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Deforestation Not ‘an Immediate Priority’ for Walmart Despite Financial Risks

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By revenue, Walmart is the largest company in the world, employing about 2.2 million people and serving over 265 million customers a week. Private-label products sold by Walmart contain commodities that contribute to deforestation. For the forest-risk commodities – palm oil, pulp and paper, soy, and beef – Walmart has set zero net deforestation goals for 2020. Although Walmart encourages its suppliers to address deforestation in their supply chains, the company does not have a system in place to track and monitor the origin of these four commodities.

Key Findings:

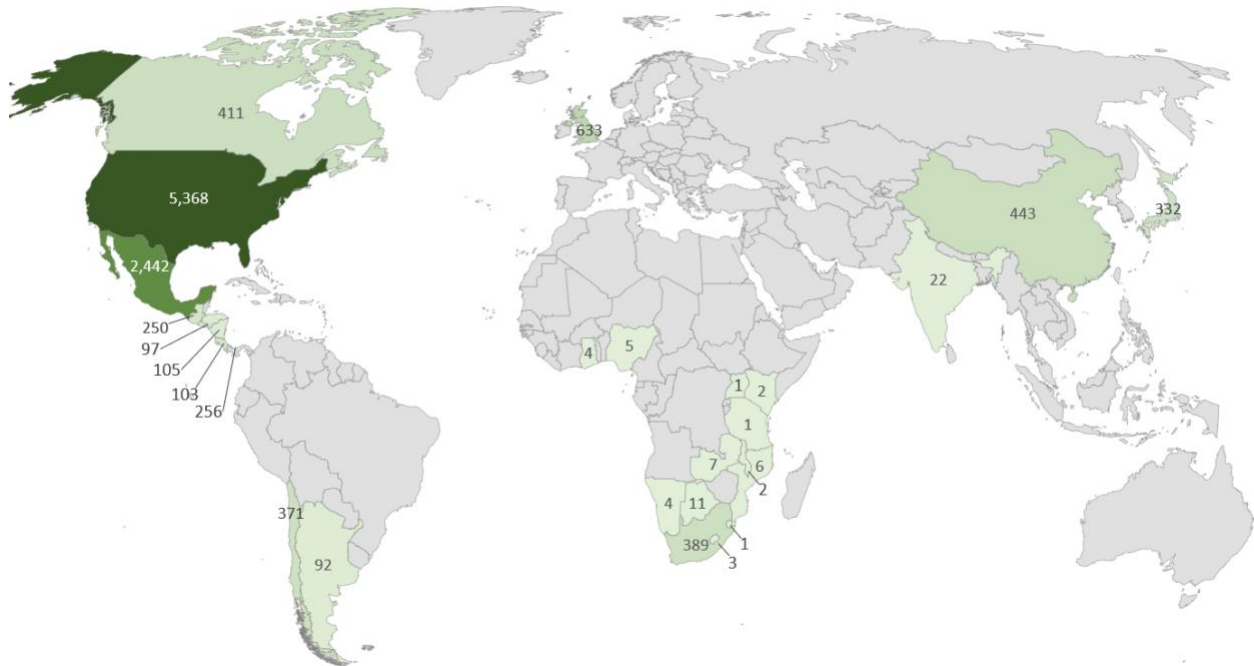
- **Walmart’s zero net deforestation policy focuses on the use of palm oil, pulp and paper, soy and Brazilian beef in its private label products.** As a member of the Consumer Goods Forum, Walmart aims to achieve zero net deforestation in its supply chain by 2020. Because Walmart does not source its key commodities directly, it relies on its direct and indirect suppliers to achieve the company’s zero net deforestation goals.
- **Walmart will unlikely meet all goals defined for its four key commodities by 2020.** For soy and beef, Walmart provides little detail on progress. In its 2019 report to the CDP, the company states that it “does not know” what percentage of the soy and beef used in products it sells is produced with zero net deforestation.
- **Walmart’s approach to supply chain transparency and non-compliance falls short of best practices.** Implementing a system to track and monitor the origin of the key commodities is not “an immediate business priority” for Walmart. Walmart sees traceability of embedded soy in livestock products as particularly difficult. It does not see deforestation risks as having substantial strategic impacts on its business. Although it regards forest risks as relevant to its business, the company does not consider risks to be financially material at the aggregate level.
- **In 2019, Walmart was publicly linked to the fires in the Amazon.** Mighty Earth found that Walmart conducted business with the Brazilian beef company JBS. Walmart is also a major buyer of Cargill’s products, the second largest Brazilian soy exporter.
- **Reputational fallout could result in a USD 15 billion financial risk from deforestation, or 4.5 percent of equity value.** In addition, it might miss out on a green financing opportunity valued at a maximum of USD 2.7 billion. Of the banks, Barclays and HSBC may compromise their deforestation-related policies by providing revolving credit facilities to Walmart.

