

# Federated Hermes Biodiversity Equity

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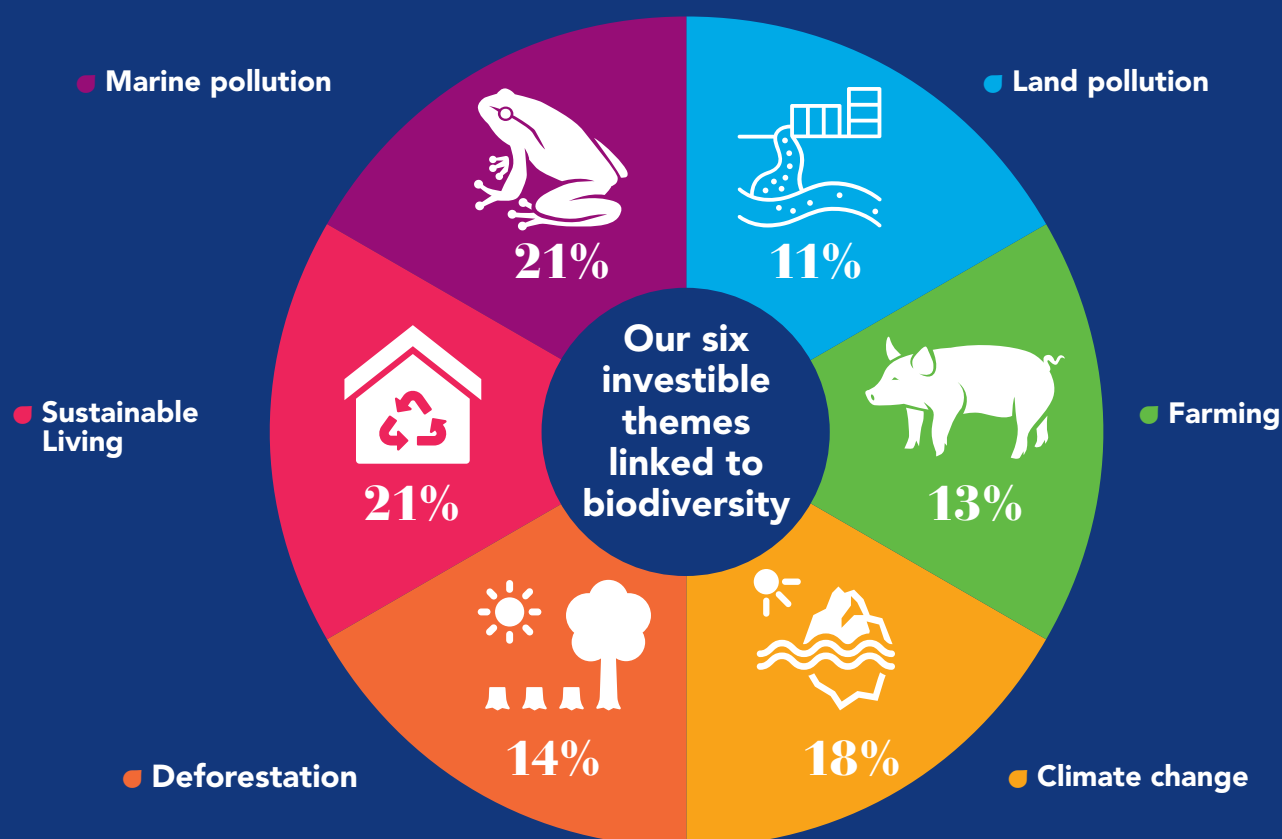


## Fund philosophy

**The Federated Hermes Biodiversity Equity Strategy** aims to achieve long-term capital appreciation by investing in a concentrated portfolio of best-in-class companies that provide solutions to avert loss of biodiversity and support its restoration.

### Thematic framework

We have extensively researched the major regional and global threats to biodiversity and have defined six investable themes: land pollution, marine pollution and exploitation, unsustainable living, climate change, unsustainable farming, and deforestation. Each of these themes has multiple sub-verticals that are aligned to specific UN Sustainable Development Goals (SDGs).



Source: Federated Hermes as at 31 March 2024.

