

ESG in Action: Danone Dealing with the plastic problem

November 2020

In brief

In this case study, we discuss the problem of plastic waste, a significant environmental, social and governance (ESG) issue which is likely to become even more important in the years ahead. We describe how one company, Danone, is addressing the challenge as well as how MFS researches and engages with the company to effect long-term change.

ESG is not just about managing risks. Those with a deep understanding of the issues can find opportunities by determining how companies plan to tackle ESG challenges.

Through effective engagement and continual dialogue, investors can work with companies across a range of issues rather than focusing on a single change.

That's important because ESG issues are complex and often intertwined. For example, plastic is a pollution problem but also a climate change problem and a significant social challenge.

The problem with plastic

In recent years, we have become more aware of the impact of plastic on people and the planet: Eight million tons of plastic waste finds its way into the ocean each year. At this rate, by 2050 there will be more plastic in the ocean than fish.¹ Research by the World Wildlife Fund for Nature found that every person eats a plastic credit card's worth of polymer particles each week.²

Despite these environmental concerns, plastic continues to be one of the most widely utilized materials due to its low cost and high convenience: It is arguably the most versatile material ever invented. Plastic is thoroughly embedded in our society and our economy. It is used to make a wide variety of products, including carrier bags, tea bags, straws, clothes, toys and food and drink packaging. Global plastics production is expected to triple by 2050, with packaging representing 40% of the demand.³ The COVID-19 pandemic has caused a surge in single-use plastic consumption, creating a headwind for society's adoption of more sustainable products.



Source: WWF, "No Plastic in Nature: Assessing Plastic Ingestion From Nature To People," June 2019

Consumers care and so should investors

Historically, the economics of recycling have not really worked. Virgin plastic is cheaper. Recycling technology, infrastructure and capacity have been insufficient, and there has been little incentive for improvement. It is therefore not surprising that there is already a consumer and regulatory spotlight on tackling plastics. And we believe investors will also increase their focus on this issue in the years ahead.

We say this because consumers are increasingly choosing to avoid plastic-related goods when possible and regulators around the globe are introducing measures to reduce single-use plastic consumption. This has already seen reduced demand for virgin plastic, which can negatively impact earnings, stock prices and credit ratings. As a result, companies may be negatively impacted from an ESG, valuation and long-term credit angle.

How do ESG ratings agencies view Danone?



Engaging with Danone

Danone, a consumer staples company widely held in MFS portfolios, is a heavy user of plastic packaging due to the nature of its business. It uses plastic packaging across much of its product line, including bottled water, which accounts for almost one-fifth of its revenues. Danone faces structurally higher costs as governments implement carbon pricing, single-use plastic bans (e.g., grocery bags, drinking straws), extended producer responsibility (EPR) laws and plastic packaging taxes.

Currently, ESG scores are not penalizing companies for the use of plastics, so Danone scores high in third-party ESG ratings. How have we engaged with the company on the issue? We could have divested, but we decided we should own and engage with Danone and carefully evaluate its plan to tackle the plastic waste issue.

MFS' fundamental approach to company analysis has generated a deep understanding of where the company is today and how it plans to tackle the plastic waste issue, helping us look beyond the headlines. This has improved our understanding of Danone's long-term sustainability of revenues and the potential impacts on valuation.

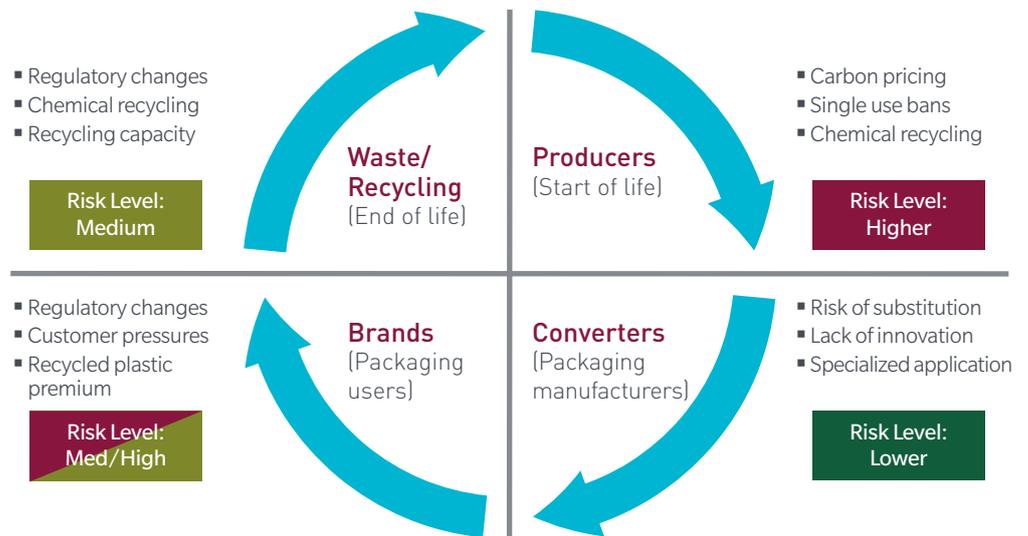
Digging deeper

Through in-depth engagement, our analysts have been able to dig deeper into Danone's efforts to reduce its plastic packaging. MFS' investment and proxy teams have held multiple meetings with the company. Engagement topics have included how Danone is dealing with packaging sustainability, its corporate culture and employee engagement. Our discussions have centered around the company's focus on sustainability to drive more consistent and superior financial results – including the implementation of responsible purchasing due diligence and a new packaging policy – with these goals:

