

A photograph of a worker in a blue shirt and yellow hard hat using a tool to tap a palm tree in a plantation. The worker is standing on a dirt path, and the background is filled with lush green palm trees. A large blue circular graphic is overlaid on the left side of the image, containing the title and subtitle.

AAK's progress report on sustainable palm oil – August 2018

The Co-Development Company

AAK

Reflections

Palm oil sustainability remains a very hot topic around the world, highlighted by proposed changes to biodiesel legislation, particularly in the EU, continuing NGO revelations of issues on plantations, high-profile end user moves away from palm oil, and some effective muscle flexing from the RSPO relating to members.

AAK's long-held view is that palm oil really can be produced sustainably, and where it is so produced it has significant environmental benefits when compared to most other vegetable oils, mainly due to the very high yield of oil per hectare.

Attempts to gain publicity by retailers and others by banning palm oil from products on sustainability grounds are at best disappointing, and have gained little support from the not quite silent (but pretty quiet) majority of engaged participants who are serious about transforming the palm industry, rather than sidelining it. These actions pander to populist belief that all palm oil is bad, a belief regrettably stoked from time to time by the less discerning NGOs for whom publicity sometimes seems to be a priority over probity.

The priority must be to produce more sustainable palm oil, to replace the production and use of non-sustainable palm oil as well as other oils with dubious sustainability credentials. From a demand perspective our perception is of consumers who see matters very much as binary, without the desire or

capacity to access the complexity of the debate around palm oil. It is therefore even more important that opinion leaders provide a simple, clear, honest, consistent and effective message in a time when too often obfuscation and polarization define public communications. That message should be that there is such a thing as sustainable palm oil, and that it is the preferred sustainability option.

The RSPO plays a central role in the sustainable palm oil debate, despite criticisms from different sides. Revised Principles & Criteria are due to be approved at the RSPO General Assembly in November. The current progress with this review is good, with many changes addressing historic criticism relating to deforestation, planting on peat, and social issues. There is strong engagement and lobbying, in particular relating to the difficult issue of deforestation in High Forest Cover landscapes, the outcome of which we await with interest. The smallholder issue remains live, with attempts to provide a solution for smallholders still not as advanced as they should be. However, there are now concerted attempts to address that major issue, which AAK sees as essential for such a large proportion of palm oil production. It is critical that the new Principles & Criteria provide a rallying point for sustainability and not a reason for further division.



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AAK continues to support the RSPO, both from within as a member of the Board and from outside. We believe that the RSPO has a continuing and significant role to play in developing the production of and demand for sustainable palm oil. We are no longer involved directly in the administration and promotion of certificate trading, but continue to be convinced that it is the most simple and effective way for end users to support certified sustainable palm oil producers by direct payments. It is pragmatic and it works. Its critics should think about the outcomes which they want, and perhaps not worry quite so much about perfecting the process.

AAK continues to support financially the jurisdictional approach to RSPO certification which the Malaysian state of Sabah is developing. There are risks and many barriers, but the prize here is worth fighting for, amounting to certification of around 12 percent of global palm oil production. The road is long, but the reward is great.

Transformation depends to a large extent on just a handful of major processors which control a large part of the market. Critically, we see significant (if not exactly consistent) changes in sustainability practices by major palm oil processors, both in policy development and implementation. We congratulate them on the progress they have made, but also recognize that the leakage recently identified by several NGOs must be addressed. We must all take responsibility for our supply chains, and the activities of our suppliers, not only relating to the oil which finds its way to our own businesses. This is a joint obligation which cannot be ignored, and acceptance of this responsibility by more stakeholders would be a significant step forward in making sustainable palm oil the norm.

Tim Stephenson
Director Finance & Global Trading, AAK AB

Sustainable palm oil achievements

Traceability

- Achieved progress in traceability to mill origin to 97 percent;
- Achieved significant progress in traceability to plantation to 35 percent;
- Continuously updating mills traceability data for bi-annual publication at AAK website.

Risk assessment

- Completed a qualitative risk assessment of all suppliers;
- Completed geospatial risk assessment of all mills;
- Identified two mills for our on-site verification program to achieve 20 mills before the end of 2018.

Supplier engagement

- Increased number of suppliers that signed up for the AAK Code of Conduct and the AAK Palm Oil Policy to 99 percent of our supplier base;
- 84 percent of AAK volumes are sourced from suppliers that have sustainable palm policies equivalent to AAK's, or from suppliers in indirect or direct engagement programs;
- 94 percent of our volumes sourced are from suppliers that are members of the RSPO.

Processes and tools

- Upgraded the AAK grievance management process and published it on our website;
- Further strengthened monitoring of grievances and active engagement with tier 1 suppliers.

Impact:

- Revisited four of the target of ten mills that have gone through on-site verification assessment;
- Completed palm oil supplier engagement workshops and training on labor practices with participants from 32 high-priority mills;
- Continued direct and substantial financial support for the jurisdictional certification approach in Sabah, impacting thousands of smallholders.