Federated Hermes is a pioneer in this field, with a strong record advocating and engaging around biodiversity. We are members of industry organisations including the **Finance for Biodiversity Pledge**, the **PRI Sustainable Commodities Practitioners' Group**, the **SPOTT Supporter Network**, the **Partnership for Biodiversity Accounting Financials**, and the **PRI plastics working group**.



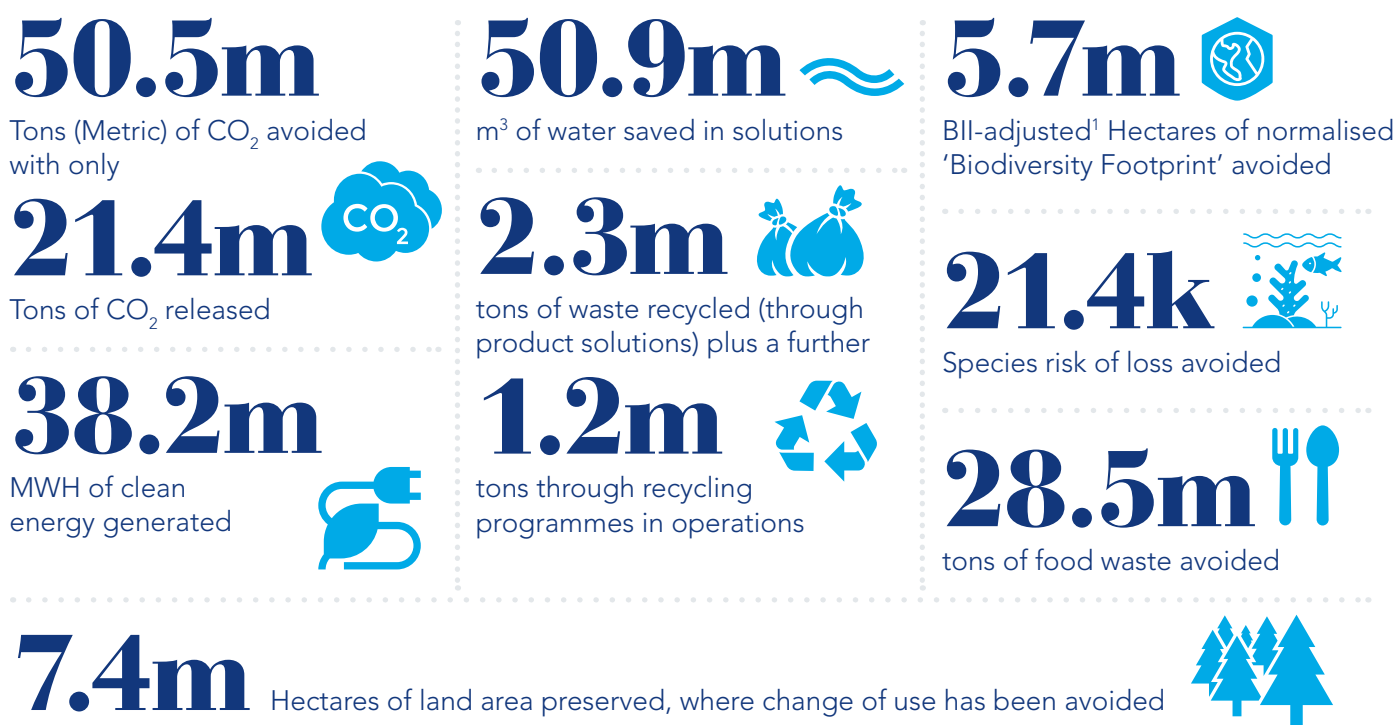


## Biodiversity Impact overview

### Total company level impact of stocks held in 2022

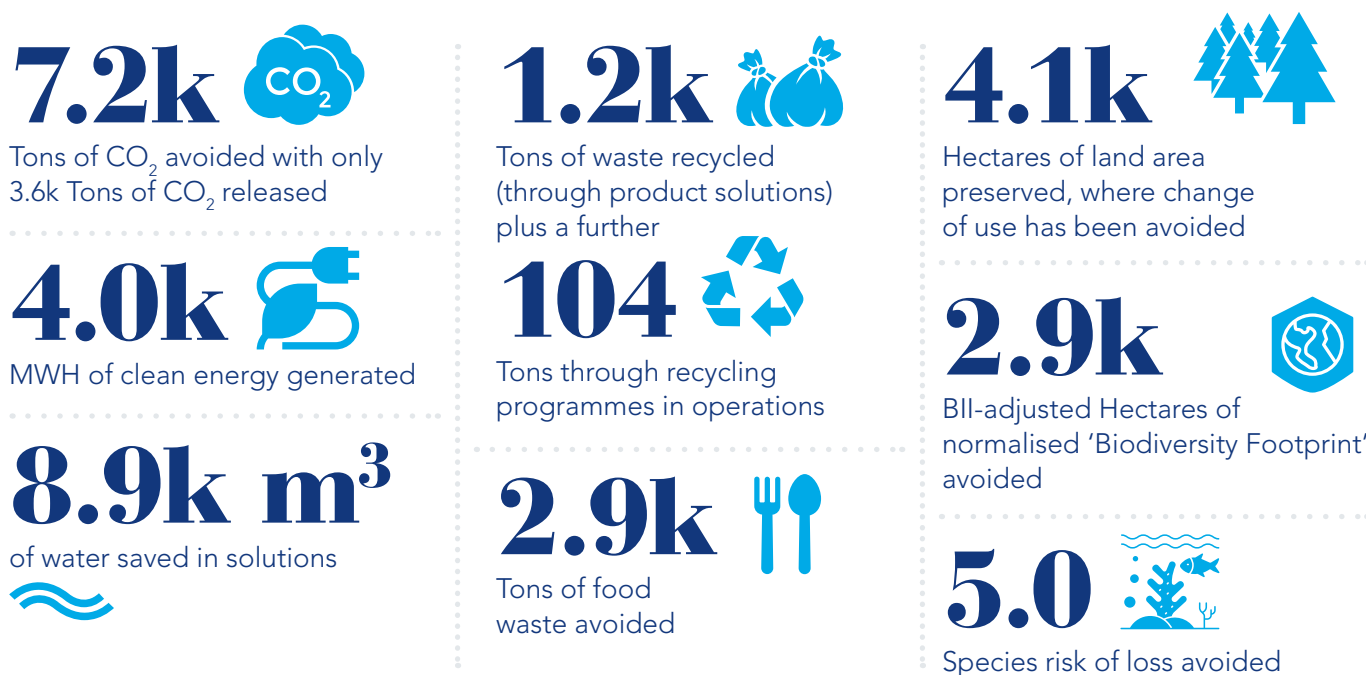
Using our proprietary Federated Hermes Biodiversity Impact Database, which we launched in 2023, we are able to present our impact data on an aggregated, cross-company basis. We have extended our original Impact Database, launched in 2020, to create **three bespoke biodiversity** metrics, as well as having qualified **10 biodiversity-adjacent** metrics, from our original Impact Database.

Put simply, these metrics depict our estimate of the total impact that our portfolio companies delivered in 2022. Our database draws on data from company, sector and industry reports.



### Impact achieved by capital deployed, 2022

In the section below, we scale the metrics to demonstrate the impact accomplished through the capital we deploy on behalf of our clients – US\$38m as at 31 December 2022.



Source: Federated Hermes Impact Calculations, Net Purpose, Natural History Museum as at 31 December 2022.

<sup>1</sup> BII: Biodiversity-Intactness-Index, a measure tracking biodiversity loss established and maintained by London's Natural History Museum.

## Thematic focus

### What makes a biodiversity champion (and why might it not be what you expect)

It takes time, resources and expertise to identify companies that can both protect biodiversity and provide investors with an attractive return. The companies that do pass our stringent selection criteria for inclusion in the Biodiversity Equity Strategy are not always the names you might expect to find there. Here's why.

A listed data provider. A company making garden decking. A food ingredients specialist. On the surface, these companies may have little in common other than their status as going concerns that have provided returns well in excess of cost of capital over the course of decades.

But look beneath the surface and, with the right tools, it's possible to tease out a common thread that unites them all: their ability to contribute to a world where biodiversity is protected, enhanced and promoted.