By revenue, Walmart is the largest company in the world

Fortune lists Walmart as the [largest company in the world](#), with a total revenue of USD 514.4 billion and total net sales of USD 510.3 billion in the fiscal year ended January 31, 2019. In 2019, Walmart served more than [265 million customers a week](#). It had over 11,300 retail units under 58 different banners, operating in 27 countries, and eCommerce websites in 10 countries. Walmart employed about [2.2 million people](#) around the world, of which 1.5 million in the U.S. alone. In 2019, the company [returned](#) USD 13.5 billion to shareholders through dividends and share buybacks. Walmart sells various food products and merchandise. The company [operates](#) through three business segments:

- **Walmart U.S.** is the largest segment with two primary store formats and eCommerce, which includes selling via multiple channels.
- **Walmart International** consists of operations outside of the U.S. and includes retail, wholesale, eCommerce, and other businesses. These categories, other than eCommerce, consist of many formats, including supercenters, supermarkets (such as Asda in the U.K.), hypermarkets, warehouse clubs (including Sam's Clubs) and cash & carry.
- **Sam's Club** consists of membership-only warehouse clubs as well as eCommerce through samsclub.com.

Figure 1. Majority-owned retail stores, wholesale clubs and other, as of January 31, 2019



Source: Walmart 2019 Annual Report

Walmart [operates in all 50 states](#) in the U.S., Washington D.C. and Puerto Rico and, through wholly owned subsidiaries, in Argentina, Canada, Chile, China, India, Japan and the U.K.. Through majority-owned subsidiaries, the company operates in Africa (Botswana, Ghana, Kenya, Lesotho, Malawi, Mozambique, Namibia, Nigeria, South Africa, Swaziland, Tanzania, Uganda and Zambia), Central America (Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua), India and Mexico.

In 2018, the company sold an 80 percent stake in its Brazilian operations to private equity firm Advent International. Walmart retained the [remaining 20 percent](#) upon the completion of the transaction. The new holding company was named Grupo Big. Also in 2018, Walmart agreed to pay a penalty of USD 138 million to settle a claim that its Brazilian unit violated the Foreign Corrupt Practices Act, [according to court filings](#).

Walmart asks suppliers to set voluntary zero net deforestation targets

Walmart's [deforestation policy](#), aimed at sourcing critical commodities produced with [zero net deforestation](#), focuses on the use of palm oil, pulp and paper, soy and Brazilian beef in its private label products. Walmart asks suppliers of these products to support forests through *“innovative sourcing strategies and the use of technology to [increase transparency and supply chain accountability](#).”* Walmart's policy is implemented for its private labels. While the company indicates that it aspires to accelerate the work with its 'National Label' suppliers, this currently falls outside the scope of Walmart's efforts.

As a member of the [Consumer Goods Forum](#), Walmart supported the resolution to achieve [zero net deforestation in its supply chain by 2020](#). In 2015, the company also signed the [New York Declaration on Forests](#). For suppliers of the four key commodities to its private label products, Walmart has set specific and company-wide [goals](#). Walmart's minority holdings, including Grupo Big in Brazil, fall outside the scope of its deforestation policy. The goals for the four key commodities are the following:

- **Palm oil**
By 2020, Walmart aims to source private-label products containing palm oil with zero net deforestation in accordance with the principles and criteria of the RSPO, or equivalent standards.
- **Pulp and paper**
By 2020, the company intends to source private label products made of pulp and paper with zero net deforestation. The company's primary focus is on products containing pulp and paper from wood fiber.
- **Brazilian beef**
By 2020, Walmart plans to source fresh beef from Brazil that has zero net deforestation. Walmart also aims to increase transparency and monitoring in the Brazilian beef industry while helping to promote increases in productivity on existing cattle lands.
- **Brazilian soy**
By 2020, Walmart expects its suppliers to source soy from Brazil with zero net deforestation. Most of this soy is used to feed livestock that ends up as meat in Walmart's retail outlets. Walmart supports multi-stakeholder and government engagement in certain regions, such as the Amazon, the Cerrado, and the Gran Chaco to achieve zero net deforestation at the regional level with geospatial monitoring.

