

Magellan – In The Know: Episode 37

Cultivating change – Nestlé’s leading approach on sustainability and creating shared value

Announcement (00:00):

The information contained in this podcast is for general information purposes and does not constitute investment advice. You should seek investment advice tailored to your circumstances before making an investment decision.



Host (00:14):

This is In The Know, a monthly investment podcast brought to you by Magellan Asset Management.

Rob Cameron (00:20):

When we announced our net-zero roadmap, we explicitly said on the transition to regenerative agriculture that we had earmarked 1.2 billion Swiss francs as an investment to support the transition in terms of financing for farmers, paying premiums, providing technical support to help them make this transition. Across the board, if you look at the sustainability agenda broadly, and it is a broad agenda, the actual investments that we've been making was something just shy of 500 million Swiss francs in 2021 that nudged up to just shy of 700 million in 2022. So substantial. And we think this year, given the scale of the projects that we're investing in, we know that they're going to deliver a good return for the business. So we see it as investment rather than cost.

Host (01:07):

That's Rob Cameron, global head of public affairs for Nestle, explaining how the company is preserving its dependable investment value while still spending hundreds of millions of dollars to tackle the biggest challenges facing today's and tomorrow's world. Welcome to Magellan In The Know. In this episode, Rob Cameron is joined by Magellan's portfolio manager of Core ESG, Elisa Di Marco, and Magellan investment analyst Tracy Wahlberg for a fascinating exploration of the company's targets and methodology and how carbon targets, regenerative agriculture, packaging innovation, and human rights are being viewed as long-term investments rather than costs. Stick around for an enlightening discussion about everything from forest regeneration, to ending child labour, and how the 150-year-old company intends on delivering solid returns for another 150 years despite the immediate costs. But first, here's a warm welcome from Tracey Wahlberg.

Tracey Wahlberg (02:07):

Hello and welcome to Magellan's In The Know Podcast. We're excited to have you for our 37th episode. I'm Tracey Wahlberg, investment analyst at Magellan, and my co-host today is Elisa Di Marco, portfolio manager of our Core ESG fund. Our guest today is Rob Cameron, Nestle's global head of public affairs. Rob, thank you for taking the time to talk to us.

Rob Cameron (02:29):

Thanks for having me on. Good to be here.

Tracey Wahlberg (02:31):

So to set the scene, Nestle has been a feature in the Magellan Global Fund since inception, generating an annualised total return of 7.5% per annum, representing a cumulative gain of over 220% in Swiss francs. It has generated more than twice that in Aussie dollar. We continue to like Nestle for its defensive characteristics, exceptional execution, and its focus on delivering stable shareholder returns through cycles. Underpinning this value creation is Nestle's strong portfolio of brands and its scale. Our listeners might recall we had Nestle's CEO Mark Schneider on the podcast to talk through the investment case in 2021. Today's conversation will be squarely focused on sustainability and how Nestle is generating returns through its sustainability agenda. As the world's largest food and beverage company, Nestle buys thousands of tonnes of coffee, cocoa, palm oil, even hazelnuts every year, and it works directly with more than half a million farmers around the world. Its supply chain hosts challenges that sit at the forefront of all ESG conversations from climate change to sustainable packaging and human rights.

(03:39):

So Rob, help us frame the importance of today's conversation. Before we get into introductions, let's address the elephant in the room. Investors care about positive returns on their investment. Why should they care about Nestle's sustainability strategy? How will this translate to shareholder value?

Rob Cameron (03:56):

Thanks, Tracy. I think that's a false dichotomy. The idea that somehow returns and sustainability don't mix, I think that's a way of thinking that simply doesn't apply. And for a company like Nestle, really what we're talking about is being well positioned for the long term. Nestle has been around for well over 150 years. We want to make sure we're around for another 150 years to come. So for us, when we're thinking about sustainability, really what we're thinking about is creating shared value for all our stakeholders. So if we're only thinking about delivering returns for investors this year and we're not thinking about how we're creating value for the communities that we work in for colleagues, for customers, for consumers that buy our product, if we're not thinking about how we're creating value that affects the whole of society, then we're not really doing our job because we won't have that longevity.

(04:51):

So then to be more specific about that, if we're thinking about sustainability, for us there are keywords like resilience. We're a company that depends upon agricultural supply chains so that we need those supply chains to be resilient from thriving resilient communities. We need to think about managing risk. Then we need to also think about opportunity and opportunity can come along in terms of consumer preferences. And we know that there is a preference increasingly from consumers that they want to know the companies they're buying their goods and services from are serious about the issues that affect them every day. And frankly, you've only got to turn the news on these days and you'll see something connected with the sustainability agenda.

(05:35):

So in a nutshell, this idea that there's an elephant in the room about delivering returns over the long term and sustainability, as I say, I think that's a false dichotomy instead of managing your company and then managing sustainability and there's a sort of separate competing thing. No, no, I think it's actually about managing the business sustainably. That's the secret at Nestle.