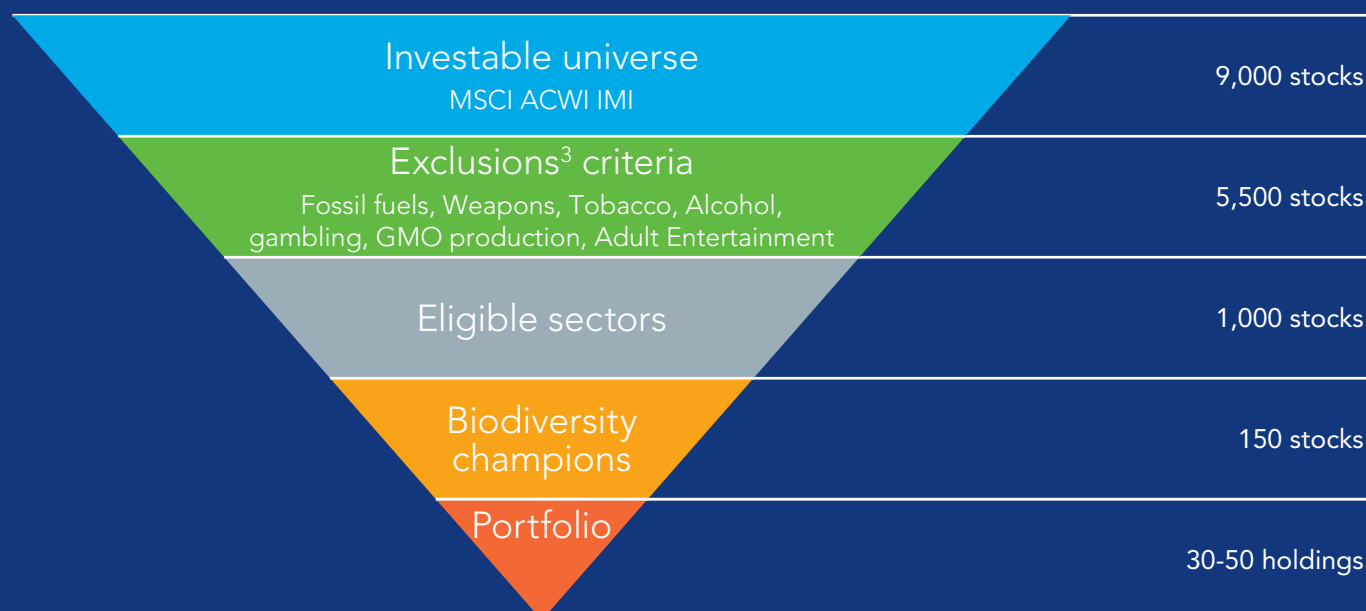
Our journey as biodiversity investors is a complex one. It involves a multi-stage process where we filter a disparate and diverse investment universe of some 9,000 stocks through a narrowing range of criteria until we can identify a comparatively small number of biodiversity champions as candidates for inclusion in the portfolio.

By distilling down the universe in this way, we can exclude non-starters on ethical grounds and match prospects against a thematic framework. We can also interrogate companies' financial profile to understand how they might influence the overall shape and performance of our wider portfolio.<sup>2</sup>

It is, by necessity, a time-consuming process, with many twists and turns, much data crunching and engagement at a company level. The approach we take to discovering biodiversity champions makes up much of the 'secret sauce' of the Strategy and what we do as an investment team.

Here, we aim to take a closer look at some of the companies in the portfolio to understand what makes them biodiversity champions. A key takeaway is that the names that come out at the end of our investment process are often not the names you might expect. We aim to illustrate how sometimes the most seemingly unlikely companies can turn out to be biodiversity champions.

**Figure 1:** Through the eye of a needle  
**Our five-stage investability filter**



<sup>2</sup> Our financial analysis of the companies deemed to be biodiversity champions provides the all-important additional tier of support for their inclusion in the portfolio. By interrogating past returns and their current finances we can begin to understand how their inclusion can affect the overall shape of the portfolio and how it could respond to future market events. In broad terms, our goal is to achieve exposure to businesses with high-quality, through-cycle revenues with the potential for high earnings growth. Our view is that the portfolio is structurally advantaged because we believe, on aggregate that it is capable of vastly superior growth at reasonable value versus the index (MSCI All Country World IMI).

<sup>3</sup> Exclusions: The Investment Manager will not invest in companies involved in specified activities, where those activities contribute to company revenues above prescribed revenue thresholds. Excluded activities include fossil fuels, electricity utilities not aligned with a 1.5 degree scenario, Controversial Weapons, conventional weapons, nuclear power, tobacco, gambling, adult entertainment, alcohol, GMO crop production and companies in contravention of the principles of the UN Global Compact. For more on this, read the appendix at the end of the report: A note on exclusions.

