



Huhtamaki:

engagement commentary

SDG Engagement Equity
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**Federated
Hermes** 
International

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ENGAGEMENT COMMENTARY:

Huhtamaki

A Finnish consumer packaging company, with a focus on paperboard, molded fiber and flexibles

Employs

18,000
people



Operates

80



manufacturing units across 35 countries, including a growing presence in emerging markets

Investment case

- Defensive company with good niches
- Organic growth opportunity
- Good return profile
- Solid management track record

The company operates in areas where it believes it has leadership or leadership potential. In the consumer packaging industry, there are decent barriers to entry, some of which include manufacturing and distribution footprint, manufacturing know-how and product innovation and quality. Although many of its products are not technologically complex to make, Huhtamaki has strong pedigree in producing large volumes of products and meeting tough customer demands for quality and service.

Engagement focus summary

There are opportunities for SDG-aligned engagements across three pillars: a company's supply chain, its direct operations, and its products and services. We have been engaging Huhtamaki on:

1. The company's sourcing of fiber (supply chain)
2. The provision of decent work and resource efficient operations (direct operations)
3. Investments in innovations which are more environmentally friendly both in terms of material usage and end-use recyclability (products)

Engagement timeline

Completed objectives

- **Recyclability of packaging** (SDG 12 and 14): Huhtamaki established commitments so that product design is recyclable, compostable or reusable, and invest in product innovation.
- **Emissions reduction targets** (SDG 7): the company established meaningful operational emissions reduction targets.

Open objectives

- **Product innovation** (SDG 12 and 14): we would like to see greater granularity around the company's commitment to design 100% of products to be recyclable, reusable or compostable per business segment.
- **Science-Based Targets** (SDG 7): we want the company to establish Science-Based Targets so as to extend its carbon-neutral production to entire value chain emissions.
- **Living wages** (SDG 1 and 10): ensure that the wages of (direct and indirect) employees equate to at least the living wage in each country of operation.

We have a positive introductory meeting with the company's investor relations team. Our discussions focus on the company's sustainability challenges, specifically the recyclability of packaging.

The company acknowledges the need to consider both the recycled content of its products and the recyclability of its products. Its collaboration with supermarket group Waitrose to develop a fibre replacement for black plastic takeaway food trays is encouraging.

Apr
2018

Nov
2018

During a discussion with the Head of Corporate Responsibility, we question the company's commitment to paying living wages to its direct and indirect staff.



SDG alignment

Theory of change



Sustainable packaging (SDG 12, 14 and 17)

As a global leader, Huhtamaki has relationships with most, if not all, of the largest consumer goods and quick service restaurant companies. It therefore has the ability to support and catalyse change for positive environmental impact.

The demand for more sustainable packaging solutions is growing fast. This necessitates in many areas plastic substitution, something Huhtamaki is well positioned to drive alongside greater support for reusability and usage of recycled content in product manufacturing. Partnerships and collaborations are required to reform the plastic packaging industry – the whole value chain needs to work and move together; progress can only be as fast as the weakest (or least committed) link.

The demand for more sustainable packaging solutions is growing fast.



Cups

A recent study by Huhtamaki dispelled the common assumption that reusable cups are more sustainable than paper cups: it found that reusable steel cups need to be used at least 130 times before their carbon footprint is lower than that of a paper cup with a lid, while ceramic cups used in cafés need to be used at least 350 times before having a smaller carbon footprint than that of a paper cup¹.

Moreover, a take-away coffee's carbon footprint can be further reduced by as much as 54% by recycling the cups and lids as efficiently as possible². Historically, and frustratingly, very few cups have found their way to specialist recycling facilities – thus while recyclable in theory they rarely are in practice. However, significant progress has been made in this area, particularly in the UK, where industry collaboration between retailers, converters, waste management companies and others have resulted in **cup recycling rates increasing 16-fold since 2016** (up from 1 in 400 in 2016 to 1 in 25 in 2020)³. All paper cup manufacturers are working towards an 85% recycling rate by 2030⁴.

The company announces a clear commitment to work towards a more circular model for flexible packaging. Its Blueloop initiative will supplement other initiatives. We welcome the collaborative approach across the value chain and see the establishment of metrics as the next step.