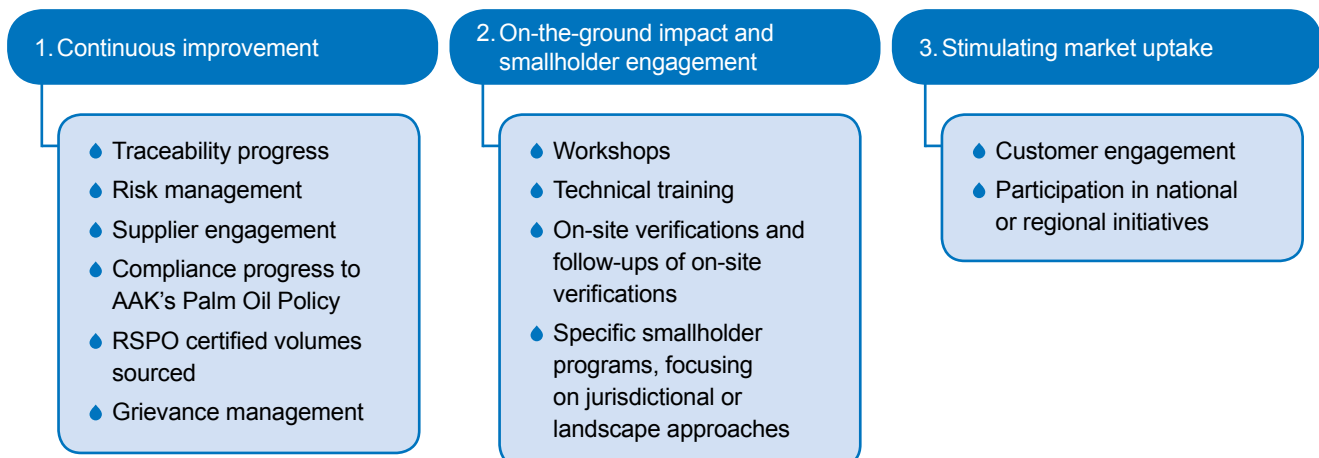
Most of the above is supported by charts from the dashboard and further explained in the progress report.

In short, AAK's Palm Oil Policy is founded on the following pillars:

- support for the Roundtable on Sustainable Palm Oil (RSPO)
- traceability to mill and plantation
- no development on High Conservation Value (HCV) areas
- no High Carbon Stock (HCS) deforestation
- no development on peatland
- Free, Prior and Informed Consent (FPIC)
- inclusion of smallholders in the supply chain

AAK policies, definitions and progress reports can be found at our website, www.aak.com.

Going forward, our sustainable palm strategy will consist of three main areas:

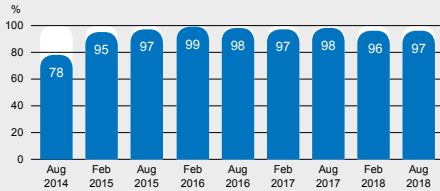




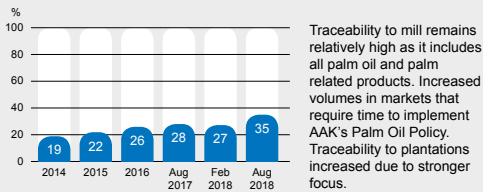
Palm oil DASHBOARD



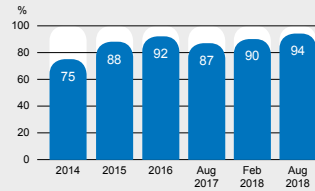
Traceability



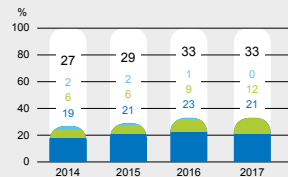
To plantation



RSPO status



It is our policy to source palm oil from RSPO members only. We see a positive increase.

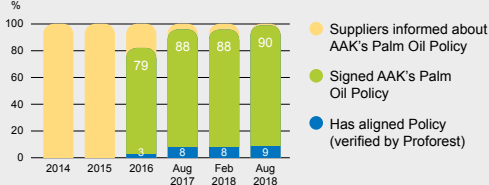
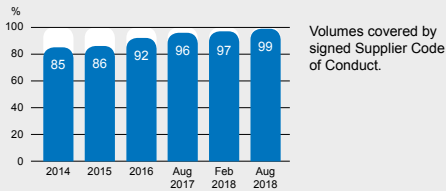


Stable share of RSPO certified sourced volumes compared to previous year, despite volume increase.

- Book&Claim
- Mass Balance
- Segregated

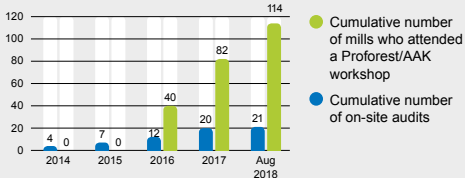


Supplier engagement



Higher priority suppliers invited to workshops facilitated by Proforest.