## Resource management and biodiversity

Many of the holdings in the portfolio have a clear and proven ability to use fewer resources than their peers and to recycle or re-purpose the resources they do use. Some contribute directly to the circular economy; some create the conditions necessary for the circular economy to take place. Others provide technologies that enable others to take part in the circular economy.

The evidence linking resource management, and biodiversity preservation is clear. In essence the fewer resources that we as a society consume, the less we encroach upon nature and draw from the bank of natural capital, thereby placing biodiversity at decreased risk.

Consider the case of US-based home decking provider Trex, for example. Unlike many of its peers, the company avoids 'virgin' timber where possible, using 95% reclaimed and recycled feedstocks – predominantly waste timber and hard-to-recycle thin plastic shopping bags – in its composite decking products.

This aids biodiversity in two ways. First, in simple terms, by avoiding virgin wood in its products the company reduces the need to cut down trees, thus helping to relieve the pressure on forests and the ecosystems that exist in them.

Second, by using hard-to-recycle thin plastic shopping bags as feedstock for its decking, Trex removes a source of pollution and sequesters it into the built environment. As a result, the planet has fewer waste plastic bags to deal with, landfill is avoided and the pressure on ecosystems reduced. (Given the vast scale of plastic pollution globally, this may literally be a drop in the proverbial ocean but, in the parlance of one well-known supplier of plastic bags to consumers: every little helps!)

Trex's data coupled with our own proprietary data tools provide a clear picture of the real-world impact this kind of resource management and recycling can have. Trex estimates it recycled c.646 million lbs of timber, and 431 million lbs of plastic in 2022. Our biodiversity impact calculator suggests this will have helped protect c.121,000 hectares of land, mainly through the prevention of landfilling and deforestation.

Thematically, then, we can say that Trex qualifies as a biodiversity champion since it meets the high bar we set for the prevention of **Land Pollution** as well as for the prevention of **Marine Pollution & Exploitation**.

Through its use of recycled wood and avoidance of fresh-cut timber it also qualifies for our **Deforestation Mitigation** theme.

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### Ice cream and biodiversity: unlikely bedfellows

Another holding in the portfolio that qualifies in unexpected ways as a biodiversity champion is Switzerland-headquartered fragrances and flavours specialist Symrise. Unlike Trex, however, it qualifies on its ability to trace the provenance of its raw materials and work with its suppliers to encourage sustainable farming methods.

The company sources more than 10,000 raw materials globally, spanning everything from nuts through to tree bark, fruit and vegetables, to herbs and spices – a full cornucopia of the often exotic and unusual ingredients that make up our modern foods and cosmetics.

Some of the raw materials used by Symrise are harvested in forests, collected by cooperatives and then sold to the company in extremely small quantities. Crucially, a good many of these are also sourced from under-threat biodiversity hotspots.

This is the case, for instance, with the vanilla pods Symrise uses in its foods and fragrances business (think everything from ice cream to yoghurt; chocolate to perfume) which come primarily from Madagascar. Not only is this Indian Ocean island state home to 80% of global 'bourbon' vanilla production, it is also a biodiversity hotspot, with fully 90% of its plants and animals found nowhere else on earth.<sup>4</sup>

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Given this, the onus is on Symrise to source its vanilla responsibly and to ensure traceability so it can understand any impact its supply chain might have on the country's fragile ecosystems.

Symrise's response has been to join the Sustainable Agriculture Initiative (SAI),<sup>5</sup> a non-profit network of more than 180 companies worldwide who aim to work together to advance sustainable agriculture practices among their suppliers. In Madagascar, this means small-scale vanilla farmers are held to account on their use of water and land, fertilizer and pest control.

This is just one small example of Symrise's responsible approach to sourcing raw materials, but it illustrates a broader theme: In 2022, the company estimated that 88% of its strategic biological raw materials were derived from sustainable sources (it has set itself a target of 100% by 2025).

We attempt to quantify this impact in real terms through our proprietary impact calculator, where we estimate that the land area preserved for biodiversity by Symrise through its sourcing and traceability policies came in at around 165 hectares in 2023-24.

