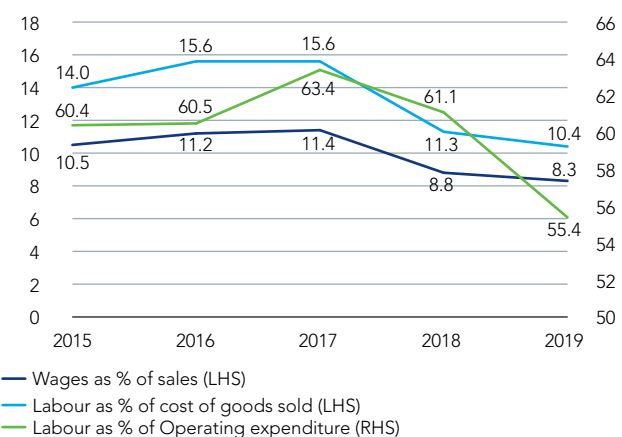
Total employees and average pay



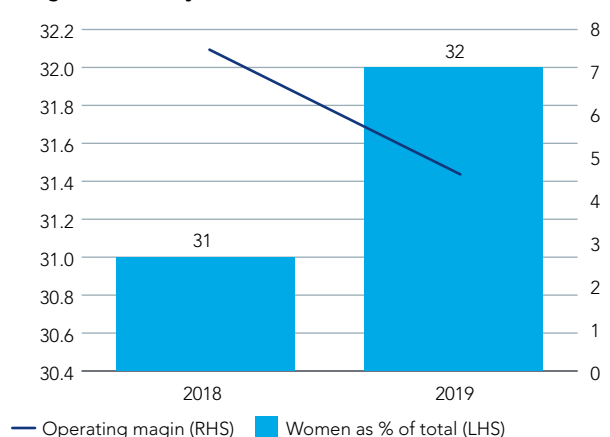
Expenditure allocations between groups



Labour costs



Margin and diversity



Source: Glanbia, as at end 2019.

Timeline

- We held a call with investor relations and the Head of Sustainability to discuss governance and sustainability.
- It appeared for the first time that the firm was centralising its sustainability efforts. The company commissioned the Carbon Trust to help it develop its approach to carbon. We discussed how it could use the Sustainable Development Goals to inform its strategy and aid its communication.

The company acknowledged in a meeting with us that its initial focus on sustainability, set out in its 2016 report, was fairly narrow as it only covered issues that could be managed internally. We encouraged the company to measure its impact across the full value chain of its products.

We initiated our position in the company through the SDG Engagement Equity Fund and wrote to the chair.

We met with management following the publication of the company's annual report, which included group-wide sustainability efforts and commitments to enhance these disclosures for the first time.

In a meeting with management, we were encouraged by the emphasis on plant-based protein offerings and how the firm was keeping an eye on potential acquisition opportunities in the area. We were also pleased that the company had engaged with the Carbon Trust to develop a climate-change strategy and – reflecting our discussions with it – set a recommendation in its annual report to work with suppliers.

We wrote to the CEO on the topic of decent-work practices.

We discussed the firm's strategy for plant-based proteins and also discussed biodiversity with management, acknowledging that sustainability was gaining attention both internally and externally.

We held lengthy discussion about progress on the firm's sustainability agenda, including employment practices and plans to measure, report on and reduce the greenhouse-gas emissions connected to the dairy farmers the company is supplied by.

We met with the company to discuss progress on a range of sustainability issues, including farm emissions. We discussed the company's approach to human capital management (in other words, the set of practices a firm uses for recruiting, managing, developing and optimising its employees) and encouraged much richer disclosure in this area. We also explained that we would like to see the company provide more detail around its strategy for plant-based proteins.