Elisa Di Marco (05:55):

Thanks Rob. That was really interesting hearing why you are prioritising sustainability and really that focus on the long-term for the business and then that focus on the consumer preference. It's really one

of the reasons why we've liked Nestle for so long. So it does give us that greater confidence in management's ability to reduce that earnings volatility over the long-term, and it definitely has, as Tracy mentioned, already has that place in our portfolio. So Rob, you are the global head of public affairs at Nestle. You've been a leader in sustainable development for some time before that. It would be great to hear a little bit about your journey and what attracted you to join the Nestle team. I

Rob Cameron (06:29):

Am actually a bit of an odd fish because a typical career path for many people would be you join a large corporate, you learn a lot of things, you go away and work in consulting, and then maybe you want to give something back and go and work for an NGO. And then maybe you take all of those things and you do it in your own company. Well, I've done all of those things, but I did them all the other way round. So many, many years ago I ran a design and communication firm. I was owner of that firm called Flag, which was a pioneer in sustainability communication. As it turned out, I was working for Nestle from the outside as a provider of those communication services. I then went off and worked with Fairtrade for a number of years, the NGO years, and again, Nestle figured largely in that work. So I knew the company then.

(07:12):

I was then in consulting for about eight years with sustainability. Nestle was a key client during that period, and then finally I joined the company close to four years ago now. So that's the journey. But throughout that period, my career over the last 25 or so years has been wholly oriented around sustainability and Nestle has been a thread that has just run through the whole time. And so when the opportunity came along to help put my shoulder to the wheel of what was happening here, it was an opportunity I couldn't turn down and I'm so pleased to be part of the team here. Yeah.

Elisa Di Marco (07:44):

I think we're going to learn a lot from you today given that background and on the work that you've done at Nestle. So thanks again for joining us. Something we wanted to touch on now is climate risk. So it's one of the key priorities for Nestle and for a lot of companies that we cover. Would you be able to set the scene for us? Why is climate a material risk? But then also are there any opportunities?

Rob Cameron (08:04):

If you think about Nestle as a global food and beverage company, pretty much everything we sell has agriculture at its heart. We are wholly dependent upon agriculture for the ingredients that make up the products that we bring to market. And it's now widely acknowledged that agriculture is a significant cause of climate change. Something in the region of... Estimates vary, but 25 to 35% of global emissions come from agriculture. So the source of our ingredients is also a driving force of climate change. So there's a responsibility there for us. And the other side of the equation of course is that climate change is having a massive impact on agriculture. So whether you're thinking about droughts or heat waves or floods, these things are having a direct effect on agricultural production. And there's a sort of additional angle of this that often is overlooked and that is the way in which crop disease starts to move around in ways that are unexpected.

(09:07):

So when think about resilient supply chains, we have to take steps now in order to make sure that our supply chains can withstand the impacts of climate change. At the same time as embracing our responsibility to take part in ameliorating the problem in the first place.

(09:25):

When it comes to the opportunity side of things, I think it's fairly evident that consumers want companies to take steps on climate change and perhaps I think especially with younger consumers, there is that implicit threat that consumers will punish those companies that are not taking action. So again, there's an opportunity side as well as the risk side, and I think that's a thread. You have to see both sides of the equation, manage the risks at the same time as making sure that you are leading consumers and giving them products that they know they can trust and they want to buy because they know you're doing the right thing.

Elisa Di Marco (09:59):

Thanks Rob. I think that's really interesting. It's thinking about the opportunities on the side of climate. I think perhaps many... We really underappreciate what those opportunities are in the food and beverage space and how important this is becoming for some consumers on leading with their wallet and making decisions in that way. Targets are a really important tool to communicate intentions to stakeholders for the company and also to guide the management team over time. Nestle has established targets to reduce greenhouse gas emissions and importantly be net-zero by 2050. Could you step us through this target and its key components?

Rob Cameron (10:33):

Yes, indeed. So we need to take a little trip back in time to put it in context. So the Paris Agreement in 2015 was for net-zero by 2050. Subsequently, there was a call from the UN Global Compact for companies to step forward and sign up in support of the Paris pledge. We did that in September 2019, so going back quite a few years now and the world has moved on a long way since then. But when we made that pledge in 2019, our responsibility was to publish a net-zero roadmap within two years. And we did that actually within about 14 months. We got on with it and we were probably the first global food and beverage company to put out a net-zero roadmap saying how we would achieve the target of net-zero by 2050. Now this was Science Based Targets initiative approved. And for listeners, Science Based Targets initiative is a collaboration of NGOs that was established to ensure rigour and specificity rather than just greenwashing big targets. I mean, we've all had too many grand targets that then don't get delivered on. So that's what the SBTi Science Based Targets initiative was there to do to check across companies net-zero plans.

