

McDonald's deforestation footprint: We're not lovin' it

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The food sector is one of the largest contributors to tropical deforestation[1] and as one of the leading global food corporations, McDonald's is a key company for investors to monitor in relation to deforestation issues.[2] Its sourcing policies can have an important impact on supply chains linked to deforestation and the company is well placed to set an example in this regard that the broader food market could follow.

McDonald's has been a prolific bond issuer since 2021, issuing $9.8bn of bonds of which only $7bn has matured. During this period, its bond issuances more than tripled, while the rest of the market's issuances remained relatively stable.[3] This could significantly increase investment-grade bond portfolios' exposure to the company.

With a large portion of its restaurants in Europe, it is key for the company to align its sourcing policies with the recently adopted EU Regulation on deforestation-free products[4] that will be enforced at the end of 2024.[5] McDonald's has committed to eliminate deforestation from its supply chains by 2030, leaving a five-year window of uncertainty about its sourcing policies.

Effective investor engagement strategies require comprehensive disclosures of a company's deforestation footprint.[6] Notably, the company does not publicly disclose the volumes of commodities sourced from high-risk countries. However, providing such data can empower investors to assess the deforestation risk and take appropriate action.

The main takeaways are:

- **McDonald's high volume of issuances suggests investment-grade fixed income investors could be building an overweight position in the company, and so may be inadvertently increasing their exposure to deforestation.**
- **McDonald's is reasonably well positioned in terms of deforestation, but there are still questions about how effectively it is carrying out its deforestation-elimination strategy.**
- **Given the recent EU Regulation on deforestation-free products, investors should ask McDonald's to disclose the volumes of products imported from high-risk countries for their European operations. Requesting full disclosure will enable effective monitoring of the company's deforestation risk.**

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[1] "Disentangling the numbers behind agriculture-driven tropical deforestation", Pendrill, F. et al., 9 Sep 2022.
[2] "McDonald's: the footprints of a giant", Reporter Brasil, March 2022.
[3] Issuances in EUR and USD. Sources: Bloomberg.
[4] "Regulation (EU) 2023/1115 Of the European Parliament and the Council", Official Journal of the European Union, 31 May 2023.
[5] "EU deforestation law: fire on the horizon for soy traders", AFII, 13 Sep 2023.
[6] "Disclosure for a deforestation-free supply chain", Accountability Framework initiative, 17 Nov 2020.

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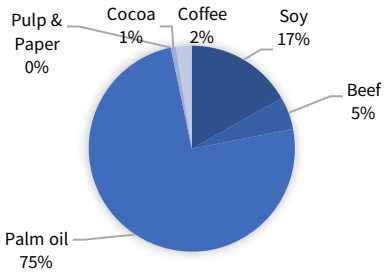
Background: McDonald's deforestation profile is significant

McDonald's environmental footprint is significant, and the company is targeted by Nature Action 100 as one of the key companies for engagement on nature loss, owing to the magnitude of its impact on nature, involvement in a key sector for nature loss and substantial size.[7]

McDonald's has made several environmental commitments concerning climate, packaging and deforestation. It should be noted that the company is currently reviewing its climate targets to ensure better alignment with a 1.5°C target and was meant to communicate more about this during 2023.[8] According to CDP's forward-looking targets, the company is currently not on track meet its commitments.[9]

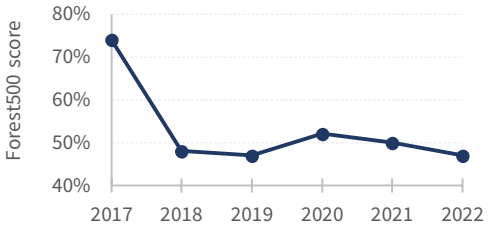
While McDonald's seems to be making substantial progress around its sustainability performance, the World Benchmarking Alliance (WBA) pointed out that its commitments can be further developed and deepened.[10] Most notably, the WBA has highlighted that the company can improve on its transparency.

Figure 1. McDonald's dependency on commodity originating in countries with risk of deforestation (in %). Sources: ForestIQ, AFII.



