

# FACTORY FARMING: ASSESSING INVESTMENT RISKS

2016 report



# KEY FINDINGS AND IMPLICATIONS FOR INVESTORS



**Jeremy Collier**  
Founder  
FAIRR Initiative

“Looking at the industry through an ESG lens produces alarming results that should raise a red flag to mainstream investors across the world”

▶ **Animal factory farming is exposed to at least 28 environmental, social and governance (ESG) issues that could significantly damage financial value over the short or long-term.** Many of these risks are currently hidden from investors.

▶ **All 28 issues can potentially affect the financial performance of companies across the food value chain.** Including large agri-business, food retailers and restaurants.

▶ **A knowledge gap exists within the investment community about managing these risks and opportunities.** Even among those investors who are integrating ESG issues into their investment decision-making processes.

▶ **The window of opportunity for investors to act is finite and shrinking.** Rising capital costs, the shifting gravity of production to developing countries, climate change and increasing social concerns over animal welfare are increasing the magnitude of risk.

▶ **Investors should undertake additional research in a number of areas to support the initial exploratory findings contained in this report.** If they are to close the knowledge gap and protect long-term value creation.

“Perhaps the most surprising thing of all in this report is the fact that most investors are failing to consider these risks”

▶ Help us close the knowledge gap. Join FAIRR at: [fairr.org](https://www.fairr.org)

# FACTORY FARMING: KILLER STATS INVESTORS CAN'T IGNORE



**Nº 1**

reason for rapid spread of bird (H5N2) and swine (H1N1) flu



**\$3.3bn**

industry losses due to US Avian Flu outbreak in 2015 <sup>[FarmEcon]</sup>

**Nº 1**

user of antibiotics in the US



**80%**

of all antibiotics in the US now used in animal factory farms <sup>[CDC]</sup>



**14%**

of global GHG emissions, more than the transport sector\* <sup>[FAO]</sup>



\*from livestock sector as a whole, with factory farming as key component

**21%**

rise in predicted losses from 'heat stress' due to warming climate

**Nº 1**

consumer of water in drought-stricken California <sup>[Pacific Institute]</sup>



**\$250m**

and rising hit on profits of California dairies due to drought in 2015 <sup>[UC Davis]</sup>



**85%**

of all soya globally is used in animal feeds, a major cause of deforestation <sup>[WWF]</sup>



**DOWN** INVESTORS IN **MCDONALDS** AND **KFC** HIT BY US\$10.8BN LOSS OF MARKET CAP IN 2014 DUE TO FOOD SAFETY SCANDAL AT A CHINESE SUPPLIER

# EXECUTIVE SUMMARY

## → Animal factory farming has established itself as the predominant mode of livestock production.

An estimated 70% of farmed animals are now raised in this system, including 99% of US farm animals, and now many Asian countries have started to implement intensive animal farming systems at pace and scale.

## → A knowledge gap exists about animal factory farming risks among investors.

Despite the evidence of its potential impacts on areas such as public health, the environment and food safety, animal factory farming has not historically received meaningful attention from the responsible investment community.

## → This report is a toe in the water to broaden current understanding of risk and opportunity linked to investment in animal factory farming.

Researchers Verisk Maplecroft analysed several economic, academic and NGO studies to understand whether there was financial vulnerability for long-term investors. It is the first study to reveal unpriced risks from the impacts of wider environmental, social and governance issues on animal factory farms.

## → Animal factory farms are vulnerable to at least 28 ESG issues that may damage their financial performance and returns.

The key risks are:

- **Environmental** – These include issues such as climate change, water scarcity and water pollution. Reports indicate that if the industry was forced to meet the costs of its pollution, this could equate to billions of dollars. As one of the largest contributors

of greenhouse gas emissions, the sector may also suffer long term damage from regulation aimed at supporting the transition to a low-carbon economy.

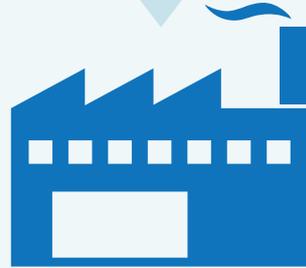
- **Social** – The report concludes that there is a significant amount of material value potentially at risk from social health impacts. These include the overuse of antibiotics in factory farms, pandemic risk and reputational damage to companies due to changing consumer attitudes. For example, the research describes how the 2009 outbreak of H1N1 strain of swine flu, thought to have originated in a US factory farm, wiped around US\$3bn of value off the MSCI US Agriculture and Food Chain Index in just two weeks. The 2015 outbreak of avian flu in the US, whose spread was catalysed by intensive farming, had similarly devastating financial impacts
- **Governance**: There are four broad governance issues that impact the animal factory farming industry, with potential changes to subsidy support from governments presenting the most significant financial risk. For example, one study argues that the success of the animal factory farming model is due largely to subsidy support, including almost US\$4bn that the US industry receives in benefits annually from subsidised grain. Shifting production to developing countries also rings alarm bells for investors due to less robust corporate governance in these countries.