(11:47):

Now the plan talks about net-zero in 2050, but crucially accepts that we have to get on with it now. So that means a 20% reduction to be achieved by 2025 and a 50% reduction to be achieved by 2030, and that reduction is to be set against the baseline, which is where were we in 2018. And that is another really important aspect of this because the important thing is as the company is growing, you would normally expect the emissions would carry on rising in alignment with the company's growth. No, what we're trying to do is make sure we get below those 2018 emissions and subsequently net-zero against that 2018 baseline.

(12:30):

Now a couple of things around what we also put in this roadmap, acknowledging that the greater part by far the majority of our greenhouse gas emissions are coming from the agricultural side of things, the supply chain. In the jargon is called scope 3. And again, listeners may start to hear about things like scope 1 and scope 2 and scope 3 and it all gets very confusing, but just think about it as what you would pay for your electricity bill in your household by paying your electricity supplier. That's your use of energy that someone else made. That's scope 2. On the other hand, if you go down to the store and buy a Kit Kat, there's going to be some carbon emissions embedded in that. Well, that's your scope 3

because it's happened something way beyond your own household. Same for us. That's exactly how it is for us and that's where our scope 3 emissions are the bigger part.

(13:20):

So for us, ending deforestation and taking a forest positive approach, that's a really important part of what we said we would do. Another important part of what we said we're going to do is a big transition to regenerative agriculture so that we reduce emissions in that agricultural supply chain. Doing both of those things, make sure we're looking after farmers because at the end of the day, we're totally dependent upon thriving successful farmers to supply those ingredients to us. So we have to make sure that they're not penalised as we try and make these transitions.

Elisa Di Marco (13:55):

Thanks for stepping us through those targets, Robin, especially the importance of scope 3, that is your supply chain on what you need to manage and that the Kit Kat will be net-zero in time.

Rob Cameron (14:05):

Indeed it will.

Elisa Di Marco (14:05):

Now we do talk a lot about climate risk and it's very clear that it's very important for Nestle. For those that aren't as familiar, they might be thinking that setting targets that are two decades away seems a long way away. Why can't we move quicker to reducing our emissions?

Rob Cameron (14:21):

It's a really, really good question and it needs to be unpacked just a little bit. So can we move quicker? We're moving as quickly as we possibly can, but the reality is that for us, going back to this idea of scope 3, that's something that happens outside of your own house. So it's actually about going and influencing what's happening as opposed to just making a simple switch.

(14:42):

If you take something like renewable energy, I think a lot of people are now very familiar with the idea of renewable energy. So rather than using fossil fuels for electricity production, the technology is largely there. We've been doing that in switching our factories to renewable electricity all around the world. So that's something that we can do straightforwardly. In the case of agriculture, you don't just go in and go to a farmer, do it this way and everything changes. If we're thinking about things like the agricultural practises that include tree planting for instance, that doesn't happen overnight. It takes time and you have to work with people to drive those changes.

(15:20):

Now for us, one of the things I've been a little frustrated about, and I think others in the company are too, is that some companies are talking about, well, we'll be net-zero by 2040 or 2039 and it all sounds very grand, but actually some of those promises are now being called out as being not substantive and not being delivered on with action today. We went the other way round and said, the goal is net-zero by 2050. That's what the world agreed to. Now what are we going to do today? We've been taking steps and our actions mean we have now what we say bent the curve. So rather than emissions going up in line with company growth, instead they're now coming downwards.

(16:02):

The amount of effort that it's taken to bend that emissions curve and turn it downwards has been immense. And it's because we got on with it straight away in 2020 and started putting these programmes and projects into place that we've been able to do that. So we're past what we call peak carbon. The trajectory is downwards. We can see the pathway to reducing those emissions by 20% by 2025, but as I say in our case, and for all other food, forest land and agricultural companies, it takes time. We're dealing with a slightly different animal than just doing a renewable electricity switch.

Elisa Di Marco (16:38):

It's a huge achievement and the complexity of your supply chain, it's something that you need to take your time to invest in. Something that we've kind of touched on a little bit along the way is the investments that you've been needing to make, what kind of investment do you need to do going forward?

Rob Cameron (16:52):

We've been quite transparent about the scale of the investments that we were planning to make. And in fact, when we announced our net-zero roadmap, we explicitly said on the transition to regenerative agriculture that we had earmarked 1.2 billion Swiss francs as an investment to support the transition in terms of financing for farmers, paying premiums, providing technical support to help them make this transition. Across the board if you look at the sustainability agenda broadly, and it is a broad agenda, the actual investments that we've been making was something just shy of 500 million Swiss francs in 2021 that nudged up to just shy of 700 million in 2022. So substantial. And we think this year, given the scale of the projects that we're investing in, and we know that they're going to deliver a good return for the business, so we see it as investment rather than cost, but it'll be something in the region of about a billion Swiss francs in 2023.

