

## The Food Industry

### Introduction

The food industry is critical to society and the global economy and is very sensitive to ESG risks. Climate change can impact food production, and at the same time, increasing environmental regulation is an operational risk, as the industry is a major producer of greenhouse gases and user of water and plastics. The industry also faces pressure from food safety regulation and social pressure about changing diets.

While the food industry is not often the focus of ESG and/or SRI conversations,<sup>1</sup> we believe this industry is another interesting example of how all industries should be examined by investors for ESG risks. Notable commitments to change agricultural policies were announced at COP26.<sup>2</sup> Investment performance in this sector may increasingly be influenced by how well companies manage exposure to ESG factors.

Within an industry that is as large and as vital a segment of the economy as the food industry, these ESG factors can also spill over into broader economic concerns for investors. From an economic point of view, food is typically the second largest consumer expenditure behind housing.<sup>3,4</sup> Given the long-term structure of leases and mortgages, we would argue that in any given year housing costs are much more predictable than food costs. Therefore, fluctuations in food costs can have a significant impact on consumer expenditures for all products.

The food industry is also a very large user of energy.<sup>5</sup> Rising energy costs due to global supply/demand, new taxes, and government environmental policies can all have a major impact on the cost of production, packaging, and transportation of food products. These factors are likely to influence food prices for consumers and their excess liquidity for other spending.

### Food Supply Chain and The Environment

Below we outline some of the key environmental concerns surrounding the food industry including climate change impact on production as well as greenhouse gas emissions and plastic usage in the industry.

Climate Change: Climate change is a danger to food production globally. While in this century crop yields have generally increased, cultivated land has decreased annually on a per capita basis. A USDA paper cited that crop yields are diminished by climate change, which can come from

**Mark R. Shenkman**

Founder & President

**Justin W. Slatky**

Chief Investment Officer

**Bob S. Kricheff**

Portfolio Manager & Global Strategist

**Amy L. Levine, CFA**

Director of ESG

For more information, please contact:

**Richard A. Keri, CPA**

SVP, Head of Business Development &  
Investor Relations  
(212) 867 - 9090

[InvestorRelations@shenkmancapital.com](mailto:InvestorRelations@shenkmancapital.com)

changes in temperature, rain fall and severe weather events.<sup>6</sup> With lower yields and less cultivated land, there may be fewer locations available with favorable environmental conditions, thus hurting production and the ability to find alternative sources.

Greenhouse Gas Emissions: The recent United Nations Foundation report cited that the food production system may be responsible for one-third of global emissions. While this is an aggressive reading in our opinion, it does highlight that emissions from agricultural tools, transportation and storing food (particularly refrigeration) add up to food systems being significant users of fossil fuels and a producer of "so-called short-lived pollutants like methane."<sup>7</sup> The report does suggest some solutions such as restoring special feeds that can reduce methane and varied crop rotations and ground coverings. Additionally, it discusses returning peatlands to their natural state as a way to drastically reduce emissions, as many of these areas that can trap greenhouse gasses have been drained to grow food.<sup>8</sup> Attempts to reduce emissions is also one driver of the "alternative-protein" market, which could dislodge traditional food players. All of these efforts are likely to disrupt food production for a period of time and carry costs for the industry and possibly individual companies.

Plastic Usage: Plastics are a high profile environmental problem. They are typically sourced from petrochemicals, decompose slowly, and cause concerns for the health of humans and wildlife from micro-plastics polluting soil and water supplies. Food value chains are reported to use 12.5 million tons in production plus another 37.3 million tons in packaging. The industry, particularly the retail portion of the food chain, has come under social and regulatory pressure to reduce plastic usage impacting costs.<sup>9,10</sup> This is again a trend that is changing costs and demand in the industry due to environmental consideration.

Other key environmental topics that are often a concern around the food industry include:

- Usage of fertilizers and long-term damage to both the environment and health.
- Use of fossil fuels in the transportation of food products.
- Refrigeration and its impact on energy usage and greenhouse gas generation.
- Water conservation as well as the diversion of supplies and impact on the overall watershed.