## → Some leading investors have already started to integrate animal factory farming risks into investment processes.

**DOWN** ANIMAL WELFARE SCANDAL LEADS TO LARGEST MEAT RECALL IN US HISTORY,  
AND BANKRUPTCY FOR MEAT-PACKER HALLMARK/WESTLAND IN 2012



INVESTORS



ANIMAL FACTORY FARMS



### 13 ENVIRONMENTAL ISSUES

Disease outbreaks | GHGs  
 Deforestation & biodiversity loss  
 Natural hazards | Climate change  
 Water pollution | Water scarcity  
 Resource scarcity  
 Poor animal welfare | Waste  
 High water use | Air pollution  
 Soil degradation

**CASE STUDY:** A warming climate is set to make factory farming less financially viable. E.g. increasing cattle 'heat stress days' by 21% by 2045. The US dairy industry already loses US\$897m/year from heat stress on cattle.



### 11 SOCIAL ISSUES

Excessive antibiotics | Infectious diseases | Social backlash  
 Changing consumers | Poor working conditions | Human rights | Shrinking labour pool  
 Community health impacts  
 Loss of rural jobs | Land rights  
 Social licence to operate

**CASE STUDY:** The use of prophylactic antibiotics in factory farms may lead to major health issues. E.g. in 2009 swine flu caused the MSCI US Agri & Food Index to plunge 1.5%; Smithfield Foods lost 12%. Over 150,000 people died from the virus.



### 4 GOVERNANCE ISSUES

Policy changes  
 Weak oversight  
 Corporate governance  
 Sustainability disclosure

**CASE STUDY:** Animal factory farming is highly vulnerable to changes in its commercial context. For example, ESG factors may threaten subsidy support such as the US\$4bn of benefits the US industry receives annually from subsidised grain.

**DOWN** INVESTORS IN TYSON FOODS EXPOSED AFTER COMPANY REVEALS ENVIRONMENTAL VIOLATIONS. POSSIBLE \$500M OF REGULAR GOVERNMENT CONTRACTS AT RISK



## CASE STUDY: MARKETS INFECTED BY 2015 AVIAN FLU OUTBREAK



In the first half of 2015 the US suffered the worst outbreak on record of the deadly H5N2 strain of avian influenza. At the time of writing it had led to nearly 50 million hens and other poultry being destroyed, and caused dramatic falls of around 14% to America's \$6 billion poultry exports.

The virus was thought to have spread further and faster than any other historical outbreak because of the role of factory farms in modern farming.

The financial implications of H5N2 have been staggering. The value of the dead birds alone has been estimated at over \$190 million 40 countries placed bans on all US poultry and many food companies including Hormel and Post Holdings issued profit warnings following declining sales due to limited supplies and lost revenue from market closures.

In Iowa the largest egg producing state egg production dropped 21%. Resulting in a egg shortage, and a doubling in egg prices between January and June. Skyrocketing egg prices also infected other stocks such as food makers like Unilever, food distributors such as Sysco, and fast food firms including McDonald's whose costs all soared. The US egg shortage also created new markets both for European egg producers whose eggs were imported to help meet demand. As well as companies like Hampton Creek whose egg free products became highly sought after as the outbreak continued and led to it becoming the fastest growing food-company in history.

The cost of H5N2 to the wider economy has been estimated to be over \$3bn.

Intensive farming practices have raised serious animal welfare, health and hygiene concerns. Simply put: if elements of this sector continue to act against the long term best interest of society, society will act against it.

Neil Brown Alliance Trust



## CASE STUDY: PERMANENT VALUE DESTRUCTION

In 2008, evidence of animal cruelty and health concerns against Californian-based meat packers Hallmark/Westland forced them into the biggest meat recall in U.S. history.

They recalled more than 143 million pounds of beef, the equivalent of around 200 jumbo jets in weight.

The recall cost them \$116 million but this was just the start of the costs and a further compensation settlement eventually forced the company into bankruptcy in 2012.

“While industrial farm animal production has benefits, it brings with it growing concerns for public health, the environment, animal welfare, and impacts on rural communities.”

Pew Commission on Industrial Farm Animal Production (US)



## CASE STUDY: MCDONALDS AND KFC HIT BY \$10BN EXPIRED MEAT SCANDAL



On 20 July 2014, a major food safety scandal in China when supplier Shanghai Hushi Food Co. (owned by US-based OSI Group) was accused of intentionally selling meat beyond its shelf life to fast-food chain restaurants in China and Japan, including McDonald's, Yum! Brands (who own KFC), and Starbucks.

Referring to the Shanghai incident in its August quarterly report, McDonald's issued a warning that “As a result of the China supplier issue, the Company's global comparable sales forecast for 2014 is now at risk.”

In the aftermath of the news, buyers quickly cancelled their orders from the Shanghai supplier and in some cases the OSI Group as a whole. Within days the OSI Group had also withdrawn all implicated products from the marketplace. Despite this, the negative news coverage rapidly hit fast-food sales in China, prompting a decline in the full-year earnings of fast-food restaurants as well as a drop in share prices.

Financial analysis for July to October that the fall in sales had a substantial impact on the company share prices of Yum! and McDonald's. The companies recorded a fall in share price of 8.29% and 7.4%, and a drop in equity of US\$3.6 billion and US\$7.2 billion, respectively, between 18th July and 20th October 2014.



Source: Bloomberg

FIGURE 4: Financial impact of food safety scandal to fast-food chains in 2014

# ABOUT FAIRR

The FAIRR Initiative is a collaborative investor network that aims to raise awareness of the material impacts farm animal welfare issues can have on their portfolio. It aims to help investors share knowledge and form collaborative engagements on issues related to farm animal welfare.

Find out more, or join us, at: [fairr.org](https://www.fairr.org)

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