(17:48):

Now of course, a good investor is going to be sitting there thinking, "That's all very well, how are they funding this in the first place?" And fundamentally, there are two ways in which we've been funding this. It's by leveraging growth and at the same time there's a huge amount of cost control and cost discipline.

Elisa Di Marco (18:03):

I think the commitments that you're making, it's really important to remember that these are investments in the future. And I think to your point that you made earlier that you've been investing for a long time to offset deforestation, for example. And as increasingly we're going to have our governments that have made these net-zero commitments, they're going to be regulating particular industries and drive change, and it's this investment that you're making now that is going to set you up for that long-term future, which is one of the reasons that we do like Nestle in that low volatility in earnings.

Tracey Wahlberg (18:29):

And Rob, if I'm understanding correctly, so more than 95% of your carbon emissions are in your supply chain and some 70% of emissions are from sourcing ingredients. You touched on innovation and agriculture as a solution when you were chatting with Elisa, I just thought maybe we could unpack this a bit. You mentioned regenerative agriculture here. Could you start with what is regenerative agriculture?

Rob Cameron (18:50):

That's a great question because actually there isn't a fixed definition of regenerative agriculture. I think over the course of the next few years you're going to see an awful lot more talk about regenerative

agriculture. It starts with soil because without healthy soils we cannot grow good crops, and indeed dairy depends on healthy soil, but a couple of things have been going on. Firstly, the overuse of synthetic fertilisers has over time degraded soils, it's degraded biodiversity. And so there isn't that kind of natural cycle that's going on inside soils that ensures the long-term health of the environment. So that's been a problem.

(19:27):

At the same time, the other thing that's been a bit of a problem, of course, has been the dramatic increase in fertiliser costs. So that's been a problem for farmers, especially over recent years. At the same time as we're all trying to address climate change and there is a lot of carbon emissions wrapped up in those fertilisers. So what we see, and we could see this in... I think farmers in Australia know this well, that drought and overtaxing the soil leads to poor soil health degradation over time. And this goes back... We've seen this many, many times over the decades. We think about dust balls in Tennessee, we can even see it in the UK. We see it in northern France.

(20:07):

There's an area of northern France that we've worked in, actually we've been at this for some time now where we've been engaged in what we call the Living Soils Initiative. And the reason we were doing that was because the farmers are just chugging their shoulders going, "Well, we keep putting this stuff on, but we're not getting anywhere in terms of yields. The soil's turning to dust and disappearing." And those poor farmers were looking at the reality that they had 15, 20 years left max, and those 15 or 20 years that they had left looked like they were degrading every year in terms of margin and profitability. That's not good for a farmer. So soils is the key. Healthy, vibrant soils that can sustain life is the key. Livestock has a role to play here as well. So managing livestock on farms. Water protection. Water is an absolute essential part of agriculture obviously, and we need to think about how we protect and preserve water courses that run through farms. So put all that together and put the farmer at the centre of it all, and that's the start of regenerative agriculture.

(21:13):

Now, another aspect of regenerative agriculture that I think people have to remember, and this comes back to that question that you asked about why it takes time. For the farmer, you've been farming in a certain way for the last 40 years. There's a certain cycle, a certain crop, a buyer comes along and says, "We'd like you to change the way that you farm. By the way, there's some downside risk in the first couple of three years because as you make this transition it's quite likely, indeed almost certain that there could be a yield tail off that you might not get the same yields as the thing's recovering, but over time, don't worry, you'll get that return. It'll all be better in three or four years time." Now, farmers are conservative in their thinking. They've got one crop cycle to make their entire investment for the year and make that investment pay. There is increasing evidence that it does come through. We know that this does deliver better returns and we've got to think about it in terms of the input costs as well as the profitability.

Tracey Wahlberg (22:09):

Thanks for that. Some of the areas we focused on when we were taking on sustainability research for Nestle internally at Magellan, and we've been doing this for a long time. I'm not sure many would know that coffee is now one of your largest profit exposures with ubiquitous brands such as Nespresso and Nescafe, and I'm also not sure many would appreciate that one in seven cups of coffee drunk globally is a Nestle produced coffee. One of the things we've been really surprised by, is something I think you called the AAA Sustainable Quality Programme and how it fits into regenerative agriculture and the success that you've had there. I wonder if you could dive into that a little bit more for us. Tell us how the programme got started.

Rob Cameron (22:51):

It goes back a long way. I mean, this is again another example of where Nestle was doing things way ahead of the rest of the world. I mean, it actually all began as long ago as 2003 with the Nespresso AAA programme, and it started with some fundamental truths that people in Nespresso realised that you cannot separate coffee quality and sustainability. Now, I'm not going to diminish the work of Fairtrade because I actually started in Fairtrade just a little bit around that time, and I was a passionate believer then in the importance of making sure that farmers had good support, that they were rewarded with price premiums if they did the right thing. And so Fairtrade I think was very much part of that. But the difference here with an espresso model was that they made the connection between sustainability and fairness and supporting farmers on the one hand and the quality of the coffee on the other. Now that's been a trend.