In October 2017, Walmart was one of the 23 global companies that [launched the Statement of Support](#) (SoS) for the Cerrado Manifesto. Walmart supports the indefinite extension of the Soy Moratorium in Brazil's Amazon region, agreed on in 2016. Additionally, Walmart supports regional agreements regarding zero net deforestation in additional high-risk biomes.

Because Walmart does not source key commodities directly, it relies on its direct and indirect suppliers to achieve its zero net deforestation goals. The company “invites” its suppliers to set targets on energy, waste, packaging, agricultural practices, product use and design, and forests. In relation to forests, Walmart suppliers submit goals related to reducing deforestation linked to palm oil, pulp and paper, soy, and beef. Suppliers can achieve the [“giga-guru” status](#), if they have set a SMART goal (specific, measurable, achievable, relevant and timebound), agreed to share it publicly, and have reported on avoiding emissions in the most recent reporting year. Submitting goals appear to be voluntary, as Walmart does not require its suppliers to meet criteria related to deforestation.

Walmart encourages suppliers to report through the Sustainability Index, a tool developed by the [Sustainability Consortium](#) in collaboration with universities, NGOs, and suppliers. This index includes data from suppliers on key environmental, social and other performance indicators. It reflects responses from over 1,500 suppliers to Walmart and Sam's Club in the U.S.. Walmart set a goal in 2012 to buy 70 percent of its U.S. goods from suppliers that participated in the index. Supplier responses nor performance targets are publicly available.

In April 2019, Walmart and HSBC launched a [global sustainable supply chain finance program](#). This program links a supplier's financing rate to its sustainability performance, allowing a company with higher sustainability ratings to receive better loan terms.

Walmart unlikely to meet targets for palm oil, soy and beef in 2020

Walmart will unlikely meet all goals defined for the four key commodities by 2020. In its most [recent sustainability report](#), Walmart gives only a detailed progress update regarding the goals on palm oil and paper and pulp. In 2015, based upon supplier reported data, all of Walmart's private label palm oil was sourced through a combination of RSPO certification criteria, including Mass Balance, Segregated, Identity Preserved and Credits. In 2017, Walmart set a [new goal](#) to source its private label palm oil in accordance with the principles and criteria of RSPO, using only Mass Balance or Segregated supply chain systems, or equivalent standards, by the end of 2020. In 2018, approximately 40 percent of palm oil used in Walmart's private label products was purchased utilizing RSPO credits, 47 percent mass balance and 13 percent segregated or identify preserved.

Regarding pulp and paper, the company stated that 91 percent of its private-label pulp and paper volume was certified in 2018 by the Forest Stewardship Council (FSC), Program for the Endorsement of Forest Certification (PEFC), or Sustainable Forestry Initiative, or it used recycled content.

For soy and beef, Walmart provides only little detail on progress. In its [2019 report](#) to the CDP, the company states that it “does not know” what percentage of the soy and beef used in its products is

produced with zero net deforestation. The company does not report volumes of certified soy or which scheme it uses.

Transparency and traceability of key commodities are not a priority

In its 2019 report to CDP, Walmart said that it did not have a system in place to track and monitor the origin of its key commodities because implementing such a system was not “an immediate business priority.”

Walmart cannot always determine the origin of the beef it sells. The company says that is the result of the complex nature of the beef supply chain. In its [2019 report](#) to the Carbon Disclosure Project (CDP), the company states that “*traceability barriers exist due to the possibility that cattle might be traded between ranchers many times before they get to a slaughterhouse, and most of these transactions are not tracked.*” Walmart asks [fresh beef suppliers sourcing from Brazil](#) to 1) source and use only beef that has been produced with zero net deforestation across all sensitive biomes in Brazil by the end of 2020 (the Amazon, the Cerrado and other sensitive biomes); and 2) report traceability of the beef chain to undergo geospatial mapping for risk assessment (slaughterhouse and full farm traceability, including direct and indirect farms). For Walmart in the U.S., this target is irrelevant because imports of Brazilian fresh beef have been suspended since 2017. Walmart-owned stores in other countries, however, may sell fresh beef from Brazil.