McDonald's deforestation exposure is largely driven by palm oil – used as a frying oil and as a par-fry for pre-cooking -[11] with soy and beef coming respectively second and third, according to ForestIQ (see Figure 1). Fast food giants' supply chains use large volumes of commodities linked to deforestation.[12] Therefore, the strength of their commitments and proper implementation of corrective measure is key for tackling deforestation globally. McDonald's high exposure to palm oil is concerning as reports indicate that only a small portion of third-party suppliers' geolocations is publicly disclosed – a key reporting element under EUDR.[13] Profundo estimates that 13% of McDonald's beef is sourced from LatAm countries while the volume of LatAm soy embedded in their products sits at 673,907 tons.[14]

Figure 2. McDonald's Forest500 score. Sources: AFII, Forest500.



The company has committed to eliminating deforestation from its global supply chains by 2030,[15] but there are concerns about the strength of its deforestation policy as outlined thereafter. The company could improve its transparency regarding its deforestation exposure and implement a more robust plan for addressing the issue. Despite being

[7] "Nature Action 100 Companies". Accessed 18 Dec 2023.
[8] McDonald's Climate Action. Accessed 28 Nov 2023.
[9] Source: Bloomberg ESG Profile. Accessed 28 Nov 2023.
[10] World Benchmarking's Alliance – McDonald's profile. Accessed 4 Dec 2023.
[11] McDonald's CDP Response – Forests 2022. Accessed 21 Dec 2023.
[12] "Fast food giants won't reach net zero while deforestation is on the menu", Forest500, 17 Nov 2022.
[13] "Regulation (EU) 2023/1115 Of the European Parliament and the Council", Official Journal of the European Union, 31 May 2023.
[14] "Financial Materiality in Latin American Soy and Beef Supply", Profundo, July 2022.
[15] Nature, Forests & Water, McDonald's website. Accessed 4 Dec 2023.

positioned among the top-rated U.S. retail companies, it received a moderate score of 47% from Forest500, an organisation that assesses companies based on their commitment strength, implementation and reporting related to deforestation.[16] It is worth highlighting that, following a decline from 74% in 2017 to approximately 50% in 2018, the company failed to significantly enhance its score thereafter (see Figure 2).

McDonald's has also received average ratings from CDP (B-) for soy, beef and palm oil[17] and MightyEarth (54/100) for beef.[18] The organisation points out that it is only halfway there in terms of actions to tackle deforestation.[18] The company notably made zero-deforestation commitments that are long-dated (2030) and relies on certification schemes for eliminating deforestation from its supply chains.[19]

The company will also be exposed to the sourcing risks arising from the newly adopted EU regulation on deforestation-free products (EUDR).[20] Although the regulation does not directly apply to the company, it is applicable to its suppliers. Therefore, if McDonald's suppliers are in breach of compliance with EUDR, there could be several financial consequences. Firstly, negative headlines may affect the company's credit risk profile. Secondly, McDonald's may be required to switch to other suppliers, which may cause supply chain disruptions and increased sourcing costs. With around 14% of its restaurants located in Europe as of 2022,[21] this is a significant risk for the company.

McDonald's has committed to eliminate deforestation from its supply chains by 2030 only, five years after EUDR takes effect. Therefore, there is no guarantee that the company will require its suppliers to comply with EUDR before 2030.

Despite the company being ahead of some of its peers, McDonald's approach to deforestation is based on long-term commitments and sourcing products that comply with certification schemes. However, there is evidence that certification schemes can be rigged and provide little guarantee against deforestation.[22] Last year, Reporter Brasil conducted an investigation revealing that the farm providing certified soy to McDonald's France main chicken supplier was still engaged in deforestation on its property.[23]

While McDonald's appears to be heading in the right direction to achieve significant improvements in its environmental footprint, it is clear that the company still has room for enhancement. There are concerns regarding the alignment of its European operations with EU regulations, particularly given the company's commitment to eliminate deforestation from its supply chains by 2030, whereas the regulation takes effect at the beginning of 2025.