Mill engagement



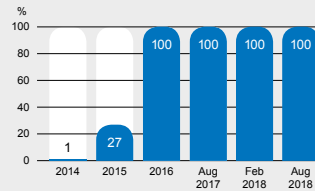
Risk management



Percentage of AAK's palm suppliers risk assessed by Proforest:

100%

Geospatial risk assessment



Other

9

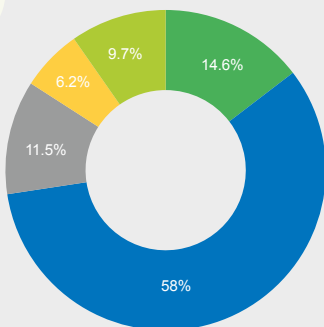
Number of progress reports

455

Number of AAK employees trained in AAK's Palm Oil Policy and Actions



84 percent of AAK volumes are sourced from suppliers engaged in sustainability programs



- Direct engagement (volumes from suppliers engaged in sustainability programs with AAK/Proforest)
- Indirect engagement (volumes from suppliers with own sustainability programs – approved by Proforest)
- Corporate level engagement
- Not engaged (higher priority)
- Not engaged (lower priority)





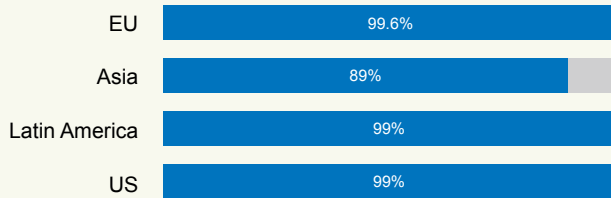
Increased transparency

As part of our continuous improvement journey we have further increased our transparency by publishing our updated grievance management process at our website. We believe

this will enable customers and other stakeholders to better understand our approach and decision-making process regarding grievances. <https://aak.com/sustainable-growth/>



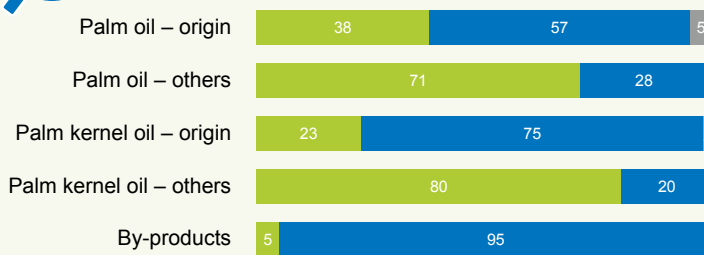
Regional traceability



Overall traceability to mill in Europe, South America and the US remains high, with almost 100% for Europe. The Asian market requires more time to be educated and to implement AAK's palm oil policy. Joining the China Sustainable Palm Oil Alliance is one of the initiatives to stimulate that.



Traceability by category

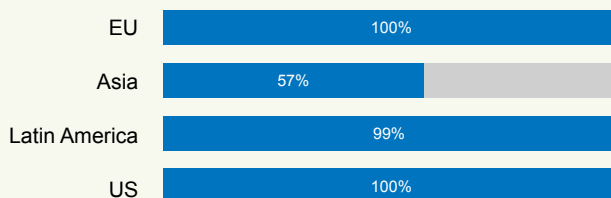


A significant increase in traceability of our by-products compared to our previous report. Palm oil sourced in origin is the category where traceability can be improved, this is clearly linked to the increased volumes into Asia.

● % plantation ● % mill ● % unknown



Volumes from RSPO members by region



We have been able to fully implement the requirement for suppliers to be RSPO members in EU, US and have made major progress in South America. In Asia (mainly China and India) the RSPO has not penetrated sufficiently and new market initiatives are needed to drive progress.



Implementation framework – a new way of reporting policy implementation progress

The implementation of AAK’s sustainable palm oil policy across the entire supply base of palm oil producers, and through multiple supply chains, is the major ongoing challenge that the sustainability of the sector demands, and one that faces all companies in the industry. The high number of producers in the supply base and the often-complicated nature of palm oil supply chains means that careful prioritization of where to apply most effort is needed. These risk assessment and prioritization techniques have been described in previous AAK progress reports.

Directly linked to this challenge is how companies can demonstrate the progress of policy implementation transparently and the impact it has. Currently, AAK and some other companies have been reporting the percentage of volumes sourced that are engaged through programs to support the implementation of policy commitments. These can be programs directly implemented by AAK with their suppliers and programs run by AAK’s suppliers that align to AAK’s own policy commitments and objectives. We believe that this performance indicator is helpful and we will continue to use it. However, its limitation is that it is only a proxy

indicator for actual impact and compliance with AAK’s policy. To address this, our sustainability partner Proforest has developed an implementation framework¹ for measuring and reporting progress that we will be trialing during the second half of 2018.

The implementation framework divides volumes into five categories:

1. **Unknown:** unknown origin and risk
2. **Known:** known origin and risk
3. **Taking action:** activities to support change underway
4. **Progressing:** making and tracking progress on the ground
5. **Delivering:** reasonable certainty that volumes meet policy

Figure 1 below illustrates how, over time and with careful monitoring of implementation progress, volumes can be moved from left to right as policy commitments are successfully implemented.