Walmart sees traceability of soy as “difficult”, as it is often an input for animal proteins. The company states that it is very hard to know how much soy is being used across certain products and where the soy was originally produced. The company asks its suppliers selling soy or products containing soy from Brazil to 1) maintain a footprint analysis to identify sourcing from higher-risk regions (the Amazon, the Cerrado and other sensitive biomes); 2) source and use only soy that has been produced with zero net deforestation across all sensitive biomes in Brazil by the end of 2020; and 3) report traceability of soy chains with geospatial mapping for risk assessment.

Walmart linked to deforestation risks in the Amazon and Cerrado

In 2019, Walmart was publicly [linked](#) to the fires in the Amazon. Walmart is one of the global retailers that buy from international meat and animal feed companies. By sourcing from these companies, global companies like Walmart were accused of “creating the international demand that finances the fires and deforestation” by campaign organization [Mighty Earth](#).

Mighty Earth found that Walmart conducted business with JBS worth USD 1.68 billion in 2018. JBS, both Brazil’s largest meatpacker and the world’s largest meat company, is highly [exposed to deforestation risks](#). JBS, like other major Brazilian meatpackers, signed the 2009 Cattle Moratorium, pledging not to buy beef from cattle connected to deforestation. However, research by governmental organizations and NGOs have repeatedly found serious violations at JBS, which has a long history of corruption and charges of deforestation in its supply chain. Fires have also burned within JBS’ supply chain. In total, NASA issued 145,482 fire alerts in September 2019 alone within JBS’ potential buying zone. A [Reporter Brasil](#)

[investigation](#) found that JBS bought from farms in protected areas in Para, where the highest number of fires took place this past summer. In 2017, the U.S. government banned imports of Brazilian beef after finding that supply from JBS and BRF SA did not meet safety standards. JBS stopped production in seven Mato Grosso do Sul plants as a result of legal reasons, while IBAMA, Brazil’s environmental agency, suspended two of JBS’ processing facilities for sourcing cattle from illegally deforested areas.

Walmart is also a major buyer of meat and other products from Cargill, the second largest soy exporter in Brazil. In April 2018, Chain Reaction Research (CRR) concluded that Cargill’s 2030 zero-deforestation deadline allowed its Brazilian suppliers to continue deforesting in the Cerrado. [Cargill’s 2019 policies](#) do not specify a time-bound zero-deforestation commitment. Notwithstanding these risks, Walmart lists Cargill as a [“Giga Guru” supplier](#), as the trader has committed to reduce absolute greenhouse gas (GHG) emissions in its operations by a minimum of 10 percent by 2025, compared a 2017 baseline.

Walmart does not recognize deforestation as a material business risk, despite reputational repercussions

Walmart argues that although forest-related risks are relevant to its business, [they are not financially material](#) at the aggregate level because of the company’s scale and scope. In addition, according to Walmart, many of the commodities that drive global deforestation – including timber, palm oil, cattle and soy – account for only less than 1 percent of the total costs of goods sold by Walmart.

According to the [Forest 500 ranking](#), Walmart’s efforts to remove deforestation from its supply chain are slightly above average (3 out of 5). It is important to stress that none of the companies in the Forest 500 is on track to eliminate commodity-driven deforestation from their supply chains and portfolios in 2020. Yet, nearly half of the companies in the Forest 500 rankings have made commitments to do so by 2020 or earlier. Walmart is one of them.