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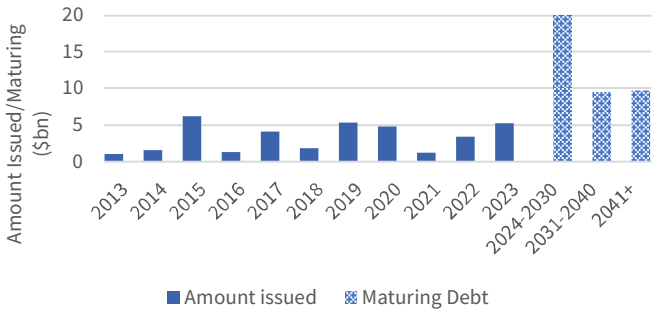
[16] See "McDonald's Corporation company profile", Forest500, accessed 4 Dec 2023.
[17] "CDP's McDonald's Corporation assessment", CDP, accessed 4 Dec 2023.
[18] "Beef Deforestation Scorecard", MightyEarth, April 2021.
[19] "Nature, Forests & Water", McDonald's website, accessed 4 Dec 2023.
[20] "Parliament adopts new law to fight global deforestation", European Parliament News, 19 Apr 2023.
[21] "McDonald's restaurants by country – 2022", McDonald's, accessed 4 Dec 2023.
[22] In the case of soy, while 40% of imported European soy is certified, only 24% answers the definition of "deforestation free". See "Setting a New Bar for Deforestation and Conversion-free Soy in Europe", Profundo, Aug 2023.
[23] "McDonald's: the footprints of a giant", Reporter Brasil, March 2022.

McDonald's refinancing risks reflect its position as a leading issuer

With 59 bonds outstanding totalling nearly USD40bn, McDonald's (Baa1/BBB+) is one of the largest issuers in the food sector. It has issued the vast majority of the bonds in USD and EUR, but the company has also tapped the JPY, AUD, GBP, CAD and CHF markets on an opportunistic basis.

While the company has not issued any ESG debt under its own name, in 2022 one of its largest franchisees, Arcos Dorados, issued a $350mn sustainability-linked bond tied to carbon emissions reduction targets.[24]

Figure 3. McDonald's maturing debt by maturity and yearly amount issued since 2013. Sources: Bloomberg, AFII, accessed 21 Nov 2023.

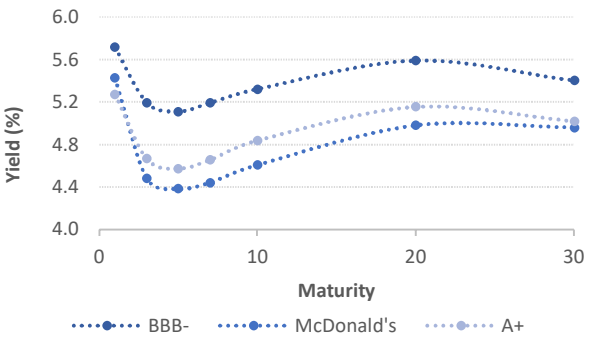


McDonald's is a frequent issuer and last came to the market on the 21st of November this year with a EUR 2bn three-tranche deal.[25] We can easily anticipate that it will come back to the market some time in 2024, especially considering that $6.2bn worth of outstanding debt will mature in 2024 and 2025 (see Figure 3).

The market's continued anticipation that McDonald's can generate strong cash-flows[26] means that its USD bonds trade much tighter than the average BBB debt, at levels closer to A-rated debt as illustrated on Figure 4.

Around $17bn of the company's debt matures during 2025 and 2030, before the company's zero-deforestation 2030 commitment. It is reasonable to assume that at least a portion of these bonds will be refinanced during this period. Headlines around the company's lack of compliance with the regulation's requirements could negatively affect the credit risk profile of the company, which would result in increased borrowing costs.[27]

Figure 4. McDonald's USD curve against average USD BBB+ and A+ curves. Sources: Bloomberg, accessed 20 Dec 2023.



Investors in bonds that mature after 2024 may question how the company plans to align its sourcing policies with the EUDR considering that its current commitments do not align with the regulation's timeline.

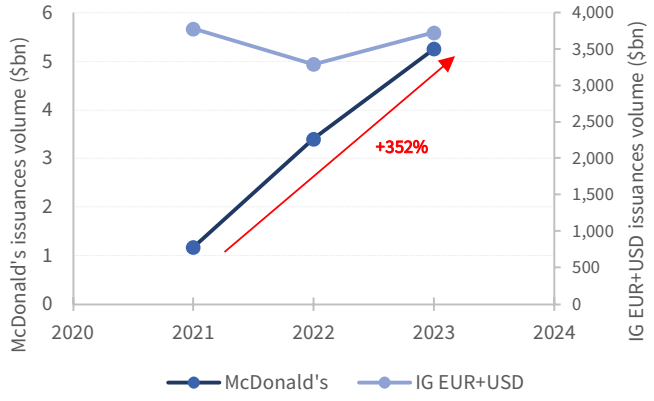
McDonald's long-dated deforestation commitments may affect the company's credit quality. With around half of its debt maturing before 2030, the company may face higher refinancing costs.