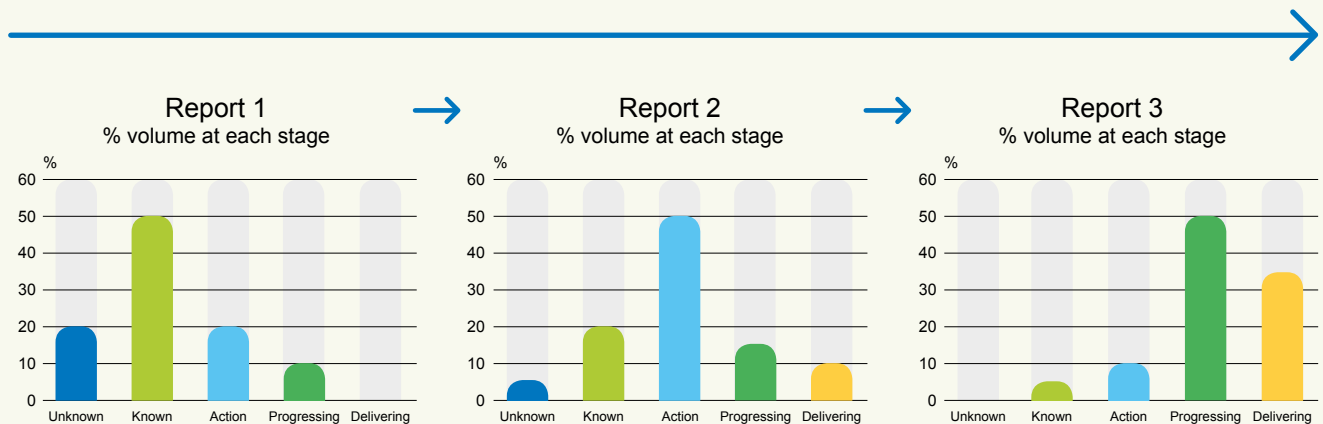


Figure 1: Volumes progressing through the categories of the implementation framework.

¹⁾ https://www.proforest.net/proforest/en/publications/responsible-sourcing-and-production-briefings/bn12_rsb_n_final_web.pdf

Volumes can be potentially allocated to the categories of the implementation framework at mill, refinery, supplier or even jurisdictional level. For example, actions and impacts that are tracked at mill level can then be aggregated at refinery level. The refinery would then assigned a profile based on the mills that supply it, which can then be transferred down the supply chain. How this could work is shown in figure 2.