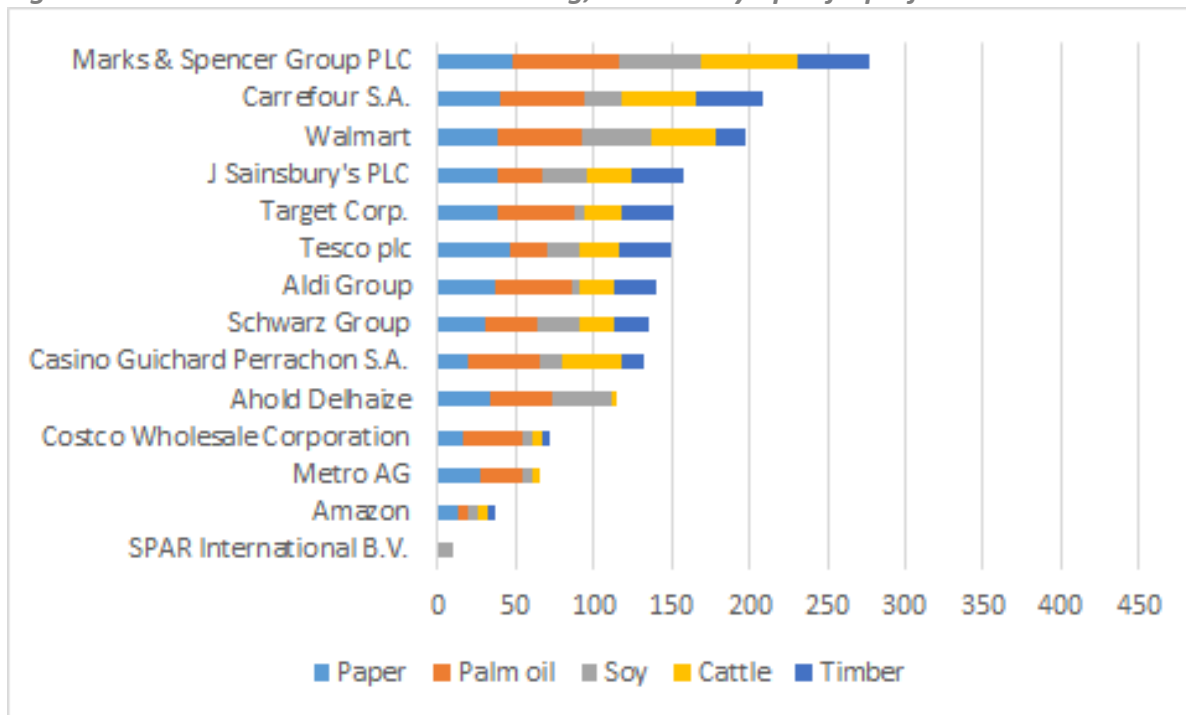
Figure 2. Walmart in the Forest 500 ranking, in relation to its peers

Company	HQ	Total score / 100	Score band / 5
Marks & Spencer Group PLC	U.K.	63.47	4
Carrefour S.A.	France	48.67	3
<i>Walmart</i>	<i>U.S.</i>	<i>46.50</i>	<i>3</i>
Target Corp.	U.S.	38.27	2
J Sainsbury's PLC	U.K.	37.43	2
Tesco plc	U.K.	36.85	2
Ahold Delhaize	Netherlands	32.71	2
Aldi Group	Germany	32.17	2
Casino Guichard Perrachon S.A.	France	30.34	2
Schwarz Group (Lidl and Kaufman)	Germany	29.19	2
Metro AG	Germany	20.50	2
Costco Wholesale Corporation	U.S.	18.47	1
Amazon	U.S.	9.47	1
SPAR International B.V.	Netherlands	4.59	1

Source: Forest 500

On commodity-specific commitments and policies, Walmart scores 198 points out of 450 in the Forest 500. Marks & Spencer leads among peers with 277 (figure 3).

Figure 3. Walmart in the Forest 500 ranking, commodity-specific performance



Source: Forest 500

Financial Risk Analysis: Investors now mostly focused on competitive landscape

Walmart has experienced a mixed financial performance over the past five years. The company's performance has been affected by, amongst other issues, increasing competition, particularly from online operators. In 2019, the company's revenue increased by 3 percent versus FY 2018, while EBITDA showed a small decline. For the [FY ending January 2019](#), e-commerce sales increased by 40 percent year-on-year. The company has been investing heavily in its eCommerce business by adding products — such as celebrity-inspired apparel and high-end camping gear — and acquisitions such as Art.com, lingerie retailer Bare Necessities, and Flipkart.