We direct the company towards the Opportunity Navigator⁵, a useful tool to understand best practice that has received positive feedback from other companies we engage with. We share our commentaries on SDG 8 – decent work and economic growth – for further context.

Mar
2019

Apr
2019

Aug
2019

Dec
2019

Mar
2020

We write to the CEO on the topic of decent work. We contend that an employee's relationship with their employer and colleagues has a profound impact on financial and mental well-being. We believe companies are uniquely placed to have a transformative impact on people's lives.

We ask about progress on establishing living wages. The company is continuing to explore vendors to support it in the necessary analysis. It is aware of the complexities in establishing what constitutes a living wage (i.e. the different needs associated with rural and urban living).

At its Investor Day, the company establishes a suite of new sustainability targets which it aims to achieve by 2030. This includes a commitment to design 100% of its products to be recyclable, compostable or reusable.



Flexible packaging

Flexible packaging is naturally thin and lightweight and thus more environmentally friendly than alternatives – thereby significantly reducing transport costs and extending food life. Notably, approximately half of all products sold in India are packaged using flexibles.

Flexible plastic packaging is one of the most prevalent forms of consumer packaging in use today, and while it has potential to be made into new products, it is largely being landfilled. Those who wishfully recycle it challenge the traditional material recovery facility's single substrate sorting systems – it often becomes a contaminant of other recyclables.

By developing innovative, simpler mono-material solutions – which offer the same or similar benefits (i.e. are lightweight and easy to use) but are more recyclable or compostable – companies have the potential to make a significant impact.



Fiber sourcing (SDG 15)

Huhtamaki's main raw material input is fiber – this is derived from full-grown trees and young trees thinned out to allow forests to grow (approximately 25% of felled wood is used to produce fiber).

Well-managed forests provide livelihoods, clean air and water, maintain biodiversity and mitigate climate change. But as the rates of deforestation worldwide increase at a concerning pace, there is a clear need to promote the sustainable management of forests to ensure that they renew and grow.



Decent work (SDG 1, 8 and 10)

Huhtamaki is one of the larger employers and most geographically spread companies in our portfolio. As such, it has the inherent potential to support the economic, physical and wellbeing of tens of thousands of direct employees and their dependents.

We have been engaging with companies comprising well over 25% of Huhtamaki's revenue base on the agenda of sustainable packaging.

Practice of change

Since the beginning of 2018, we have had multiple interactions with Huhtamaki about how it does business and what business it does – i.e. the products it produces and sells. Pleasingly, the company has been investing significantly in sustainability in recent years with investments in its expanding sustainability function, its people and, most importantly, its product development.

Additionally, through our stewardship business, EOS at Federated Hermes, we have been engaging with companies comprising well over 25% of Huhtamaki's revenue base on the agenda of sustainable packaging.

Progress to date

At a curtailed March 2020 Investor Day, the company announced updated sustainability targets. We are satisfied that two of our original engagement objectives have been completed: the company has publicly committed to design 100% of its products to be recyclable, reusable or compostable. It has also committed to carbon-neutral production, with 100% of electricity to be derived from renewable sources.

Cups

The company's Future Smart Cup range already boasted 100% renewable material input. Yet, the plastic lid used to prevent spillages of takeaway beverages still had a disproportionately negative impact on the carbon footprint of the overall product. Plastic lids are rarely recycled (they are made from hard polystyrene), and they are energy intensive to produce. In response to our engagements and the feedback we conveyed from Huhtamaki customers, the company brought a fiber-based alternative to market in late 2019.

Flexibles

In 2019, Huhtamaki launched Blueloop – a concept that aims to make flexible packaging more circular by promoting mono-materials and adopting a holistic approach to design. Building on already easily recyclable materials – PP, PE or paper - the end products will have an economically viable use after collection.

Other innovations

Last year the company launched forward-looking and practical innovations, including paper straws in collaboration with fast-food chain McDonalds and Fresh, a recyclable and home compostable fiber-based food tray for ready-to-eat meals. Fresh replaces the commonly used black plastic ready-meal tray – an annoyance of many waste-sorting machines.

The company has committed to **carbon-neutral** production, with **100%** of electricity to be derived from renewable sources.



Beyond the products

Already, the company derives 99% of its fiber from certified sustainable sources, with the 1% gap pertaining to its Indian fiber sourcing. However, we welcome its commitment to reach 100% certified sustainable fiber sourcing and in time we hope preference will be given to the more robust certifications to further raise the bar.