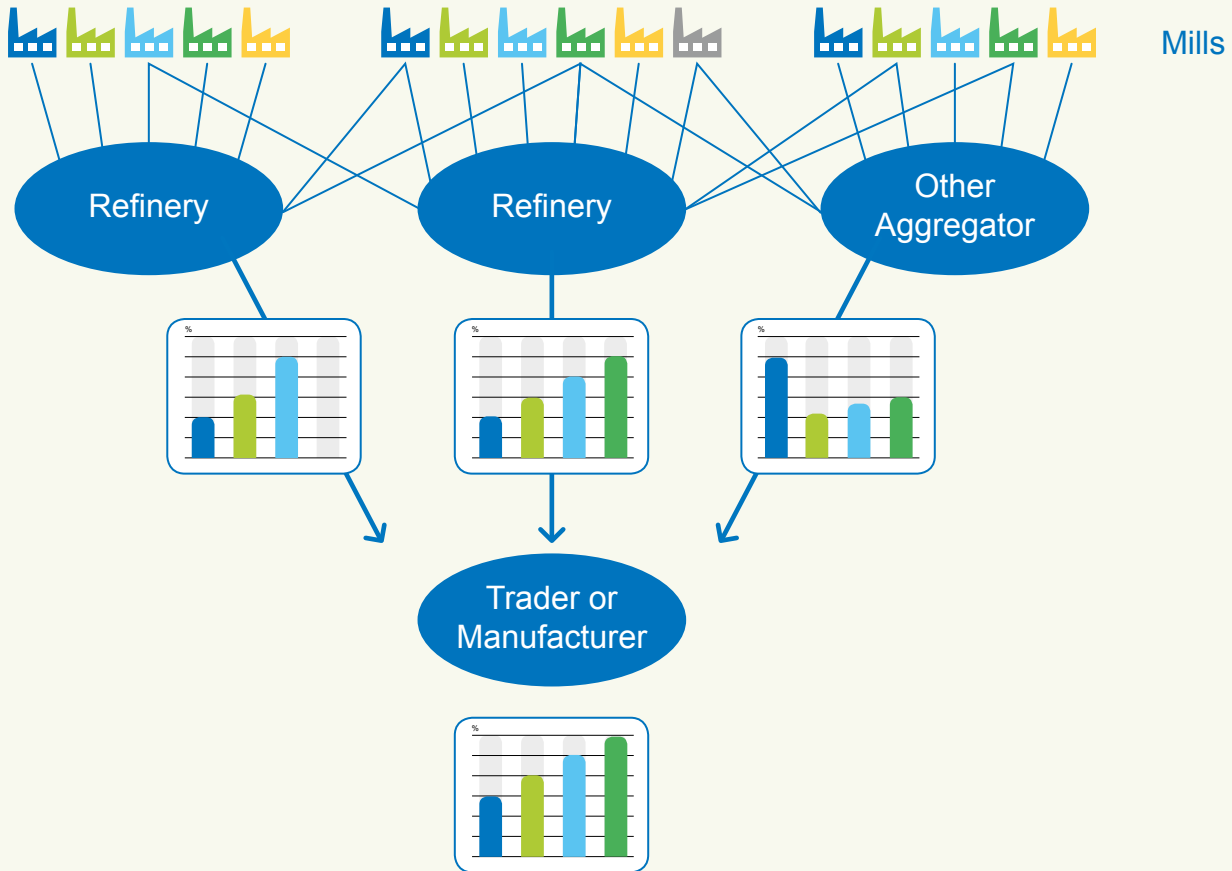


Figure 2: Categorized mill profiles moving down the supply chain to refinery and downstream buyer.

The concept will be tested and further developed by Proforest using AAK traceability and policy implementation data. AAK aims to adopt this approach to reporting implementation progress from 2019 onwards, subject to successful trials being undertaken to ensure that the proposed new reporting format appropriately reflects AAK’s implementation process.

Social risk assessment

Since last year, AAK has been supporting Proforest’s development of a social risk assessment tool. Information about this was included in AAK’s progress report from August 2017. In May this year, AAK, along with some other companies that have been supporting the development of the tool, attended a workshop organized by Proforest. Experts from different NGOs also attended to add additional perspectives. The objectives of the workshop were to demonstrate the progress made, to discuss the drivers and needs of social risk assessment, and to identify and coordinate next steps.

AAK will continue to support the development of the tool and is looking forward to use it to help risk assess our own supply chains on a much more granular level than what has been possible before. Currently, our social risk assessments have been at country level, but the new tool will allow us to distinguish between different sub-national jurisdictions, where the risk of negative social impacts can vary significantly based on a range of underlying factors. This will improve our ability to identify and address social risks in our supply base in a much more targeted way.

On-the-ground impact and smallholder engagement

Supplier engagement follow-up

Since the launch of AAK's sustainable palm oil policy in 2014 we have been engaging with our suppliers at group and mill level to support the implementation of our policy commitments in our supply base. At mill level, we have audited 18 mills located in regions where risk of non-compliance with our commitments is high, and/or were high-priority suppliers in terms of volumes. Our target is 20 mills by the end of 2018. That said, this year we have reduced the number of new mills we are visiting to focus our resources on revisiting mills to assess and verify their progress in closing the policy gaps detected during the original visits. This is important

to understand the impact that our supplier engagement programs have had in changing practices on the ground, and to give congratulations or further support to those mills.

To date this year, we have revisited four mills out of our target of ten for 2018. Progress has been observed at all mills. One mill in Malaysia has gone from having no real understanding of AAK's sustainability policy commitments when first visited in late 2014, to becoming RSPO certified this year. As the follow-up visits continue we will track the progress made and hope to see similar successes.

New supplier engagement

As detailed above, the major focus for us this year has been to revisit mills and suppliers previously engaged to understand the impact of our work. Nonetheless, our program of new engagement continues in line with our priorities and strategy to make the greatest possible impact.

We continue to work with a key supplier in Malaysia on improving labor practices in their third-party supplier mills. The focus has been on 50 high-priority mills, categorized as

