

Acute	Chronic	Legal and policy	Market	Technology	Reputational
Physical risk		Transition risk			

Deforestation Allegations Trigger Share Selloff of Swedish Oils and Fats Firm AAK

Swedish specialty oils and fats manufacturer AAK AB is highly exposed to nature-related risk through the import and use of plant-based oils in many of its products. Despite its claims to source palm fruit only from sustainable sources, in June 2023, a news report emerged alleging that the company knowingly engaged with mills supplied by Indonesian palm plantations that had been illegally cleared.

AAK experienced a 5% decline in its share price the day after the news broke, reflecting investor concern over the credibility of sustainable palm oil initiatives in the industry.

100% Share of gross value added by the food and beverage sector that is moderately or highly dependent on nature

5.5% Decline in AAK's share price across June 13-14, 2023, following the publication of an article alleging exposure to illegal palm oil

23% Potential downside for AAK shares in the month following the news, according to buy-side analysts

Materiality of nature impacts and dependencies

'Materiality' refers to the influence some factor, event or information has on a company's valuation, the omission of which in a financial statement could mislead investors or other stakeholders.

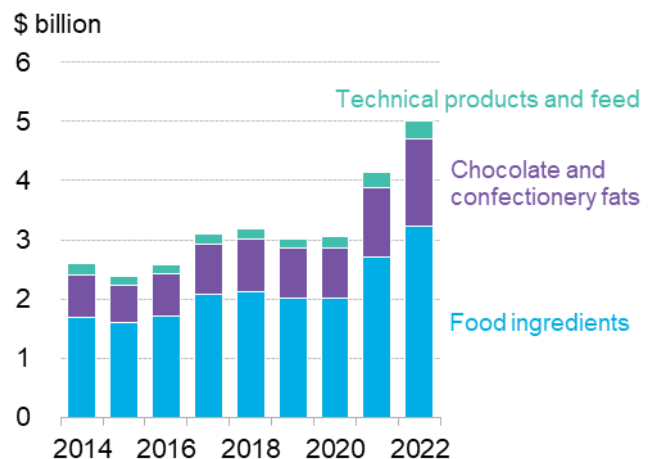
'**Single materiality**' is conventionally used in accounting. For nature, it captures only how a firm's valuation can be affected by changes in the ecosystem services that production depends on.

'**Double materiality**' also considers the impacts of the firm on nature, capturing how production processes change the state of nature.

Manifestation of nature risk

Founded in 2005 as the result of a merger and later becoming the eighth-largest palm oil company globally, AAK (STO: AAK) and its antecedents have more than 150 years of experience processing and manufacturing plant-based oils. The company now sells chocolate and confectionary fats, food ingredients, feed and other products globally. It imports raw shea, soybean and palm oils from Southeast Asia and West Africa, refining them at facilities around the world and exporting to food manufacturers globally. Its revenue and market cap are each around \$5 billion.

AAK's revenue is derived from three product groups linked to food and agriculture



Source: BloombergNEF, Bloomberg Terminal. Note: Technical products include fatty acids and glycerine.

Indonesia's rainforests are among the most biodiverse areas on the planet, home to 10% of the world's mammal species, including orangutans, tigers and rhinos, and identified by BNEF as a priority region for biodiversity finance. The World Resources Institute places palm oil second on a list of commodities that

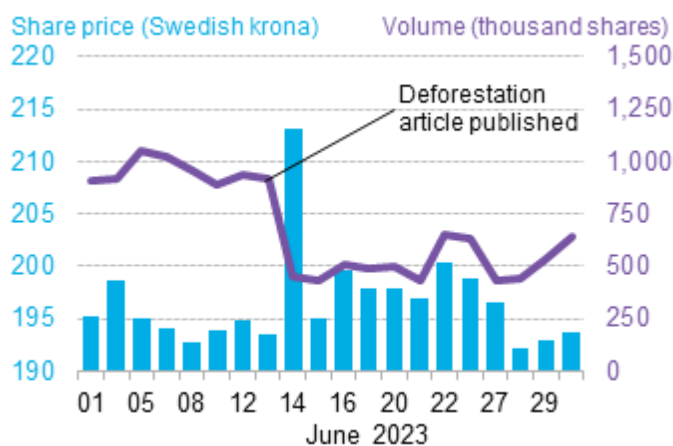
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drive deforestation, behind beef. AAK has striven to build a sustainable palm sourcing practice, co-founding a [voluntary industry standards initiative](#) in 2003 and implementing a suite of initiatives to improve traceability and transparency.

Against this backdrop, on June 12, 2023, Swedish newspaper *Sveriges Natur* [published](#) the results of its investigation into 20 mills that extract oil from illegally grown palm fruit in Tesso Nilo, a national park in Sumatra, Indonesia, in which land clearance and deforestation are explicitly prohibited. Citing plantation owners and local workers, it reported that AAK knowingly purchased from all 20 mills. The investigation followed a similar story by another Swedish newspaper three years earlier.