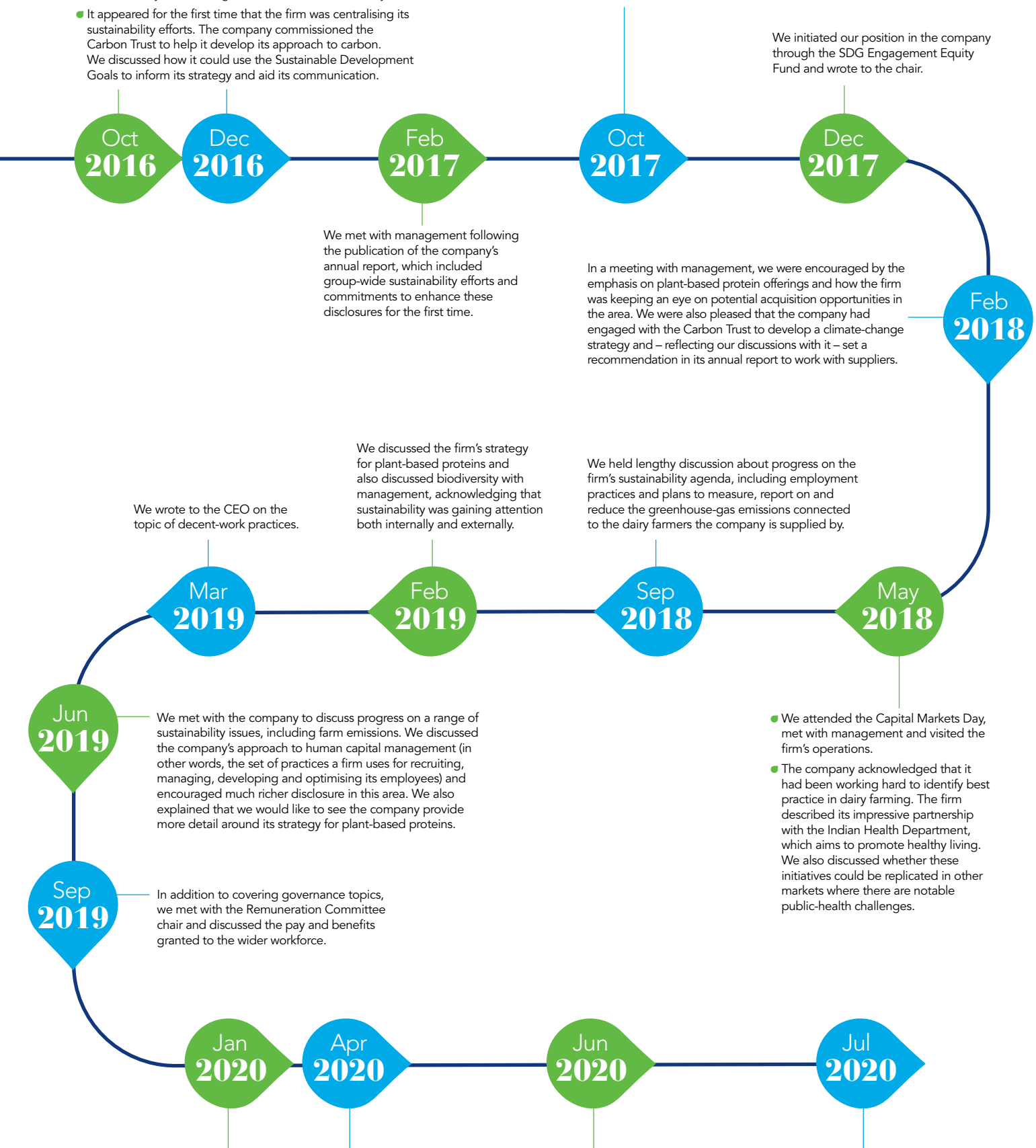
In addition to covering governance topics, we met with the Remuneration Committee chair and discussed the pay and benefits granted to the wider workforce.

- We attended the Capital Markets Day, met with management and visited the firm's operations.
- The company acknowledged that it had been working hard to identify best practice in dairy farming. The firm described its impressive partnership with the Indian Health Department, which aims to promote healthy living. We also discussed whether these initiatives could be replicated in other markets where there are notable public-health challenges.

We spoke with the Innovation Centre for US Dairy and presented at its spring conference. During the conference, the Innovation Centre committed that the entire industry, from farm to fork, would achieve carbon neutrality by 2050. We reinforced the need for the industry and individual parties to supplement this overall commitment with interim ones and regular reporting on progress towards the goal.

We spoke with the Senior Independent Director about governance matters and how the company needed to raise ambitions around sustainability. We were reassured that work is underway internally.

We wrote to the CEO to formally set out the areas that we wanted the company to address in its internal sustainability review, encouraging it to be bold and ambitious with the goals it ultimately sets itself. We addressed five areas: carbon footprint, responsible nutrition, employees and decent work, packaging, and programmatic partnerships in international markets.



Themes

International

Glanbia's Performance Nutrition business has previously partnered with the Indian and Malaysian governments to offer Fit initiatives, which were designed to help consumers understand the benefits of a healthy and active lifestyle. Through its Optimum Nutrition brand, the Performance Nutrition business provides detailed classroom education programmes to retailers and consumers. These are then supported by in-market sampling, education and work-out programmes that come alive through a mobile vehicle tour.

It is conceivable that government efforts throughout the world – and particularly in countries with relatively higher levels of obesity – will increase in the wake of Covid-19, which has had a relatively higher impact on the unhealthy. As Glanbia adjusts its route-to-market strategy and relies more on direct-to-consumer activities and ecommerce, the potential synergies from these sorts of initiatives becomes greater.

Packaging

Glanbia aims to achieve zero waste to landfill for all business units where possible, something that the Performance Nutrition business has already achieved. Glanbia Performance Nutrition has also focused on waste within the full supply chain and is encouraging consumers to recycle and reduce waste.

In addition, there are instances across the business where original product packaging is being replaced with more sustainable and recyclable versions. The company has also indicated that it will look at refill solutions in future.

Engagement progress and next steps

Since our conversation with Glanbia in 2016, we have recorded more than 20 engagement interactions with the company, including meetings with various board members and management. We have also visited Glanbia's production and innovation facilities in Chicago, as well as its Ireland offices.

We will continue to engage in a constructive manner with company management and the board. Our focus will remain on encouraging it to adopt an ambitious strategy which underpins and supports the firm's long-term commercial success, while also minimising the negative and scaling-up positive societal impacts.

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