- Make all packaging 100% recyclable, reusable or compostable by 2025
- Collect and recycle waste in its biggest markets
- Develop packaging products beyond plastic, such as cartons, glass and refillable systems

To best engage with companies such as Danone, it is important to understand the plastic packaging industry supply chain in order to assess the primary risks for each part of the value chain.

Risks to the Plastic Value Chain by Sector



Where do we go from here?

We will continue to engage on these topics with Danone. Recent discussions suggest the company may need to focus more on the most material issues facing its business. In spite of our concerns in this area, we continue to hold the stock. We believe it is attractively priced based on the categories in which Danone operates and its willingness and focus on developing more sustainable product packaging. The world is changing more rapidly than many companies and investors realize or can keep up with. Rather than simply screen out or divest, we believe a better way to invest responsibly involves fully understanding the nature of a company's business and engaging with it to build a more sustainable future for our planet and its people. ▲

¹ Source: World Economic Forum, "The New Plastics Economy: Rethinking the Future of Plastics," January 2016.
http://www3.weforum.org/docs/WEF_The_New_Plastics_Economy.pdf

² Source: WWF, "No Plastic in Nature: Assessing Plastic Ingestion From Nature To People," June 2019
https://wwfeu.awsassets.panda.org/downloads/plastic_ingestion_web_spreads_1.pdf

³ Source: CIEL, "Plastic & Climate: The Hidden Costs of a Plastic Planet," May 2019
<https://www.ciel.org/wp-content/uploads/2019/05/Plastic-and-Climate-FINAL-2019.pdf>

Please keep in mind that a sustainable investing approach does not guarantee positive results.

The views expressed are those of the author(s) and are subject to change at any time.

Unless otherwise indicated, logos and product and service names are trademarks of MFS® and its affiliates and may be registered in certain countries.

Distributed by:

Please note that in Europe and Asia Pacific, this document is intended for distribution to investment professionals and institutional clients only.

Distributed by: **Latin America** – MFS International Ltd.; **Canada** – MFS Investment Management Canada Limited. No securities commission or similar regulatory authority in Canada has reviewed this communication; **U.K.** - MFS International (U.K.) Limited ("MIL UK"), a private limited company registered in England and Wales with the company number 03062718, and authorized and regulated in the conduct of investment business by the U.K. Financial Conduct Authority. MIL UK, an indirect subsidiary of MFS, has its registered office at One Carter Lane, London, EC4V 5ER UK and provides products and investment services to institutional investors globally. This material shall not be circulated or distributed to any person other than to professional investors (as permitted by local regulations) and should not be relied upon or distributed to persons where such reliance or distribution would be contrary to local regulation; **Singapore** – MFS International Singapore Pte. Ltd. (CRN 201228809M); **Australia/New Zealand** – MFS International Australia Pty Ltd ("MFS Australia") (ABN 68 607 579 537) holds an Australian financial services licence number 485343. MFS Australia is regulated by the Australian Securities and Investments Commission.; **Hong Kong** – MFS International (Hong Kong) Limited ("MIL HK"), a private limited company licensed and regulated by the Hong Kong Securities and Futures Commission (the "SFC"). MIL HK is approved to engage in dealing in securities and asset management regulated activities and may provide certain investment services to "professional investors" as defined in the Securities and Futures Ordinance ("SFO"); **For Professional Investors in China** – MFS Financial Management Consulting (Shanghai) Co., Ltd. 2801-12, 28th Floor, 100 Century Avenue, Shanghai World Financial Center, Shanghai Pilot Free Trade Zone, 200120, China, a Chinese limited liability company regulated to provide financial management consulting services.; **Japan** – MFS Investment Management K.K., is registered as a Financial Instruments Business Operator, Kanto Local Finance Bureau (FIBO) No.312, a member of the Investment Trust Association, Japan and the Japan Investment Advisers Association. As fees to be borne by investors vary depending upon circumstances such as products, services, investment period and market conditions, the total amount nor the calculation methods cannot be disclosed in advance. All investments involve risks, including market fluctuation and investors may lose the principal amount invested. Investors should obtain and read the prospectus and/or document set forth in Article 37-3 of Financial Instruments and Exchange Act carefully before making the investments.