The company is also already making some use of post-consumer and post-industrial paper (it represented 29% of its total input in 2019) and we hope this will be scaled up further in time.

Separately, large proportions of the company's workforce are situated in markets with low or minimal minimum wages and/or relatively few rights (for example, 22% are based in the US and 20% are in India). Positively, employee turnover has been declining, down from 21% in 2017 to 14% last year, and engagement levels rising. However, in its approach to pay, the company uses the term 'basic needs wage' as opposed to Living Wage – an area we believe there is scope for further progress.

Next steps

We are encouraged by the positive progress that Huhtamaki has made during the course of our engagements. We are confident that the management team are supportive of further embedding sustainability into the company's business model and strategy. Our focus going forward is principally threefold:



1. We will continue to engage on product development and for lifecycle considerations to be systematically incorporated into the innovation process.

While the company is reliant on its customers following through on their own public commitments – the test is not how 'sustainable' its new products are on paper but whether they respond to the practical needs of brands and consumers alike. In so doing, Huhtamaki will be in a position to capitalise, gaining market share and expanding margins accordingly while helping reduce the industry's environmental impact.

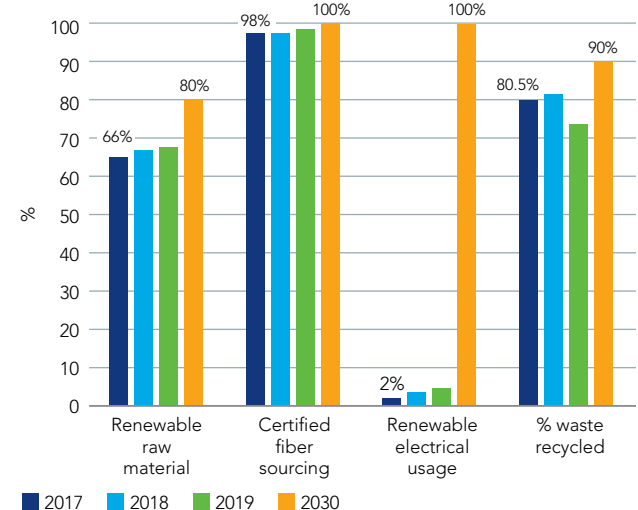


2. We will continue to ask the company to establish Science-Based-Targets pertaining to the total emissions associated with the business.

In practice, this means extending its current commitment of carbon-neutral production to the measurement, reporting and targeted reduction in emissions associated with its raw material inputs and product usage. With the ongoing trend of substrate substitution from plastic to paperboard and fiber, Huhtamaki should be well positioned to align itself to the low-carbon world that the Paris Agreement aims to deliver.

3. We would like to see the company's ambitious and meaningful approach to establishing a number of environmental KPIs to be replicated for certain social matters too, such as a commitment to, and assurance over, the payment of at least a living wage to all direct and indirect employees.

Figure 1. Huhtamaki's 2030 sustainability targets



Source: Federated Hermes, based on data from Huhtamaki, as at April 2020.

Huhtamaki repurposed one of its factories giving it capacity to produce

4m

face shields per week for the NHS.

It has since replicated this activity across other sites to reach

10m

units per week.

Responding to the coronavirus

In response to the global coronavirus pandemic, Huhtamaki has suspended its dividend. In addition, as a result of coronavirus-related demand reduction, it repurposed one of its factories in Northern Ireland, giving it capacity to produce 4m face shields per week for the UK's National Health Service (NHS) – and it has since replicated this activity across other sites to reach 10m units per week.

References:

¹ "Taking a closer look at paper cups for coffee," published by Huhtamaki in 2019.

² Opportunity Navigator is a tool that can help employers create a customised road map for achieving business and social impact through Opportunity Employment. Opportunity Employment practices are strategic investments that build diverse entry-level and frontline talent pipelines, support retention and productivity, and often lead to improved morale and performance. For more information, see <https://opportunitynavigator.org/>.

³ "Taking a closer look at paper cups for coffee," published by Huhtamaki in 2019.

⁴ "Taking a closer look at paper cups for coffee," published by Huhtamaki in 2019.

⁵ "Taking a closer look at paper cups for coffee," published by Huhtamaki in 2019.

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