Oil sourced from palm fruit illegally grown within the protected Tesso Nilo is extracted by nearby mills, mixed with oil from legitimate palm plantations, and sold into a complex global supply chain, making it difficult for downstream manufacturers and retailers to trace its origin.

The allegations triggered a selloff of AAK’s shares, with five times usual trading volumes and a 5.5% price decline over June 13-14, 2023



Source: BloombergNEF, Bloomberg Terminal. Note: X-axis spacing due to trading data.

Financial and reputational impact on AAK

For a sustainability-focused oils and fats company, the palm oil supply chain brings inextricable reputational

risks. News of practices seemingly in violation of its zero-deforestation ambitions spooked equity investors, sending daily trading volumes to over five times their usual average and precipitating a 5.5% fall in the company’s share price over June 13-14, 2023.

The article, which received media coverage outside of Sweden, quickly attracted attention from buy-side research analysts, who estimated a potential 23% downside to the company’s share price for the month. AAK published a [press release](#) in response to the allegations, emphasizing the importance of palm oil and the company’s commitment to its sustainable sourcing policy, though not directly addressing the situation in Tesso Nilo or admitting wrongdoing.

AAK’s share price took four months to recover, returning to its early-June level in the second week of October, when third-quarter results showed operating profit exceeded analysts’ estimates. This suggests that there has not been a long-lasting reputational impact for the company. Nor have there been significant changes in management. Swedish asset managers saw the need to [react](#) to the news investigation, affirming their backing of AAK, while noting that they were continuing to monitor the situation.

Despite the short-lived impact, the incident heightens AAK’s future risk exposure, as the increasing prevalence of deforestation and sustainable soft commodities in the climate dialogue is fueled by growing global demand for palm oil. In this context, a repeat of June’s allegations and a failure to establish fully traceable and deforestation-free palm oil sourcing by its 2025 target may have lasting financial and reputational impacts, while also exposing its investors to similar risks.

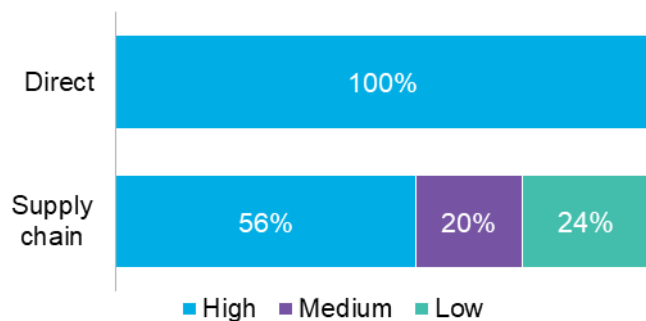
Nature risk across the food and beverage sector

The food and beverage sector is highly exposed to nature risk. The World Economic Forum estimates that 100% of the industry’s direct economic value generation is moderately or highly dependent on nature, as is 76% of the value generated by the food

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and beverage supply chain. This risk manifests in a myriad of ways: physical dependencies on ecosystem services such as pollination are foremost, though transition risk is already emerging as policy and investor expectations begin to shift; systemic risk is likewise becoming more material as the possibility of large-scale ecosystem collapse increases.

Nature dependency of gross value added across the food and beverage sector’s direct operations and supply chain



Source: World Economic Forum, BloombergNEF. Note: AAK is classed as a food and beverages company as it derives most of its revenue from such products.

The sector also has considerable impacts on nature. According to the ENCORE nature tool’s impact drivers, which assess the impacts of production processes on ecosystem services and natural capital, the sector has a high materiality rating for water use and greenhouse gas emissions, among others. The Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services (IPBES) notes that changes in land and sea use, 80% of which are caused by agriculture, are together the biggest drivers of nature and biodiversity loss. The next-largest driver is resource exploitation, with agriculture again being the industry most responsible.

Due to the scale of nature impacts and dependencies across the sector, examples of nature-related risks are plentiful. The newspaper investigation that alleged AAK’s connection to mills processing palm oil also cited Mondelez International, Unilever and Colgate-Palmolive, alleging that they all source palm oil in a

similar manner to AAK. Three further examples relating to deforestation are presented below.

Similar risks and opportunities for adjacent firms

Company	Risk type	Description
Cadbury	Reputational and market	Cadbury New Zealand and Cadbury Australia were forced into an about-turn on their decision to substitute palm oil for cocoa butter in pursuit of cost savings, after consumer outcry in 2009.
PT Kallista Alam	Legal and reputational	In 2014, the Indonesian palm oil company was ordered to pay \$30 million in fines and reparations for its illegal clearance and burning of protected forest, a violation of a newly enacted moratorium on plantation concessions.
BNP Paribas	Legal and reputational	The bank was sued in February 2023 by a Brazilian non-governmental organization, which claimed the bank did not conduct sufficient due diligence on the companies to which it provides financial services, despite BNP Paribas’ commitment to cease financing activities associated with deforestation.

