IOI Corporation

Responsible Alpha co-developed the business, economic, and investment analysis used by 123 environmental, indigenous rights, and racial justice organizations in their letter to the Honorable Gary Gensler, Chair, U.S. Securities and Exchange Commission on the proposed rule "The Enhancement and Standardization of Climate-Related Disclosures for Investors." The submission is here.

Responsible Alpha's analysis suggests investors need companies to disclose their climate-related financial risks and strategies for managing them, their greenhouse gas (GHG) emissions, their plans to remain viable or thrive in a low-carbon future economy, and their financial resilience across these dimensions, as it relates to and is in support of the communities where these companies exist, and their impacts are often felt and underreported. To further buttress and support this analysis, Responsible Alpha wrote 12 business cases of which the case below on IOI Corporation is one.

Summary

IOI Corporation,[i] $6.5 billion market capitalization, 30,000 employees, $660 million in fixed income, In March 2016 IOI was suspended for five months from the Roundtable on Sustainable Palm Oil (RSPO), after revelations that IOI subsidiaries in West Kalimantan, Indonesia, were responsible for the illegal clearance of 11,750 hectares of tropical forest, including 1,300 hectares within a state production forest, and “deep peat clearance”.[ii] As a result of the suspension, IOI lost access to markets for certified sustainable palm oil (CSPO). More than 50 percent of IOI’s revenues come from RSPO sales, so the suspension had a significant and immediate material impact on its business.[iii] As a result, IOI’s net income was negative $14.8 million in Q2 2016, compared to a $30 million gain in Q2 2015.[iv]

CSPO is important in the processed food supply chain because it reduces supply chain risks including deforestation. Industry heavyweights like Unilever and Cargill have made “No Peat, No Deforestation, No Exploitation” commitments business as usual. RSPO’s suspension meant that 27 of IOI’s clients concerned about sustainability suspended contracts with IOI and had to source palm oil from IOI’s competitors.[v]

In May 2016 IOI filed suit against RSPO in what some analysts believe to be an attempt to deflect damage to its reputation.[vi] If so, it was to no avail. Twenty-seven clients canceled contracts to purchase RSPO certified products from IOI. Its stock slid 17 percent between March and May 2016. Moody’s issued a negative outlook on IOI’s earnings on May 10, 2016 and reaffirmed the outlook on August 11. That month, IOI returned to RSPO with renewed commitments to improve its record and the suspension was lifted. IOI’s shares rallied in August, but a year later, some clients had not resumed doing business because of perceived risk that IOI would not be able to enforce sustainability practices in its operations. In September 2017 IOI sold its Loders Croklaan oils and fats business unit.[vii]

Company Overview

IOI Corporation Berhad (IOI) is a leading global integrated and sustainable palm oil player. IOI Corporation has its hands in a variety of industries. The company is primarily engaged in palm oil production. Its Malaysian plantation holdings are planted mostly with oil palm trees. IOI refines the oil from its plantations and produces edible oils, oleo-chemicals, and specialty fats. It also has operations in real estate; oleo-chemical and rubber production; specialty oils and fat production; residential and commercial real estate investment and development; luxury hotels and convention centers; and golf courses. IOI Corporation has operations in about 15 countries worldwide.

Their palm oil business consists of upstream plantations in both Malaysia and Indonesia; and downstream resource-based manufacturing business. Their resource-based manufacturing business consists of three segments: refining, oleochemical and specialty oils and fats. They own two palm oil refineries in Malaysia and four oleochemical manufacturing plants in Malaysia and Germany.

Their specialty oils and fats manufacturing business is carried out by their 30 percent-owned associate company, Bunge Loders Croklaan (formerly known as IOI Loders Croklaan), which has manufacturing operations in Malaysia, the Netherlands, USA, Canada, Ghana and the People's Republic of China.

Their downstream products are exported to more than 60 countries worldwide. Their landbank includes 96 estates and 206,987 hectares producing 2.9 million mt fresh fruit bunches (FFB) in 2021.

While U.S. Customs and Board Protection banned three Malaysian palm oil companies for importing their products into the U.S. in 2020 – FGV Holdings with a 432,821 hectares landbank and Sime Darby Plantations[viii] with a 718,174 hectare landbank[ix] – IOI also faces many labor complaints themselves.[x]

While IOI reports its Scope 1 and 2 emissions – in 2021 at 2,908,476 $tCO2_e$ – IOI des not report its Scope 3 emissions.[xi]

Climate, Community, and Environmental Risks

Climate Risks

Climate risks include the direct release of GHGs into the atmosphere, both from forest clearing and the resulting fire risk from the altered ecosystems, especially peatlands. Indonesia has become one of the world's leading GHG emitters due to deforestation, driven significantly by palm oil production. Acute risks include extreme fire weather. Chronic risks include elevated temperatures, impacts on water supplies, and impacts to public health.

Clearance of land for oil palm plantations is a direct source of GHG emissions and should be disclosed. The risks associated with palm oil production were, as the IOI case illustrates, financially material to the company and its shareholders. In addition, business practices were demonstrably material to the market, to the environment, and to human health. Those firms in the industry that participate in the RSPO recognize this and already voluntarily disclose these risks and their measures to mitigate them. A strong case can be made that the entire industry should be required to disclose direct material risks, and risks to their community.

Transition risks to businesses like IOI include regulatory risk, such as greater regulation of the palm oil industry. Twenty-five percent of IOI's total land bank is contested (more than 200,000 hectares) and more has been damaged from the fires of 2015. The record of illegal activity heightens the risk of greater regulatory scrutiny.