Figure 4: Key financial figures, as of January 31, 2019

USD billion	2015	2016	2017	2018	2019	CAGR (2015-2019)
Net revenues	485.7	482.1	485.8	500.3	514.4	1.4%
Gross profit	120.6	121.1	124.6	126.9	129.1	1.7%
Gross profit margin	24.8%	25.1%	25.6%	25.4%	25.1%	
EBITDA	36.6	33.4	32.6	33.4	32.6	-2.9%
EBITDA margin	7.5%	6.9%	6.7%	6.7%	6.3%	
Net profit adjusted	16.2	14.1	13.5	13.3	14.5	-2.7%
Net debt	36.4	37.7	35.9	35.7	46.4	6.3%
Net debt/EBITDA (X)	1.0	1.1	1.1	1.1	1.4	
Enterprise value	315.3	250.6	242.0	353.3	329.4	
Market Cap	274.3	209.8	203.4	314.7	275.8	

Source: Bloomberg November 25, 2019.

For nine months ending October 2019, Walmart saw strong sales growth in the eCommerce sector, as Walmart U.S. eCommerce sales grew 41 percent due to strength in online groceries. In November 2019, the company published its [nine-months FY 2020 results](#) ending October 2019. Revenue increased by 1.8 percent while operating income decreased by 4 percent compared to the previous year’s nine-month result. [Online sales](#) rose during the past nine months, especially for grocery items, but the costs of online commerce due to acquiring labels and enhancing speed of delivery continue to put downward pressure on earnings. After the share price underperformed from 2015 to 2018 due to Walmart’s lagging online strategy, in the last 12 months, the share price has moved in line with peers and leading indices as online sales get more weight in total Walmart revenues.

Revenue at risk mainly in the U.K. and Canadian market

Revenue-at-risk is calculated at USD 6 billion, equal to 2 percent of equity value. Walmart’s revenues are mainly generated in the business-to-consumer segment. Walmart’s markets where consumers are most sensitive to ESG events, according to a [Bloomberg](#) report, are the [U.K. and Canada](#). The company has respectively [633 and 411 stores](#) in these two markets. In comparison, South and Central American countries’ consumers appear to be less concerned about climate change. In the U.S., a majority are concerned, while climate worries in India and China are strongly focused on pollution. Other [research](#) indicates that in the U.S., Walmart has relatively many clients in the below-average income categories and with a high share in Baby Boomers (born 1946-1964) and Generation X (1965-1981), which choose Walmart for its relatively low pricing. Therefore, the company’s client base in the U.K. and in Canada is most sensitive to ESG issues and to Walmart’s lagging policies and implementation of deforestation policies.

Walmart’s net revenues in the [U.K. and Canada amounted](#) to respectively USD 30.5 billion and USD 18.6 billion, for a total USD 49.1 billion, or 10 percent of global net revenues. By applying a company-wide gross margin of 25 percent, the U.K. and Canadian entities would generate a USD 12.3 billion gross margin. In case NGOs campaigning against Walmart’s Canadian and Asda (U.K.) subsidiaries, customer purchases could fall by 5 percent, and gross profit would decline by USD 0.6 billion. The DCF value of the gross profit loss is USD 6 billion, or 2 percent of the equity value.

Low financing risk in short-to-medium term for Walmart

Walmart faces a low risk of increasing cost of capital in the short to medium term due to deforestation related risks. This is primarily because its bondholders and shareholders are mostly from the US. These financiers do not have any deforestation related commitment. However, this may change as the practices of responsible investment picks up momentum in the US and these financial institutions increasingly develop deforestation related policies for their investing and financing activities.

Figure 5: Bondholders of Walmart, based on the most recent filing date (in USD million)

No.	Financial institution	Country	Value
1	Vanguard	U.S.	1,788
2	Cathay Financial	Taiwan	1,075
3	Qunyi Securities	Taiwan	1,074
4	Yuanta Financial	Taiwan	971
5	Northwestern Mutual Life Insurance	U.S.	793
6	BlackRock	U.S.	545
7	Capital Group	U.S.	455
8	American International Group (AIG)	U.S.	423
9	Prudential Financial (US)	U.S.	410
10	State Farm	U.S.	410

Source: Thomson Reuter Eikon, 'Bondholdings of Walmart,' retrieved in November 2019.

Figure 6: Shareholders of Walmart, based on the most recent filing date (in USD million)

No.	Financial institution	Country	Value
1	Vanguard	U.S.	15,015
2	BlackRock	U.S.	11,493
3	State Street	U.S.	7,985
4	Fidelity Investments	U.S.	2,948
5	Bank of America	U.S.	2,393
6	Geode Capital Holdings	U.S.	2,217
7	Northern Trust	U.S.	1,973
8	State Farm	U.S.	1,856
9	T. Rowe Price	U.S.	1,633
10	Wellington Management	U.S.	1,534

Source: Thomson Reuter Eikon, 'Shareholding of Walmart,' retrieved in November 2019.

