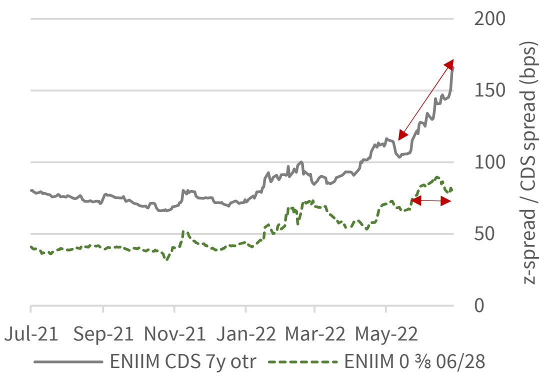
SLB bond radar: Eni (potentially) coming to market

Ulf Erlandsson(*), Stéphanie Mielnik, Josephine Richardson

Bloomberg flags that Italian oil company Eni (Ticker: ENIIM) might be coming to market shortly.[1] Eni as an oil company was one of the first in the sector to issue a sustainability-linked bond (SLB). It is AFII's view that SLBs could be a crucial transition financing instrument, even if the general SLB market has been less than ambitious so far. Eni has a fairly ambitious transition plan for net-zero by 2050, signified by four key performance indicators (KPIs), and with an almost linear trajectory to 2050 (rather than back-loaded). The KPIs include Scope 3 emissions which is a clear positive.[2]

Figure 1. ENIIM on-the-run 7y CDS vs ENIIM 0.375 2028 z spread indicating a substantial increase in positive basis in the past month. Source: Bloomberg.



Any forthcoming Eni bond issuance that fully aligns with the sustainability KPIs would be an important step in towards driving more ambition into the SLB market. So far, despite the overarching issuer KPIs, the specific Eni SLB instrument has not included Scope 3-related sustainability performance targets (SPTs) and the issuer recently updated their framework to clarified that the Scope 3 SPTs would come into play for longer terms structures. AFII opines that Scope 3 SPTs will highlight enhanced impact opportunity and should drive beneficial pricing.

This is especially important in the current context of inclement European market, if not weather, conditions. As illustrated in Figure 1 as well in press-reports,[3] there is substantial pressure in cash bond markets which normally leads to issuers having to issue new bonds at substantial premiums to secondaries. Add to this a particular dynamic around Italy, and one would expect any issuance to come at a substantial new issue premium (NIP).

Indeed, we see this as an opportunity to apply the option-pricing approach presented in earlier AFII papers to drive both ambition of SPTs as well as the opportunity to lower cost-of-capital for the issuer.[4] The pricing model specifically looks at SPT ambition level as well as coupon step-up size and step-up-maturities to arrive at a fair value premium that the investor could pay in order to get the optionality inherent in the SLB.

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[1] "EUROPEAN IG BOND PIPELINE: Possible Issuance in Coming Weeks", Bloomberg, 18 Jul 2022.
[2] Eni's estimated Scope 1+2+3 emission number is 365Mtpa, approximately 1% of global annual emissions.
[3] "CDS volumes surge as bond trading slumps", IFR, 15 Jul 2022.
[4] "An option pricing approach for sustainability-linked bonds", AFII, 18 Mar 2022. Access the "Sustainability-linked bonds – A practitioners' perspective" webinar through the hyperlink.

(*) Anthropocene Fixed Income Institute (www.anthropocenefii.org), uge@anthropocenefii.org

General comments

Below follows some notes on the current SLB structure as well as sustainability-linked financing framework, with associated outstanding question marks from AFII's side. We are looking forward to understanding more on the forthcoming structure and hope to engage with investors on this.

Structure and issuance: The original ENIIM 0.375 2028 SLB (XS2344735811, A-/Baa1) was the last bond Eni issued and came in June, 2021. The book was more than 3x oversubscribed, and printed 25bp inside of the Initial Pricing Target.[5] The SLB had two SPTs where a breach of either would lead to a 25bps step up. The SPTs were:[6]

1. Increase renewable energy installed capacity to at least 5 GW by the end of 2025, vs. 0.3 GW in 2020,
2. Lower net greenhouse gas emissions of upstream activities to at least 7.4 million tons by the end of 2024, or -50% vs. 2018.

Step-ups apply, in case of failure to reach the SPTs, in 2025 (for SPT 2.) and/or in 2026 (for SPT 1.).