(23:49):

So in the programme now we've got something like 140,000 farmers a part of the Nespresso AAA scheme. There's a really, really strong connection between Nespresso and its buying programmes, and those communities.

(24:03):

One of the other things that Nespresso I think has been really good at is this what we call the reviving origins programme. Now, many coffee communities, if you look, coffee communities often are very poor communities in relatively challenged parts of the world. So with Nespresso, they'll often go in and they'll work with a local community. We've done this in parts of Columbia as well. You go in and work with a local community, get to know their needs and help them rebuild their coffee industry as an alternative rather than some of the other things that they could be growing, but instead a thriving community that's built on coffee. We help communities to do that. So it's been a great example and it's like kind of... for me it's like the apex of the coffee pyramid because then you've got Nescafe and you mentioned scale, one in seven cups of coffee. The sheer scale of the rest of Nestle's coffee enterprise is absolutely huge, but Nespresso is that pinnacle of quality and sustainability and it's like a kind of learning platform and the rest of the coffee folk and Nestle can learn from those experiences and start to apply it at an even bigger scale.

Tracey Wahlberg (25:08):

I like what you've said there where Nestle has an opportunity to really use a premium brand like Nespresso and learn from it and develop those learnings into its larger behemoth brands. And Nespresso is a globally recognised brand, but I'm not sure many would realise that Nescafe trumps it in revenue per annum. So is that to say that that is what Nestle is doing? You are taking those learnings and applying it to Nescafe and the beans grown for Nescafe are evolving in the same way?

Rob Cameron (25:40):

Yeah, Nescafe, as you rightly say, is operating on a bigger scale. Nescafe has been working on sustainability for the longest time, but more recently we announced the new Nescafe 2030 plan. It's about overall a 1 billion Swiss Franc investment. What matters is the impact that it's having on farmers. So for instance, farmers, if they're poor, they cannot afford to renovate their coffee trees. Now coffee trees have a lifespan and you are looking at your coffee farm and your coffee trees are starting to get a little bit degraded. Really what you should do is grab those plants up, replant and go again. But of course then there's a time lag before you get those plantlets up and running and they're productive. It takes a few years before you get a crop. Often farmers get trapped in this cycle. If they don't renovate their farms, their yields decline, their productivity is declining, their profits are disappearing, not a good outcome.

(26:41):

That's why Nescafe has been engaged in distributing plantlets so that those little plantlets, they're already growing. We've distributed something like 23 million coffee plantlets over recent times and we'll continue to do that.

(26:58):

Using the technologies that we have here, what we want are disease and drought-resistant coffee plants. And we've done the research and we've come up with new strains of coffee plantlets that will grow quickly, that are more drought resistant, that increase yields by about 50% and you're reducing your carbon emissions by about 30%. So that's the kind of inputs that Nescafe can have at scale, helping farmers to renovate their farms and address climate change and produce really great coffee at a really great margin in future.

Tracey Wahlberg (27:35):

So when we were last speaking with your CEO internally about regenerative agriculture, he mentioned it's a slam dunk innovation. And it does sound like you've had a lot of success here, and particularly in the coffee supply chain as we just noted, but the sceptic in me still wonders, isn't it ambitious to think we can modify commercial farming practises and rollout regenerative agriculture everywhere globally?

Rob Cameron (27:58):

First thing to say is that there are certain parts of the world where farmers are already practising regenerative agriculture, but overall, the transition is underway and we know it's underway because we see our peers and our competitors around us adopting similar directions of travel.

(28:13):

Now, from our point of view, we know we can make a difference at scale and we know we have to. So what we also want to do, is we have to think about it in terms of the product. So talk about regenerative agriculture, and I can imagine listeners thinking of that as something quite abstract, but actually we can really translate it into everyday products such as a pizza. So if you take a DiGiorno's pizza, we sell something like 210, 215 million DiGiorno pizzas a year. This is a massive, massive brand.

(28:39):

You start thinking about, "Okay, so what does regenerative agriculture have to do with that?" Well, wheat is the beginning of the base of course, and we've just made a huge commitment in the US that a hundred thousand acres of farmland are going to be transitioned to regenerative farming practises, and that's going to make a huge difference. Reducing fertiliser use, improving biodiversity, improving water retention, improving that soil health again, soil health again, always soil health. So that's going to make a big, big difference with that a hundred thousand acres of farmland transitioning to deliver 105,000 tonnes of wheat.

Tracey Wahlberg (29:13):

That's massive.