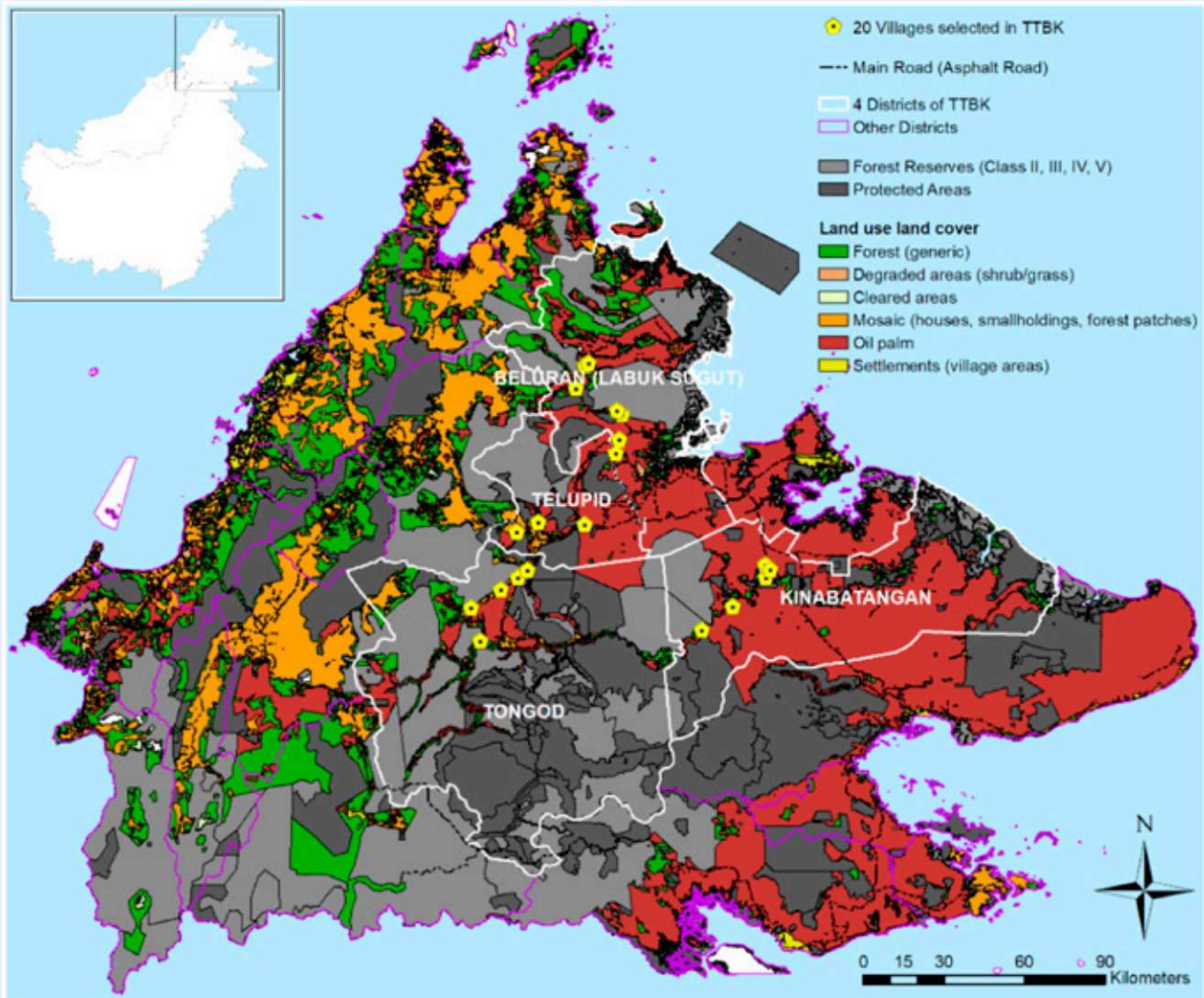
such because of the volumes they supply and their lack of policy commitments at parent group level. So far, 32 of these mills have been engaged through this program, with the remaining 18 due to be covered by the end of 2018. In addition to this we are continuing our program of mill verification visits. Two are scheduled for mills in Malaysia later this year, and one took place in Guatemala in August.



Forever Sabah progress

Sabah continues its quest to achieve jurisdictional certification to the RSPO standard by 2025. AAK has completed its first year of support for Forever Sabah, the lead organization assisting smallholders to contribute their part to Sabah's incredible ambition.

The past year has been extremely busy for the Forever Sabah team. As mentioned in previous progress reports, work has been focused on four trial districts – Telupid, Tongod, Beluran and Kinabatangan (TTBK). Five villages from each of these four districts have been selected.



Map of Sabah (northern Borneo) with the 20 selected villages in the four districts of Telupid, Tongod, Beluran and Kinabatangan (TTBK); overlaid with Protected Areas (dark grey), Commercial Forest Reserves (light grey), and other land use/cover associations for remaining land.

Armed with an exhaustive 36-page questionnaire, the young dedicated team interviewed 134 smallholders from the 20 villages, with, in all honesty, varying degrees of enthusiasm. Some received the team with welcome and hope; others shooed them away with disdain. The field coordinators lived in the villages, experienced life in real-time rural Sabah, and witnessed the pains and pleasures, ploys and politics of kampung (village) society.

The questionnaire covered subjects that related to: household socio-economic information; smallholder's knowledge and agronomic practises; knowledge of RSPO; land issues; socio-culturally important sites; aspects that relate to people's use of forest resources; and, perceptions on changes within their environment in general and due to oil palm.



To help the field teams access remote villages, AAK funded the purchase of two 4x4 vehicles. In doing so, the teams could cover ground efficiently and safely.

The interviews were not just about collating data but also to build awareness to organize and mobilize. Each of the 20 villages have now formed active committees to tackle the issues identified and to work closely with their designated Forever Sabah district field coordinator.

Collating and analyzing the data required some additional support and AAK was able to provide laptops for the field teams to record and manage all the data gathered from the interviews.

From all the data collected a comprehensive report was published in May 2018. It provides a fascinating insight into the importance of oil palm for smallholders and the enormity of the challenges to achieve RSPO certification by 2025.

The first task you would think would be a simple one: How many smallholders are there? In 2016, The Malaysian Palm Oil Board (MPOB) had registered 34,866 smallholders with under 40 hectares (ha). The study reveals that 33 percent of the sample in TTBK were not registered by the MPOB. The actual number of smallholders may be around 53,000. Oil palm has become the dominant land use for smallholders. In TTBK it occupies 81 percent of the surveyed smallholders' land, resulting in oil palm providing between one third and one half of all smallholder household income. However, their current oil palm production systems still leave most in poverty and with livelihoods less resilient.