[24] "Fast food franchisee eyes SLBs for rapid emissions reduction", Global Capital, 20 Apr 2022.
[25] "McDonald's is lovin' it, getting triple decker cheap", Global Capital, 21 Nov 2023.
[26] "McDonald's Credit Research", Bloomberg. Accessed 21 Nov 2023.
[27] According to UNFCCC, the highest impact linked to land-use change for restaurants is reputational risk. See "Assessing the financial impact of the land use transition on the food and agriculture sector", UNFCCC, Sept 2022.

Unintended increased deforestation exposure

McDonald's holds an important weight in investment-grade fixed income portfolios. The company is respectively among the top 15% and top 10% issuers of the iBoxx USD Liquid Investment Grade Index (IBOXG) and the Bloomberg Euro-Aggregate Corporates Index (LECPTREU). It also holds the largest food position of the IBOXG and the second largest one after Nestlé in the LECPTREU.[28]

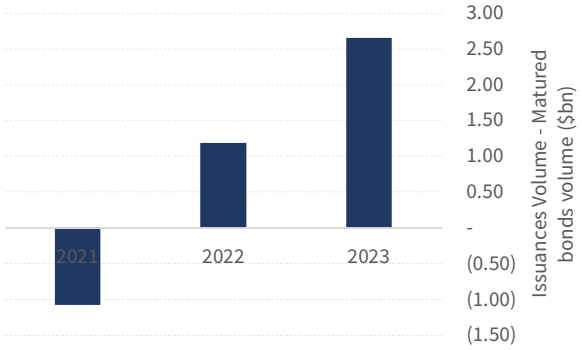
Figure 5. McDonald's issuances volume since 2021 compared with the rest of the IG market. Sources: AFII, Bloomberg.



As shown in Figure 5, McDonald's has been a prolific issuer over the past three years with a 352% issuance volume increase between 2021 and 2023. This is in stark contrast with the rest of the investment-grade market for which issuance volumes remained stable. Considering that $6.2bn worth of McDonald's outstanding debt will mature in 2024 and 2025, it is reasonable to expect that the company will continue its issuance frenzy for the foreseeable future.

The large increase in McDonald's issuances compared to the rest of the investment-grade market implies that the company's weight in investors' portfolios is significantly increasing. This is underscored by the observation that more bonds matured than were issued, as illustrated in Figure 6.

Figure 6. McDonald's issuances volume since 2021 compared to maturing bonds. Sources: AFII, Bloomberg.



While it is natural for indices to show that companies' positions fluctuate over time, an increased allocation in McDonald's bonds might raise investors' exposure to risks related to deforestation.

This higher weighting may be creating inadvertent increases to the benchmark investors deforestation exposure, which may not be observed or understood. Consequently, this can result in heightened financial risks for investors.[29]

McDonald's issuing more bonds could mean investors end up with larger positions in the company. As a result, they might unintentionally increase their exposure to deforestation. Given the risks related to EUDR, investors should ask McDonald's to disclose the volumes of products imported from high-risk countries for their European operations.

[28] Source: Bloomberg. Accessed 18 Dec 2023.

[29] "Assessing the financial impact of the land use transition on the food and agriculture sector", UNFCCC, Sept 2022.

Conclusions

Despite significant improvements in its sourcing practices, McDonald’s is still exposed to deforestation risks, especially amid growing regulatory pressures. Sourcing certified products does not assure the elimination of deforestation from the company’s supply chains, making it uncertain whether McDonald’s can attain its zero-deforestation goals. This exposes McDonald’s investors to considerable deforestation risk.

The substantial rise in its issuances may unintentionally increase the deforestation risk for investment-grade investors. To improve their understanding of this risk, investors should urge McDonald's to publicly disclose the volume of commodities sourced from countries with a high deforestation risk.

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