Hence Symrise qualifies for two of our investability themes: **Sustainable Living and Responsible Sourcing.**

In the case studies below, we consider two further examples of unlikely biodiversity champions and how our engagement with them has helped them improve.

The above does not represent all of the securities held in the portfolio and it should not be assumed that the above securities were or will be profitable. This information does not constitute a solicitation or offer to any person to buy or sell any related securities or financial instruments.

<sup>4</sup> Source: Royal Botanical Gardens, Kew: Madagascar's extraordinary biodiversity: challenges & opportunities for the future, 22 December 2022.

<sup>5</sup> <https://saipatform.org/who-we-are/>

## Engagement case studies



CASE STUDY

### RELX: What's data got to do with it?

**RELX is global provider of information and analytics for professional and business customers in more than 180 countries.**

In common with the companies mentioned earlier in this report, a reasonable question for investors might be: what does a data provider have to do with biodiversity? But, again, look beneath the surface and the rationale for holding RELX in the portfolio becomes clear.

The company owns 18% of the world's research journals, and a third of the most important journals when weighted by impact ("the ones people care about").<sup>6</sup> Within these, RELX, or its subsidiary Elsevier, owns several of the most cited journals in medical and life sciences research including *The Lancet* and *Cell*.

Through its efforts to validate, improve and disseminate science, then, we believe that RELX plays a significant role in supporting biodiversity and biological science research, which is critical to its overall protection and preservation.

The company stated that, in 2022, it provided around round

**15%** of the material available in Research4Life

#### Our engagement

Our interactions with RELX have predominantly focused on the company's approach to biodiversity and artificial intelligence (AI) but also its approach to providing open access to information to underserved communities.

On open access, the company stated that it recognises the social benefit of providing open access to information. An example of this is its partnership with Research4Life, a project in conjunction with UN agencies and over 200

publishers, to provide material which can be accessed in low- and middle-income countries. The company stated that, in 2022, it provided c.15% of the material available in Research4Life, encompassing approximately 5,000 journals and 30,000 e-books. We asked the company if it would consider publishing a public strategy on open access provision, or disclose quantitative targets in this area. The company stated that it does not have formal targets for improving provision of access in a numerical sense, but considers it to be a high priority area.

On biodiversity, the company spoke about its own internal biodiversity efforts, such as tracking water usage and ensuring paper is sourced responsibly, and how an overall goal of disseminating knowledge to those who need it links well with biodiversity, given its increasing importance for its customer base.

The company also spoke about how much of its content production, particularly in scientific journals, is focused on this topic.

On AI, the company stated that it considers AI to be a huge potential growth area, and has also identified responsible AI principles to ensure that it is developing AI solutions in a considerate way. For example, one of the responsible AI principles focuses on avoiding bias in data sets used for training on AI products. The company also mentioned that its products are able to accurately cite sources from data sets used, which allows for better validation of output.

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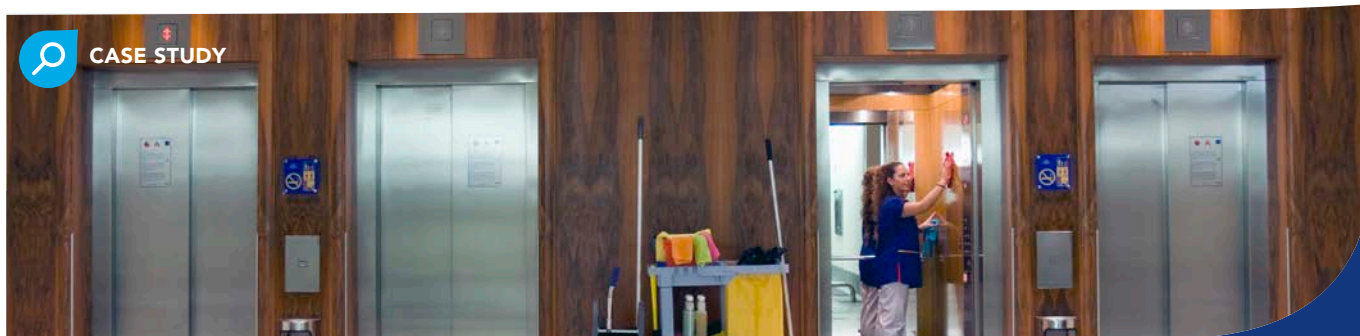
<sup>6</sup> Source: RELX Annual Report and Financial Statements 2022.