### Social and Governance Factors and The Food Industry

Social and governance issues are also significant in the food industry. Products have come under social, media and regulatory pressures for being unhealthy or misleading on their nutritional values. This has been particularly true on children's foods. Additionally, socially conscious consumers may shift their product demand, which is often given as a reason for the growth of consumption of plant-based milk products.<sup>11</sup> Clearly the safety of food products is critical to the success of any company in the industry. Even strong, well run companies can suffer unexpected safety issues, and it is critical that a company manages these situations in a thorough and timely manner. For example, Kraft-Heinz recently rapidly recalled some drink products that reportedly had a foreign object in them.<sup>12</sup>

## CONCLUSION

"Every society is three missed meals from chaos" – V. Lenin<sup>13</sup>

While we don't often quote Lenin, and agree with him, the statement above does highlight how critical the food supply chain is, and how much regulatory and social scrutiny the industry can come under. Food security is necessary for an economy to function successfully, and food costs can dramatically impact consumer's view of inflation and their disposable income for other purchases.

Climate change can clearly disrupt the stability of food supplies. At the same time, efforts to reduce the environmental damage done by the food supply industry could also impact food security. The food industry is already highly regulated. If new environmental mandates are too severe, they could impact the economics of production and thereby limit the availability and access of food types, as costs required to meet some ecological transitions could make some production untenable.

The food industry's enormous environmental impact will likely require it to transition and should be considered when investing in these companies. These changes will presumably come from changes to the demand side, supply side as well as likely be driven by regulation. Investors must consider the consequences of each change on the entire food supply chain and food security.

Changes to the food industry that might be driven by ESG factors can impact large portions of the investment markets – including food producers, restaurants, retailers, agricultural equipment manufacturers, consumer packaging and logistics companies.

While a simple carbon target or a negative screen on fossil fuels may check a box, we believe the food industry's ESG concerns can be wide-reaching and very subtle. In our opinion, a full analysis "embeds" an analysis of ESG risks into the credit approval process. This industry highlights how important it is to undertake ESG analysis for all credits and industries, not just the seemingly controversial ones.

## SOURCES

<sup>1</sup> We would note that the cattle/meat industry does get some focus on product health and methane output, but we believe this is minor compared to the focus on industries involved in fossil fuels or mining.

<sup>2</sup> <https://ukcop26.org/nations-and-businesses-commit-to-create-sustainable-agriculture-and-land-use/>

<sup>3</sup> <https://www.bls.gov/news.release/cesan.nr0.htm>

<sup>4</sup> Depending which data one uses, healthcare costs, including insurance, could be considered the second largest expenditure.

<sup>5</sup> <https://www.ers.usda.gov/amber-waves/2017/june/the-relationship-between-energy-prices-and-food-related-energy-use-in-the-united-states/>

<sup>6</sup> [https://www.usda.gov/sites/default/files/documents/CCFS\\_Executive\\_Summary.pdf](https://www.usda.gov/sites/default/files/documents/CCFS_Executive_Summary.pdf)

<sup>7</sup> <https://unfoundation.org/blog/post/climate-change-and-food-three-key-takeaways-from-the-ipccs-climate-science-report/>

<sup>8</sup> <https://news.un.org/en/story/2021/11/1105172>

<sup>9</sup> <https://news.un.org/en/story/2021/12/1107342>; <https://www.fao.org/3/cb7856en/cb7856en.pdf>

<sup>10</sup> <https://www.plasticsoupfoundation.org/en/plastic-facts-and-figures/>

<sup>11</sup> <https://www.foodnavigator-usa.com/Article/2019/01/24/48-of-consumers-buy-dairy-and-plant-based-milks-reveals-IPSOS-survey#>

<sup>12</sup> <https://www.npr.org/2021/11/16/1056268917/kool-aid-country-time-drink-mixes-recalled-glass-metal-in-powder>

<sup>13</sup> <https://www.goodreads.com/quotes/853096-every-society-is-three-meals-away-from-chaos#:~:text=Quote%20by%20Vladimir%20Lenin%3A%20%E2%80%9CEvery,three%20meals%20away%20from%20chaos%E2%80%9D>