Barclays and HSBC may compromise their deforestation related policies by providing revolving credit facilities to Walmart. Walmart has USD 15 billion of outstanding revolving credit facilities. Within the top-10 revolving credit providers, Barclays is a signatory of the New York Declaration on Forests and the Soft Commodities Compact. It has also committed to curb deforestation in the timber and palm oil sector. The bank's policy does not cover deforestation from soy or cattle. HSBC has a policy on soy and cattle, applicable to upstream as well as downstream companies sourcing from suppliers involved in deforestation. By providing revolving credit facilities to Walmart, both these financial institutions may compromise their responsible banking policy commitments.

Figure 7: Revolving credit facilities to Walmart, per investor parent, not yet matured as of October 31, 2019 (2014 January - 2019 November, in USD million)

No.	Financial institution	Country	Value
1	Wells Fargo	U.S.	6,515
2	Bank of America	U.S.	6,515
3	Citigroup	U.S.	6,515
4	HSBC	U.K.	5,369
5	JPMorgan Chase	U.S.	4,102
6	Barclays	U.K.	1,905
7	US Bancorp	U.S.	1,207
8	Toronto-Dominion Bank	Canada	887
9	Royal Bank of Scotland	U.K.	855
10	Northern Trust	U.S.	625

Source: Thomson EIKON (2019, November), Loans; Bloomberg (2019, November), Loan Search.

The green financing opportunity cost could be valued at USD 2.8 billion, per DCF valuation. A [growing trend](#) of green and climate financing is currently rewarding companies for reaching certain ESG goals. Walmart has set up such a program with HSBC for its suppliers. In general, loans and bonds with green criteria and/or less ESG violations could result in lower interest rates of circa five basis points, and in the future, maybe up to 50 basis-points in case sizeable steps are made, including on zero-deforestation. With USD 54 billion of gross debt (excluding new lease accounting), five to 50 lower basis points could translate to USD 27 million to 270 million of lower interest cost. The DCF value of these cost savings is USD 270 million to USD 2.7 billion.

Value of additional reputation risk is relatively limited due to low valuation

Walmart's loss in reputation value could be in the range of USD 15-79 billion. At the USD 118.55 share price of November 25, 2019, Walmart's P/E FY20 ratio is 10 percent below that of a peer group, while its EV/EBITDA ratio is 20 percent below the peer group. EV/EBIT shows a 10 percent discount (Figure 8). These current percentages of the relative valuation multiples are slightly higher than they are in a five-year average context (which are respectively -16, -21 and -13 percent; see Figure 8). Under the assumption that a reputation event would adjust the share price to the five-year average of the relative valuation multiples, Walmart's share price could fall by five percent to USD 113.2 per share. In total, Walmart might face a decline of USD 15.2 billion in reputation value, which partly overlaps the revenue-at-risk calculation of USD 6 billion (see above). With a market cap of USD 336 billion (3 December 2019), the value of reputation risk is 4.5 percent of equity value.

If a string of reputation events were to occur, including other environmental, social and governance issues, the relative valuation could fall back to the five-year low in relative valuation. Such a scenario would put USD 79.3 billion reputation value at stake (24 percent versus equity value).

Figure 8: Relative valuation of Walmart versus peer group and potential reputation value decline

As on 25 November 2019	5-year Low*	5-year Average*	5-year High*	Current*	Difference Average and Current*	Implicit USD share price 5-year Average	Implicit USD share price 5-year Low
P/E	-33%	-16%	2%	-10%	-6%	111.4	91.3
EV/EBITDA	-35%	-21%	-5%	-20%	-1%	115.6	95.6
EV/EBIT	-32%	-13%	5%	-10%	-3%	<u>112.7</u>	<u>85.6</u>
Average						113.2	90.8
Current share price						118.55	118.55
% premium vs average						5%	31%
Current -/- average USD						5.3	27.7
No. of shares (bn)						2.86	2.86
Value loss (USD bn)						15.2	79.3

Source: Chain Reaction Research; Bloomberg (2019, November). *percentages refer to % discount/premium of Walmart valuation multiples versus the average valuation multiples of the peer group.

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