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## CASE STUDY



## Cintas: cleaner, better for a brighter future

Our second case study focuses on Cintas, a company providing uniforms, cleaning products and services to businesses.

With Cintas, the biodiversity credentials come from a different direction. Here, we view the company's efforts at reducing waste, reducing water usage and improving energy efficiency as providing critical support to resource management.

### Leaders are increasingly talking about sustainability and the board is engaged.

By leveraging industry-leading technology that extends the life of garments, Cintas offers the option of drying, cleaning and processing products more efficiently from a water, energy and chemical perspective than can be accomplished on site, or at home. The resulting reduction in resource intensity helps alleviate pressure on natural resources, and consequently biodiversity.

### Our engagement

We spoke to the vice president of ESG and chief compliance officer, as well as the head of investor relations. We began by asking about the governance, resourcing and integration of sustainability across the business. We asked how the culture of recycling and circularity, which was core to the company's founding, is reflected and integrated today. The company said there is high integration of sustainability, with quarterly meetings with executives and a monthly meeting for a larger group of partners. Leaders are increasingly talking about sustainability and the board is engaged.

We explained that we would welcome the company conducting an assessment of the nature-related impacts, dependencies, risks and opportunities across its value chain in-line with the Task Force on Nature-related Financial Disclosures (TNFD) recommendations. We noted that the company probably has some idea of its most material impacts already.

We asked about the approach to hazardous chemicals in the business. The company views its chemical safety programme as going above and beyond what is required, including through having 128 facilities certified to a high standard by Occupational Safety and Health Administration (OSHA).

We acknowledged the company's work on carbon and water to date, especially through an operational efficiency lens. We strongly encouraged the company to set forward-looking, science-based targets for climate change and water. Emissions intensity has fallen by 35% over several years but the company said it is not currently planning to establish interim targets following guidance from the Science-based Targets initiative (SBTi) because of uncertainty around electric vehicle technology adoption.

On water, it explained how its business model already contributes to significant water savings, using half the amount of water compared to laundry being done at home and by recycling 90% of the water it uses. It gave examples of feeding into irrigation in California and indigenous landscaping in Arizona. We explained that in a subsequent conversation we would like to explore the company's approach to the circular economy in more detail, including its ability to quantify how its business model reduces negative environmental impacts and how it can further strengthen its approach, for instance through sustainable material sourcing and its approach to product end-of-life.

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## Appendix

### A note on exclusions

In aiming to achieve superior long-term returns (i.e. returns that are superior in the sense that they provide positive benefit to the environment and society as well as long-term returns), the Investment Manager will also exclude investment in the following companies (based on information available to the Investment Manager on these companies):

- Companies that generate over 5% of their revenues from the extraction or exploration of fossil fuels or from the use of fossil fuels for electricity generation;
- Electricity utility companies with a carbon intensity that is not aligned with a below 1.5° scenario;
- Companies that generate over 0% of their revenues from the manufacture of Controversial Weapons or by providing either an essential and/or tailor-made product or service to the manufacturers of Controversial Weapons and companies that generate over 5% of their revenues from production of Conventional Weapons;
- Companies that generate over 5% of their revenues from nuclear power;
- Companies that generate over 0% of their revenues from the production of tobacco products and companies that receive over 5% of their revenues from tobacco distribution;
- Companies that generate over 2% of their revenues from gambling products;
- Companies that generate over 2% of their revenues from adult entertainment products;
- Companies that generate over 2% of their revenues from the production of alcohol and companies that receive over 10% of their revenues from alcohol distribution; and
- Companies that generate over 5% of their revenues from GMO crop production.

### Federated Hermes Biodiversity Equity Fund 3

In addition, the Investment Manager excludes companies that are in contravention of the principles of the UN Global Compact.



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Our goals are to help people invest and retire better, to help clients achieve better risk-adjusted returns and, where possible, to contribute to positive outcomes that benefit the wider world.

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- **Fixed income:** across regions, sectors and the yield curve
- **Liquidity:** solutions driven by five decades of experience
- **Private markets:** private equity, private credit, real estate, infrastructure and natural capital
- **Stewardship:** corporate engagement, proxy voting, policy advocacy

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