Source: BloombergNEF

Regulatory shifts present a new frontier of transition risk for companies operating in the food and beverage sector. The most prominent example of this is the EU Deforestation Regulation, which is causing firms that trade food products within the bloc to consider their exposure to deforestation.

EU Deforestation Regulation

The EU Deforestation Regulation on Deforestation-free Products, also known as the EUDR, came into force on June 29, 2023, and requires companies trading in seven at-risk soft commodities to conduct extensive due diligence in their supply chains. This is to ensure that their production does not result from recent deforestation, forest degradation or other breaches of environmental laws. The seven commodities are beef, cocoa, coffee, palm oil, rubber, soya and wood. From

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December 30, 2024, it will be illegal to trade these products in the EU market or to export them from the EU if they are tied to deforestation, punishable by fines proportionate to the environmental damage caused, though limited to 4% of the firm’s EU turnover. For more, see: *Supply Chains Will Be Challenged By EU Deforestation Rules* ([web](#) | [terminal](#))

Managing nature risks in the food and beverage sector

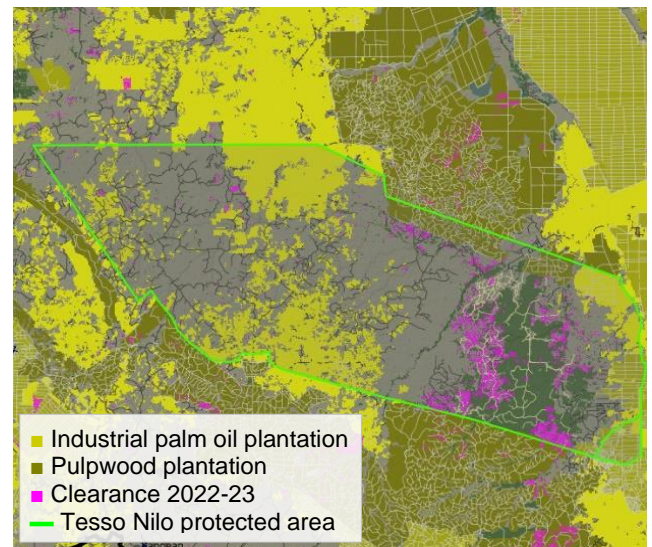
AAK is well placed to mitigate similar risks in the future as an early pioneer of deforestation-related commitments – a point that its management appears to appreciate, touting zero-deforestation and full-traceability pledges for palm oil by 2025. Its biggest challenge is ensuring that these commitments translate into timely execution. It is making significant progress: in 2022, some 71% of its palm supply was verified to be deforestation-free and 87% was traceable to plantation, representing respective gains of 4% and 7% from the previous year. Its 3Q 2023 earnings report saw these figures reach 77% and 91% respectively, although that still leaves a substantial portion from indeterminate origins.

Other companies in the sector can learn from the progress of AAK. Its internal and external verification of palm sourcing, including the use of technology, and membership of industry groupings such as the Roundtable on Sustainable Palm Oil (RSPO), provide examples of good practice. Making zero-deforestation pledges remains an important first step for firms concerned about their palm sourcing, though as of October 2023, only 26 out of the 319 packaged food companies tracked by Bloomberg have done so. As global policies tighten, the risk of financial impacts on firms exposed to deforestation increases.

To minimize the financial costs stemming from impacts and dependencies on nature, firms whose supply chains are exposed to deforestation should actively target full traceability to legal plantations. This will help them avoid market and legal risk from changing investor preferences and regulatory pressure.

Understanding nature-related impacts and dependencies can be enhanced by using the existing reporting and disclosure architecture and its supporting suite of relevant metrics and targets. These commitments are not enough, however, as demonstrated by the ongoing destruction of the Tesso Nilo rainforests over the past two years.

Tesso Nilo continues to experience deforestation despite its protected area status



Source: BloombergNEF, Nusantara Atlas.

Financial institutions also have an opportunity to minimize exposure to potential risks from the sector. Understanding how recipients of their debt and equity finance interface with nature, then implementing and enforcing tighter restrictions, will better insulate them against the market and reputational risks that impacted companies such as AAK in recent months.

More from BNEF:

Supply Chains Will Be Challenged by EU Deforestation Rules ([web](#) | [terminal](#))

Biodiversity Finance Factbook: COP28 Edition ([web](#) | [terminal](#))

Sustainable Agriculture: 10 Things to Watch in 2023 ([web](#) | [terminal](#))

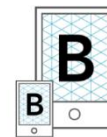
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