## OFFICES

## SHENKMAN CAPITAL MANAGEMENT, INC.

461 Fifth Avenue  
New York, NY 10017  
(212) 867 – 9090

262 Harbor Drive  
Stamford, CT 06902  
(203) 348 – 3500

## SHENKMAN CAPITAL MANAGEMENT LTD

49 St. James's Street  
London, UK SW1A 1JT  
+44 (0) 207 268 2300

## DISCLAIMERS

The Shenkman Group of Companies (the "Shenkman Group") consists of Shenkman Capital Management, Inc., and its affiliates and subsidiaries, including, without limitation, Shenkman Capital Management Ltd, Romark Credit Advisors LP, and Romark CLO Advisors LLC. The Shenkman Group focuses on the leveraged finance market and is dedicated to providing in-depth, bottom-up, fundamental credit analysis.

Shenkman Capital Management, Inc. ("Shenkman" or "Shenkman Capital") is registered as an investment adviser with the U.S. Securities and Exchange Commission (the "SEC"). Romark Credit Advisors LP is also registered as an investment adviser with the SEC and Romark CLO Advisors LLC is registered as a relying adviser of Romark Credit Advisors LP (together, "Romark"). Shenkman Capital Management Ltd is a wholly-owned subsidiary of Shenkman Capital Management, Inc. and is authorized and regulated by the U.K. Financial Conduct Authority. Such registrations do not imply any specific skill or training.

The information and opinions expressed herein are provided for informational purposes only. This information is not intended to be, and should not be considered as, impartial investment advice, an offering of investment advisory services or an offer to sell or a solicitation to buy any securities. Any offer to sell or any solicitation to buy securities of an investment fund managed by Shenkman or invest in any Shenkman strategy will be made only by means of the Prospectus or Offering Memorandum relating to that fund or pursuant to an investment management agreement for a separately managed account. All interests in securities of any fund shall not be offered or sold in any jurisdiction in which such an offer, solicitation or sale would be unlawful or would require registration of disclosure until the requirements of the laws, rules and regulations of such jurisdiction have been satisfied. In certain jurisdictions, including Switzerland, this is an advertising document.

Third-party information contained in this presentation was obtained from sources that the Shenkman Group considers to be reliable; however, no representation is made as to, and no responsibility, warranty or liability is accepted for, the accuracy, adequacy completeness, timeliness or availability of such information, including ratings. The Shenkman Group is not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, or for the results obtained from the use of such content. THE SHENKMAN GROUP DOES NOT GIVE ANY EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. THE SHENKMAN GROUP SHALL NOT BE LIABLE FOR ANY DIRECT, INDIRECT, INCIDENTAL, EXEMPLARY, COMPENSATORY, PUNITIVE, SPECIAL OR CONSEQUENTIAL DAMAGES, COSTS, EXPENSES, LEGAL FEES, OR LOSSES (INCLUDING LOST INCOME OR PROFITS AND OPPORTUNITY COSTS OR LOSSES CAUSED BY NEGLIGENCE) IN CONNECTION WITH ANY USE OF SUCH THIRD-PARTY CONTENT.

The data, information, and opinions contained herein are current and/or accurate as of the date stated or the date of this presentation, whichever is later; Shenkman Capital is under no obligation to update any data, information, or opinions contained herein.

The inclusion of particular investment(s) in this presentation is not intended to represent, and should not be interpreted to imply, a past or current specific recommendation to purchase or sell an investment. These materials do not undertake to explain the risks associated with any investment. No person or entity should make any investment unless satisfied that it (or its investment representative) has asked for and received all information that would enable it (or them) to evaluate the merits and risks thereof.

This paper, including the information contained herein, may not be copied, republished or reposted in whole or in part, without the prior written consent of Shenkman Capital. SHENKMAN®, SHENKMAN CAPITAL®, and other Shenkman trademarks and logos used herein are registered trademarks of Shenkman Capital Management, Inc. All rights reserved.