Low average yields of FFB around 10 tons/ha/year on small average landholdings just under three hectares and low grades of FFB sometimes sold at distant facilities with high transport costs are the main issues and of particular concern. 75 percent of oil palm field plots had been planted only since the year 2000 and 70 percent of the farmers indicated that they had a fairly good knowledge of oil palm production. However, the results of the field study indicated that many smallholders struggle with issues like effective handling of agricultural chemicals, FFB grading, and long-term planning (especially its financial elements).

Only 36 percent of smallholders have land titles while 61 percent of smallholders in the TTBK villages are growing their oil palm with Land Application (LA) status, namely on land for which they have applied but to which they do not have title. Insecurity of tenure is a problem for the farmers and the environment as it is associated with vulnerability and low levels of investment in production and land care. It is also a major problem for the society as it creates instability and risk of conflict.

As for the next 12 months, AAK is again committed to support the Sabah smallholders with particular focus on land tenure. Together with Forever Sabah we will support the development of a methodology to Facilitate Land Applications (FLAP) for smallholders to streamline their applications with the local Land Surveys Department (LSD). The intention by working with this department is to submit dossiers for the 20 trial villages rather than individual holdings to facilitate a more efficient process leading to quicker approvals. If the methodology is successful and approved a roadmap will be developed for roll-out across Sabah.

Securing land tenure cannot be underestimated. It is a requirement for RSPO certification and it secures indigenous smallholder rights and reduces social conflict as well as increases incentives for long-term investments by those smallholders in productivity and sustainability. This issue is the single-most important one to smallholders, which ripples throughout the landscape to impact production practices and yield, land encroachment and deforestation, livelihoods and poverty. This is going to be one of the hardest and most important issues to address for Sabah's Jurisdiction Certification process.



Stimulating market uptake

Regional initiatives

As a founding member and Board member of the Roundtable on Sustainable Palm Oil (RSPO), AAK is committed to supporting its evolution and expansion across the palm oil sector. AAK recognizes that the RSPO is not perfect and that there has been some criticism of both the auditing process and stringency of the standard itself. Nonetheless, a publication by Forest Peoples Program rated the RSPO as the strongest certification for palm oil currently available. Moreover, the RSPO continues to grow and 2018 sees the revision and publication of the updated Principles & Criteria, which may address some of the concern over the rigor of the standard.

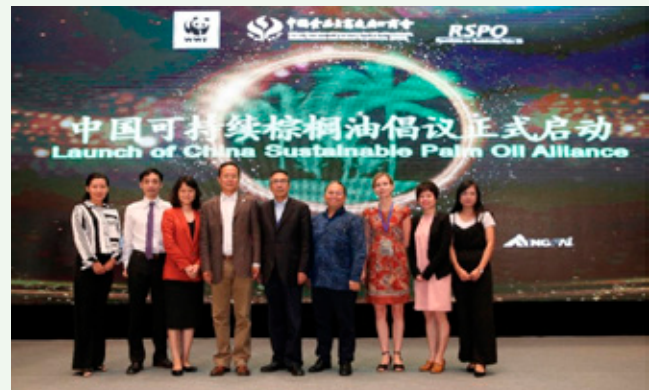
The key to further development of the production of sustainable palm oil is the demand side of the supply chain. Major regions like Europe have evolved and the uptake of RSPO certified materials has achieved significant levels. In other regions it is important to drive the uptake and educate consumer goods companies and other stakeholders about the RSPO and about the possibility of buying palm oil from plantations that are managed in an environmentally and ethically responsible way.

RSPO certified oil provides both the companies and consumers the best assurance possible. AAK recently joined two of these regional initiatives.

The China Sustainable Palm Oil Alliance

The China Sustainable Palm Oil Alliance (the Alliance) was recently launched at the 2018 China Sustainable Palm Oil Supply Chain Forum. The objective of the RSPO, China Chamber of Commerce of Foodstuffs and Native Produce (CFNA), and World Wildlife Fund (WWF) is to create a platform for win-win cooperation among the stakeholders in the palm oil supply chain and promote sustainable palm oil in China.

AAK has joined the Alliance with other companies and stakeholders in the palm oil supply chain to make a joint commitment about taking step-by-step actions to promote the adoption of sustainable palm oil in China's palm oil market.



The North American Sustainable Palm Oil Network

With the establishment of the North American Sustainable Palm Oil Network (NASPON), the members aim to accelerate the shift to sustainable palm oil by fostering industrywide collaboration and education.

NASPON consists of associations, civil society organizations, consumer goods manufacturers, foodservice retailers and palm oil traders and producers committed to increasing

the use of certified sustainable palm oil (CSPO) and certified sustainable palm kernel oil in North America. This coalition is necessary to bring this market into the global sustainable palm oil discussion, to focus on the specific North American challenges and to build a critical mass of demand for sustainable palm oil.

AAK is committed to advocating customers to increase the volume of RSPO certified purchases, with the ultimate (though still remote) objective to achieve RSPO certification of all palm oil, palm kernel oil and derivatives purchased. We believe that these initiatives support this commitment and will ultimately benefit all companies, communities, and consumers.