Rob Cameron (29:14):

That is more wheat than we need for our DiGiorno pizzas. So what that means is that there's regeneratively farmed wheat that's available for others to source and this is kind of way in which I can see this going now. Farmers are often saying to us, "It's all very well you at Nestle you come along and ask us to transition to regenerative agriculture, but we're not necessarily hearing that from everybody

else. Other buyers aren't asking for it." Well, if other buyers are asking for it and they're asking for similar things, not different versions of regenerative agriculture, then I think farmers are going to make that transition much more readily than if they're not being asked by others or being asked to do different things. So it's really important that we do work and align with our peers and competitors so that we get this transition aligned, and I think that's really starting to happen.

(30:02):

When you look at, going back to the pizza example, tomatoes are already being farmed regeneratively in many parts of North America. I've seen examples in Spain where despite the heat and despite the droughts that we've been experiencing, seen in Europe of late, the production is continuing uninterrupted.

Elisa Di Marco (30:22):

Thanks, Rob. That was really interesting hearing about that difference at scale that you're able to have at Nestle given the breadth within your supply chain. A topic that we touched on a little bit already was deforestation, but I'd really like to jump into that a little bit more here. Deforestation can come from the expansion of agricultural crops and then it can be contributed to climate change. Now at Nestle, you have the term forest positive. I would love to hear, well, what does that actually mean and how will you achieve this?

Rob Cameron (30:52):

We began deforestation journey as long ago as 2010, and we set out that we wanted to be deforestation free by 2020 in our top five commodities at risk from deforestation. So that's palm, sugar, meat, pulp, and paper and soy. Now we've been on that journey. We were in good shape actually to achieve that no deforestation by 2020. But we realised as we went through this and all the learning we were doing, that there were some flaws in our argument and it was that like many companies, we grappled with trying to figure out, well, okay, we need to completely understand the supply chain. We need to know where everything is coming from. What we realised was that there were gaps in knowledge, and when we peeled back the layers of those gaps in knowledge, what we saw was that there were an awful lot of very small farmers who were at risk of being severely disadvantaged if we drove through and focused all of our production, all of our buying in certain suppliers and ignored the needs of those small producers. So it took us a little bit longer to get to zero deforestation. We're more or less there now on those five commodities.

(31:56):

Now, what we also learned was that ending deforestation is not the end, actually. It's one thing to say that we've eliminated deforestation, but it's not one of those things that you can then dust your hands and say, job done, and go and think about something else. Deforestation is always a risk, and so you have to be constantly vigilant. How can we ensure we're managing this and thinking about this in the longterm? So the forest positive strategy starts with of course, end deforestation and it also means restoring degraded land, restoring forests, planting trees. That's the kind of positive side of it. And the further side of it is that you have to think beyond your own immediate value chain. This is what we call landscape thinking.

(32:41):

So if we know we're sourcing from a particular farm and if there's deforestation occurring in farms just up the road from there, there is a very strong likelihood that our farm could be at risk of some form of deforestation as well. Because thinking beyond the value chain, beyond the farm resource, from think about the landscape, that broader thinking is a really important part of this.

(33:04):

Incidentally, landscape thinking. We've learned about as we did various pilots in Banda Aceh in Indonesia, we did some really deep studies and we've really gone under the hood of this. We really understand it now. That thinking about landscapes and going beyond the immediate farm is very applicable in regenerative agriculture as well. So that's some learning that we are now transferring and applying elsewhere. We need to think about human rights in those communities, and by doing that, that's what we call forest positive. It's a very community-oriented way of thinking, takes a lot of effort on the ground. But I think if we're serious about not only ending something, but actually going back to creating shared value, which we talked about earlier on, the idea of thriving communities, that I think is what we should be doing for these key commodities. So that's the way we've been thinking about it. It's an ongoing, constantly vigilant journey as well as the community thing.

(33:55):

One last point I think it's worth making is the application of technology. These days with satellite technologies, we can be monitoring farms in real time every single day. Literally every single day. We can see whether there is some sign of trees being fell and if so, boom, we can be in there. So the deployment of resources is so much more efficient with these new monitoring technologies.

Elisa Di Marco (34:18):

That's so much depth when you're kind of talking through that in how you think about monitoring the supply chain and managing deforestation, but then also having that positive impact on the forest and then local communities and those smaller suppliers. It's a really important way that the firm's been thinking about it. Another one I wanted to touch on here was chocolate. So most probably don't want to hear that chocolate is an ingredient that does come with challenges and human rights is one that really kind of comes to mind when we think about the cocoa seed supply chain. So there's risks to farmer livelihoods, labour conditions, and then issues with child labour. How has Nestle worked to address these industry challenges and what do you do to improve the industry?

Rob Cameron (34:58):

I mean, there's a whole raft of issues associated with cocoa production and they're all, I think largely well documented. I mean, one of them of course is child labour. This has been a problem in cocoa producing countries for many, many years now, and largely it's driven by poverty. Farmers don't have the ability to employ labour if there was labour available, which often there isn't. We source most of our cocoa from the Ivory Coast, Cote d'Ivoire in West Africa. Ghana is another significant cocoa producing country.