Eni has a full sustainability-linked financing framework[7] with additional KPIs that were not present in the issued SLB structure, and relating to Scope 3 emissions, albeit with observation dates well beyond the maturity of the bond.[8]

3. Net GHG life-cycle emissions. Overall Scope 1, 2 and 3 emissions associated with Eni's activities and products, to zero in 2050.
4. Net carbon intensity (Scope 1, 2 and 3) to zero (net carbon sinks) in 2050.

This goes into a long-standing debate on how to look at fossil fuel companies and their total carbon footprint. For Eni to acknowledge a full life cycle, including Scope 3, net zero target for 2050 is exactly the level of ambition we need to see for this sector. Looking at the updated framework of 2022, the company indicates that the latter Scope 3 related KPIs should apply to longer-dated issuances.

Scope 3 metrics for SPTs: Naturally, we would prefer to see (and believe investors agree) all KPIS of the sustainability-linked financing framework to be brought into actual forthcoming SLBs. Note that there has been indications that all Eni financing going forward will be in sustainability-linked format, signaling their commitment to climate transition.[9] It would also, and we here refer to the company's own statements in the sustainability-linked financing framework, make it better aligned to the requirements of the ECB to purchase SLB bonds.[10]

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[5] "Eni SLB breaks new ground", IFR, 7 Jun 2021.
[6] "Eni launches the first sustainability-inked bond issue in its sector", Company press-release, 7 Jun 2021.
[7] "Sustainability-Linked Financing Framework – May 2021", Company material, 2021, with associated second party opinion from Vigeo-Eiris. An updated framework is available "Sustainability-Linked Financing Framework – May 2022" with added detail on intermediate targets (updated second party opinion).
[8] "Eni SLB leaves out Score 3 KPIs", IFR, 5 Jun 2021.
[9] "Eni SLB 'a step in the right direction' – but oil firms risk 'fairytale' net zero targets", Environmental Finance, 9 Jun 2021. From the article: "[the investor] believed it was a "boon" that the firm intends to include all future issuance in this format", AFII has not been able to independently corroborate this.
[10] We have recently identified Eni as a top-25 carbon intensive issuer in the ECB's corporate bond purchase program, see "Wind-down (of CSPP) is coming", AFII, 8 Jun 2022, as well as a recent comment on the ECB's

Pricing and coupon step-up size: The original SLB priced with a 0.375% coupon and an 0.25% step-up, with a new issue spread pricing of mid-swaps+50bp. That bond currently trades at a spread of 81bp, or 2.55% all-in yield. If one looks at the step-up as a proportion of all-in yield, or even as of spread, it is much smaller today than at issuance. Hence, it could make sense to discuss more material step-up levels, and as we have shown in our option pricing approach, this should allow for the issuer to issue new SLBs inside the current secondary curve.

Usage of offset for net zero targets: A point of comment in the second party opinion is with the regards to the use of carbon offsets to reach net-zero targets 2050, where the opinion points out that research has raised "concerns related to the role of CCS and carbon offset in decarbonisation strategies." As we have observed another oil company issuing SLB paper where petrochemical production (i.e. plastics) has been attributed as a 'carbon sink',[11] we think any Eni issuance would benefit from highlighting that that petrochemical carbons sinks are not applied. In general, understanding the role and analytical frameworks to account for offsets will be important in terms of projecting likelihoods that SPTs will be reached, and should thus have real pricing implications.

Cash versus derivative valuations: Finally, a technical note on relative valuations. If investors feel certain that Eni will be issuing all debt in SLB format going forward, there is an argument to be made that over time, the derivatives (CDS) trading on ENIIM should be considered 'sustainable' as well.[12] As we note in the figure, the CDS basis has been growing rapidly in the low liquidity market conditions as of late. Currently we, see maturity matched CDS vs the ENIIM 0.375 2028s trade at around 160bp, which is more than twice the actual bond spread.

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actual plans, "Tilt and Run – ECB climate policy update", 5 Jul 2022. Note that the ENIIM 0.375 2028 bond actually has been purchased through the CSPP.

[11] " Repsol Transition Financing Framework", June 2021.

[12] Eni currently has EUR22bn of bonds outstanding, with a maturity hump around 2028 with approximately EUR3.5bn maturing that year. There is only EUR1.5bn of fixed bonds maturing after 2031. Note however that the company has EUR5bn of perpetuals/hybrids outstanding, but all with first calls inside 2031.

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