Key next steps for 2018:

1. Continuous improvement

- ◆ Focus on 100 percent traceability to mills, despite volume growth in new regions (India and China);
- ◆ Continued focus medium- and high-priority suppliers and regions based on our supplier prioritization assessment in Q1;
- ◆ 100 percent of our suppliers signed up to (revised and consolidated) Code of Conduct and either signed or have an aligned sustainable palm oil policy;
- ◆ Follow up on six mill on-site verifications, two new mill verifications;
- ◆ 100 percent Indonesian volumes covered by engagement;
- ◆ 100 percent sourced from RSPO members;
- ◆ 100 percent of grievances covered by systematic action plans.

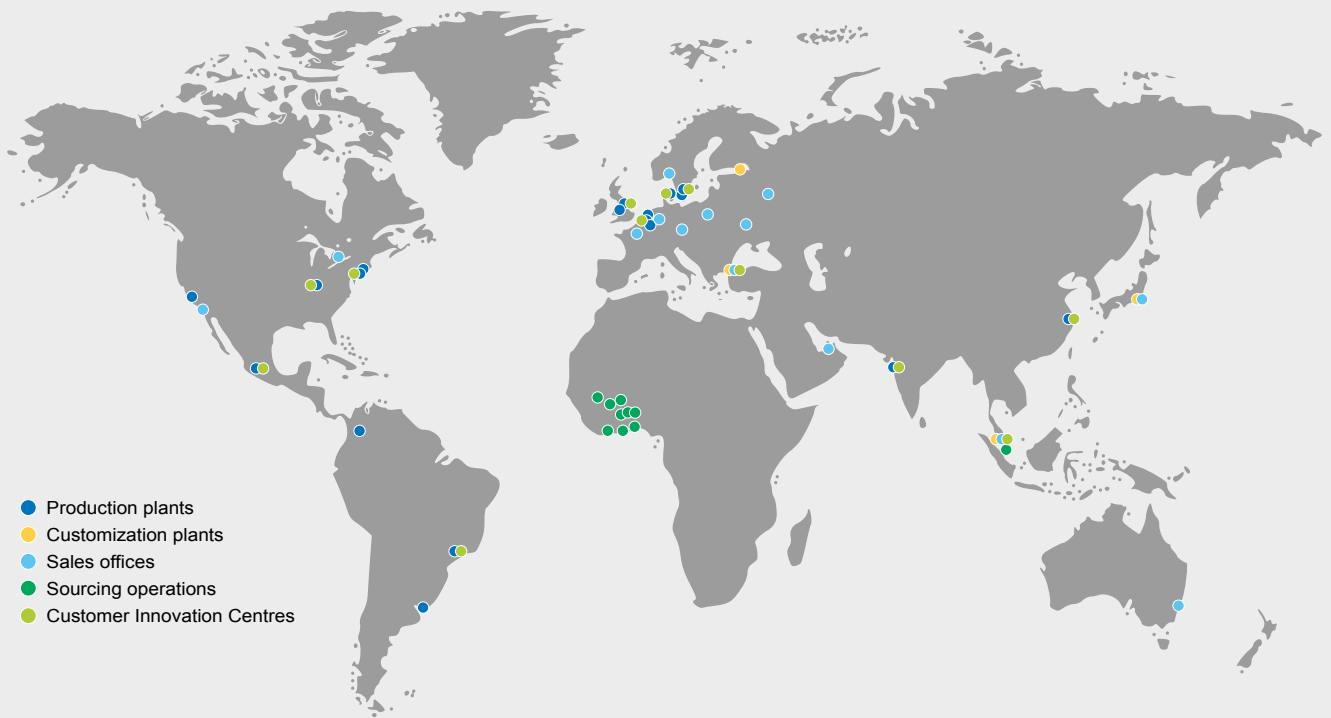
2. Smallholder engagement and on-the-ground impact

- ◆ Execution of the action plan for labor workshops and training sessions to cover 50 high-priority mills;
- ◆ Continue to drive progress with the Forever Sabah engagement;
- ◆ Kick off new smallholder project in Latin America.

3. Stimulating market uptake

- ◆ Continue to be the trusted and knowledgeable partner for our customers in sustainable palm;
- ◆ Right tools and training for sales teams and customer innovation teams;
- ◆ Continue to contribute in regional market uptake initiatives.





We are AAK

AAK is a leading provider of value-adding vegetable oils & fats.

Our expertise in lipid technology within foods and special nutrition applications, our wide range of raw materials and our broad process capabilities enable us to develop innovative and value-adding solutions across many industries – Chocolate & Confectionery, Bakery, Dairy, Special Nutrition, Foodservice, Personal Care, and more.

AAK's proven expertise is based on more than 140 years of experience within oils & fats. Our unique co-development approach brings our customers' skills and know-how together with our own capabilities and mindset for lasting results.

Listed on the NASDAQ OMX Stockholm and with our headquarters in Malmö, Sweden, AAK has 20 different production facilities, sales offices in more than 25 countries and more than 3,400 employees.



We are AAK – The Co-Development Company.