(35:24):

Now, we were one of the first, in fact, the first company to establish what we call the child labour monitoring and remediation system. Now, that's a very long way of saying we put an awful lot of effort into going out to the farms that either we're sourcing from directly or that we know our suppliers are sourcing from and monitoring on the ground to see if there is a risk of child labour occurring. And sadly, it's not something that can be immediately eradicated. So the reason why we do it is to make sure that we're on top of it and the model that we established, the child labour monitoring and remediation system, we set up early 20 teens and has now been adopted by the industry as a standard. So our efforts have now been embraced by the rest of the industry as that's how you need to look at this and you need to work directly to ensure that farmers understand that they really shouldn't be doing this. So there's an awful lot of cultural training that's needed as well.

(36:22):

Now, more recently we've been looking at this from a bit like the deforestation thing. It's one thing to think about what you want to stop, but what is it you want to actually achieve that can actually get to the heart of the matter in the first instance? And that's why we've launched what we call the Cocoa Income Accelerator because we know that it's poverty that's often at the heart of this. Now you could say, "Well, why don't you just pay more for your cocoa?" We also know that that has knock-on consequences in terms of radical increases in supply that then lead to oversupply that then lead to price collapses. Yes, a fair price should be paid. Absolutely. Yes, premiums must be paid. We do, but the simple economic argument doesn't work. We know it doesn't. What we can do though is find other ways to help farmers to be more profitable, and that's the Income Accelerator Programme. So the way we work this is that farmers are rewarded with premiums for good quality cocoa, fine, as well as a fair price in the first instance. Then they are given an extra premium for the things that we want to see that we think will make a difference to that farmer and to their communities.

(37:28):

The first thing is, are your kids in school? If your kids are registered and attending school, you will get an extra premium from us. If you are engaged in good agricultural practises such as pruning, you will get an extra premium. Actually, we know that pruning will increase your yield so that you get a double advantage. If you are engaged in income diversification, you will get an extra premium. So if you're trying to do something like honey or if you're engaged in flower production or whatever else it might be, that could generate extra income for the farm, you will get a premium from us.

(38:05):

So what we're trying to do is to reward the behaviours that we think farmers will benefit from. In the end, it stimulates outcomes. We're doing this in partnership with IDH and KIT, a Dutch NGO, and we've piloted it across a thousand farms already. We've now gone to scale with this programme, and I'm delighted to say that on one of our major chocolate brands, we're actually going to take the model and now bring it to the consumer proposition. So what we're doing on the farm in cocoa producing regions is now going to become part of the offer. There'll be some special additions coming up, and this is going to happen with some of our other brands like Nescafe as well. I'm absolutely thrilled about the idea that what we're doing with farmers that's making a difference to their livelihoods is going to flow through into a consumer facing brand proposition. That's I think got real power to it.

Elisa Di Marco (38:59):

We completely agree. The sustainable solutions that you've described for these higher risk agricultural commodities, it's really pleasing to see that it's a thoughtful solution to addressing these risks in these smaller communities.

Tracey Wahlberg (39:10):

Agreed. But Rob, we're coming to the end now, but we couldn't have a podcast on ESG in food and beverage manufacturing without discussing the changes happening in packaging. It's an important feature of food safety. It ensures products remain safe for consumption from production to pantry. Consumers and regulators now seem to be aligning here, advocating for change in plastic packaging and also in landfill waste. And we recognise Nestle have ambitious targets here. So talk us through how you're working to execute on these please, and what Nestle thinks about this change.

Rob Cameron (39:43):

As you rightly say, it's an issue that's been a top of mind for many, many years now, and we made some big commitments, as you say, so that we said that we wanted our packaging... I mean, it starts with a vision. Actually, maybe we should start with a vision. The vision is very clear. None of our packaging

should end up as landfill or litter. Period. That's it. None of it. We don't want it as landfill. We don't want it as litter. We don't want it in the oceans. We want to eliminate waste in all forms and especially packaging. So we set the targets of making sure that all of our packaging is designed for reuse and recycling, and we're working towards a 2025 goal, looking like something in the region of 95% plus.

(40:22):

The other goal that we set was that we should reduce the use of virgin plastic. Some plastics like PET are very recyclable, so we shouldn't really be using new virgin plastic at the rate that we are. So reduce virgin plastic use by 30% by 2025. So that's the goals that we set ourselves.

(40:42):

Now, there's a number of different ways in which we're setting about achieving that, and we've got effectively five pillars. The first is just to reduce the amount of packaging or eliminate it altogether where we can. So secondary packaging, those plastic layers that go around things, can we get rid of that? Can we reduce the headspace in the bottle? Those sorts of simple things that eliminate or reduce the amount of packaging.