Other firms are facing political and regulatory headwinds including, in a surprise move, the government's newly announced ban on palm oil exports, announced on April 22, 2022. President Joko Widodo expressed concern about global food prices on the heels of Russia's invasion of Ukraine.[xii] In a recently televised election debate Widodo also introduced an energy self-sufficiency plan based upon use of palm oil as a feedstock.[xiii]

IOI's competitors capitalized on this uncertainty in the CSPO market. IOI's suspension denied it market access, temporarily reducing global CSPO supply by 6 percent. Kuala Lumpur Kepong reportedly raised its CSPO prices est. 40 percent in response. Restoring access to buyers' markets was stifled by IOI's reputational risk and ongoing NGO scrutiny. Greenpeace pressured IOI through April 2017 until a commitment to sustainability practices was negotiated.

While IOI reports its Scope 1 and 2 emissions – in 2021 at 2,908,476 $tCO2_e$ – IOI des not report its Scope 3 emissions.[xiv]

Community Risks

In the peatlands of Kalimantan, deforestation affects public health because establishing plantations requires the drainage of peat swamps. Fire is used to open the forest for the oil palm. Drainage of peatland results in drying of deep layers of peat. When dry, peat is flammable and is extremely difficult to control, because it can smolder underground for months. When conditions are drier than ordinary, this in turn creates a very high fire risk. This was the situation in the Indonesian fire emergency of 2015. Scientists estimated that exposure to smoke resulted in more than 100,000 excess human deaths across Indonesia, Malaysia, and

Singapore.[xv] Deforestation and associated illegal land grabs also render indigenous communities of Kalimantan landless and unable to forage, hunt, or even access clean water.[xvi]

Environmental Risks

Palm plantations are the major driver of deforestation in Kalimantan, as well as peatland drainage. This results in the loss of High Conservation Value forests and habitat for critically endangered species including orangutan and tiger. Between 2001 and 2018 Indonesia lost 16 percent of its forest cover (26 million hectares of forest), resulting in the release of around 10.5 gigatons of CO_2. A variety of factors, including regulatory action, have curtailed deforestation for palm oil plantations but deforestation has not slowed overall; drought, no doubt amplified by the damage to forest ecosystems and drainage of peat, is now a major driver.[xvii]

In 2018 The Indonesian government reacted to the situation by issuing a 3-year moratorium on new oil palm permits. The government has now let the moratorium lapse, while maintaining that it will not approve new permits.[xviii] [xix]

Risks to Investors and Cost to the Company

Costs to IOI Corporation

- After IOI suspension, IOI lost access to markets for certified sustainable palm oil (CSPO). More than 50 percent of IOI's revenues come from RSPO sales, so the suspension had a significant and immediate material impact on its business.[xx]
- 27 of IOI's clients corporate clients stopped purchasing from IOI, moving sourcing to competitors such as Kuala Lumpur Kepong (KLK).
- As a result, IOI's net income was negative $14.8 million in Q2 2016, compared to a $30 million gain in Q2 2015.[xxi]
- IOI stock slid 17 percent between March and May 2016 after the suspension was announced. That stock price, as of April 2022, has not returned to its high price in Q1 2016.
- Moody's issued a negative outlook on IOI's earnings on May 10, 2016 and reaffirmed the outlook on August 11.
- IOI's suspension denied it market access, temporarily reducing global CSPO supply by 6 percent.
- KLK reportedly raised its CSPO prices est. 40 percent in response.
- Unilever did not announce that it resumed sourcing from IOI until August 2017.
- September 2017, IOI announced it intended to sell a 70 percent in its refining business, Loders Croklaan, for $946 million to Bunge. IOI Corporation plans to use the proceeds for future investment opportunities or working capital, dividend payment to shareholders and repayment of borrowings, the filing showed.
- IOI cut its exposure in the Indonesia palm oil industry in 2016 with the sale of its subsidiary.

Risks to Investors

- September 2017, Moody's affirmed the Baa2 issuer rating of IOI Corporation.[xxii] Moody's changed their outlook on all ratings of IOI Corporation to stable from negative.[xxiii]
    - "The change in ratings outlook to stable reflects IOI's strengthened commitment towards sustainability in its operations and our expectation that the company is well-positioned to be removed from the watch list of the Roundtable on Sustainable Palm Oil (RSPO)."[xxiv]
    - "The stable outlook also incorporates IOI's announcement to divest a 70%-stake in IOI Loders Croklaan. Although the divestment reduces IOI's scale and diversification, proceeds from the sale will be partly used to reduce borrowings which will result in an improvement in IOI's leverage profile to around 3.0x for its fiscal year ending 30 June 2019."[xxv]
    - IOI's added commitments include (1) obtaining third-party verification on progress towards the implementation of its SPOP; and (2) adopting peatland management practices in its Indonesian plantations, as aligned with the Palm Oil Innovation Group's standards, an initiative that strives to adopt sustainably responsible palm oil production globally.[xxvi]

- IOI has a 28.52% ownership in Singapore-listed Bumitama Agri Ltd.,[xxvii] $1 billion market capitalization, $160 million in fixed income in two corporate bonds, crude palm (CPO) and palm kernel oil (PKO) producer with oil palm plantations located in Indonesia

References

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[v] These 27 companies were Ahold, ADM, Beiersdorf, Bunge, Cargill, Colgate-Palmolive, Delhaize, Dr. Oetker, Dunkin' Donuts, Ferrero, Fonterra, Golden Agri-Resources, Hershey's, Johnson & Johnson, Kellogg's, Louis Dreyfus, Marks & Spencer, Mars, McDonald's, Mondelēz, Neste Oil, Nestlé, Olam, Proctor & Gamble, Reckitt Benckiser, Unilever, and Wilmar.
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