(41:02):

Second thing is around reuse and refill, and we've seen quite a lot of changes in reuse and refill, and particularly in things like personal care products where you can buy large bags, refill your small plastic container, that's terrific. We have a different challenge of course with food and beverages because as you've already said, quality and safety are the absolute paramount keys to all of this, and we can't jeopardise quality and safety. So that's a bit of a challenge, but reuse and refill is a key focus for us.

(41:32):

Then there's the question of materials. What are the other materials we can use? What better materials of paperization, for instance? Where can we find other materials that are more biodegradable than plastic is and replace? And we've got a whole massive R&D unit here in Switzerland that's focused on just that. Then there's the infrastructure and the systems, better systems. How can we lend our voice to ensuring that consumer behaviours are changing, that regulation is shifting. I'll say a bit more about that in a moment. And then finally, new behaviours. We need to educate our retail partners. We need to educate ourselves. So there's a lot of programmes going on inside the company. We need to work with consumer groups to help people understand how to manage this problem because it's not something we can do on our own. We also need to do this with peers.

(42:20):

One of the other ways in which we're showing some leadership, and here's a bright spark of hope in sometimes consumer, somewhat depressing world, the UN for all its criticisms has actually convened a plastics treaty. And there is an agreement being negotiated at the moment for a legally binding global plastics treaty. And the idea of this is that those same misfunctions that we see, the dysfunctionality of local collection systems that are so variable, and you can be in one part of the country and you'll find a system that looks like this and it looks completely different elsewhere. The same is true at global level. We need a consistent approach to this where member states come together and agree how we are going to tackle this to eliminate the scourge of plastic waste. And that treaty is one that we at Nestle are playing a leading role on the business side in encouraging an ambitious outcome.

(43:12):

So we've made great progress. We're at something like 82% of our plastic packaging is already at that design for recycling or reuse. We will, I think, hit that plus 95% goal by 2025, and we'll keep at this because if the vision is none of our packaging ends up as landfill or litter or in the oceans, we have to be constantly vigilant in ensuring that we get there.

Tracey Wahlberg (43:37):

So if I'm hearing you correctly, that means some of your packaging I could compost in my garden in the future?

Rob Cameron (43:42):

Yeah, indeed. In fact, you already can. We have coffee pots that are compostable. Now, there is a distinction between industrial compostability and just chucking it in your garden, but that distinction will get less and less over time. And that idea of paperization and biodegradable packaging, these are all the things that we're looking at because there is not a silver bullet for this one. There is not going to be one single solution to this. So you have to reduce it in the first place and eliminate it where possible. Reuse and refill is a part of it, then better materials, some of which will be compostable. Yes.

Tracey Wahlberg (44:12):

Thanks for diving into all this detail, Rob. We really appreciate Nestle's transparency on these topics. They're not easy topics to discuss, and we appreciate your radical transparency. Before we wrap up, I wonder if we can revisit our question at the beginning and this time for cash flows. If you didn't invest in these changes now, what would be the impact to Nestle's ability to generate those sustainable cash flows that we love as investors well into the future?

Rob Cameron (44:38):

Business is quite simple, really. Find great products, put them on the market at price points that people want to pay. That's the secret of business success. Now, if I think about the sustainability agenda, and going back to your very first question, and I think about where we're at in the world today, and I think about the future, we know consumer preferences are going in a certain direction. We know regulation on sustainability issues is not going to weaken. It's only going to strengthen. So if we want to be the preference for consumers, if we want to avoid the costs that are going to come our way in terms of regulation, if we want to avoid those costs that are coming our way in terms of the impacts of climate change, if we want to create shared value, these are the investments that are just like an R&D investment. These are the investments that are necessary to be a successful business in the future. And Nestle is nothing if not a long-term company, and it wants to be stable. This is what delivers stable returns in future.

(45:36):

There's a triangle that maybe sums it up quite well. The triangle is growth, sustainability, margins. Those three things are always going to be a little bit intention, but they have to be seen in a dynamic where they're pulling a little bit against each other, but you can't separate the one from the other. If we don't grow, we're not going to be delivering margins. We won't have the money to invest in sustainability. If we don't focus on sustainability, frankly, the margins are going to be worn away and we probably won't grow. So those three things are there. They're intention, but they're part of a system, and that's how we think about the future.

Tracey Wahlberg (46:09):

Yeah, that's great. Thanks Rob. Thanks for taking the time with us to discuss Nestle's sustainability strategy.

Rob Cameron (46:15):

Thanks for having me. Enjoyed it.

Host (46:17):

That was Nestle's global head of public affairs, Rob Cameron, in discussion with Magellan's portfolio manager of Core ESG, Elisa Di Marco, and Magellan investment analyst, Tracey Wahlberg. We trust you've enjoyed this episode of Magellan In The Know. Join us in a month's time for the next episode. For more information on upcoming episodes, visit magellangroup.com.au/podcast, where you can also sign up to receive a regular investment insights programme. Thanks for listening.

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