

Enel returns to the SLB market: per angusta ad augusta[1]

Josephine Richardson (*)

Enel, an Italian utility company and flagship issuer of Sustainability-Linked Bonds (SLBs),[2] announced on 23 Apr 2024 that it would miss its 2023 emissions intensity target, leading to a step-up coupon on ten SLBs.[3]

The pricing reaction on impacted bonds was swift; SLBs which would receive an increased coupon outperformed on average 0.59% in the week following the announcement.[4] This market move is an understandable reaction given the bond details have changed, and impacted SLBs will now receive a higher coupon. It also validates the option pricing approach to SLBs.[5]

Two months on, we review how this miss has affected Enel's ongoing financing. Has it been able to communicate a new sustainability trajectory with investors ? How has its pricing in the secondary market performed? How have its recent primary deals been received?

- **Enel has communicated that its emissions reduction trajectory remains aligned with a 1.5°C pathway**. Analysis of its biannual and quarterly reporting suggests it is likely to meet the next 2024 emissions intensity target, which is referenced in some of its SLBs.
- **Its recent market moves show a mixed picture.** Enel's Credit Default Swap (CDS) spread has outperformed the index, showing there has been no significant re-assessment of its credit-worthiness by the market. Its EUR bonds however seem slightly to have underperformed, which may be due to some investor divestment flows.
- Enel has just come back to market, with its first bullet issuance since the target miss, structured as an SLB. It issued $2bn across a 5y and 10y deal, **reportedly pricing 5-8bp through its secondary curve** on a day where the average new issue premium was 4bp.[6] This implies the bond was a total of 9-12bp tighter than average bond pricing, rewarding Enel with attractive funding spreads. **Enel's continued commitment to the structure is a vote of confidence in the SLB market.**

[1] Through difficulty to honours.
[2] To view our recently published handbook please visit "Sustainability-Linked Bond Handbook: A practicioner's guide".
[3] "Sustainability Report 2023", Enel, accessed 4 Jun 2024.
[4] Please see "Enel SLBs: fortes fortuna juvat", AFII, 26 Apr 2024.
[5] For full details please see "An option pricing approach for Sustainability-Linked Bonds", AFII, 8 Nov 2022.
[6] "Enel Comes Through Guidance as Deal Flurry Persists", Bloomberg, 18 Jun 2024.

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(*) Anthropocene Fixed Income Institute (www.anthropocenefii.org). Author for contacts: jor@anthropocenefii.org

Enel's decarbonisation trajectory

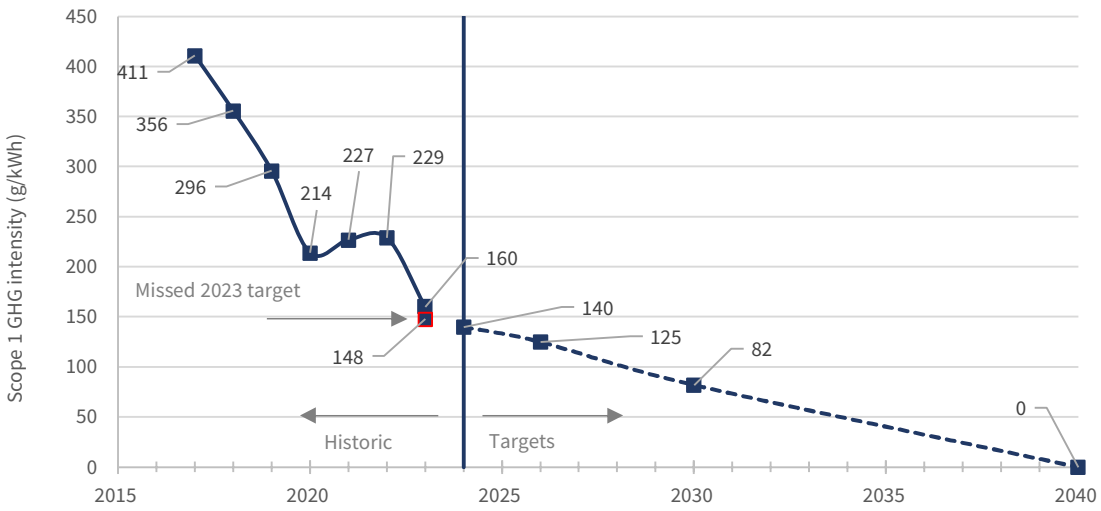
In its 2023 sustainability report, where the missed target was confirmed, Enel reiterated that "*the Group's emissions intensity in 2023 remained in line with the 1.5°C trajectory. In fact, the industry's decarbonisation approach under the SBTi initiative set a maximum threshold of 246 gCO_2e/kWh for Enel for 2023, well above the actual figure.*" [7]

Historic KPI performance is in Figure 1. The 2023 target was 148gCO_2e/kWh and the actual figure was 160. In terms of analysing the trajectory from this point, Enel has historically reported emissions intensity on a semi-annual basis, and generation mix quarterly.

Enel's 2023 half-year discloses a figure of 173 g/kWh for H1 on 101,999 MW of generation.[8] H2 generation was 105,322 MW which implies a H2 intensity figure of 147g/kWh. This highlights on a spot basis, how little improvement is needed to achieve the 2024 target.

Furthermore, in Q1 2024 Enel reported that 80.7% of its generation was emissions free (Hydro, Wind, Geothermal, Solar or Nuclear),[9] an increase from 71.5% for H1 2023 and 75.0% in H2 2023. This would suggest further emission intensity reductions have been achieved in the year.

Figure 1. Enel Scope 1 emissions intensity historic values and targets. Source: Enel.



These figures combine to give confidence than the 2024 target is achievable, and this miss may not be material to Enel's long-term decarbonisation ambitions.

Enel's bond market performance

An open question in sustainable finance is what impact missing a target could have on a borrower's sustainability trajectory, and so investor perception of its credit-worthiness.

Table 1 (overleaf) gives recent market performance for Enel and some comparable indices.

[7] P21 of "Sustainability Report 2023", Enel, accessed 20 Jun 2024.
[8] Half-year Sustainability disclosures at Jun 30, 2023 available at "Sustainability", Enel and 1H and FY 2023 Key Figures available at "Financials", Enel.
[9] Generation details are available in Key figures at "Financials", Enel.

Enel's Credit Default Swap (CDS) spread has tightened 1.5bp compared to a widening of 1.3bp of the iTraxx index.

However its bonds are more mixed. The EUR bonds seem to have underperformed some equivalent Bloomberg composite spreads, whereas the USD bonds on average have performed in line.[10]

Table 1. Market moves for Enel and calculated Bloomberg composite spreads. Source: AFII, Bloomberg, accessed 20 Jun 2024.

	17-Apr-24	17-Jun-24	Change (bp)
Enel CDS	65.6	64.1	-1.5
iTraxx	61.8	63.1	1.3
ENELIM €3.375 28s	55.1	69.8	14.7
ENELIM €3.875 29s	63.5	74.5	11.0
ENELIM €0.875 31s	81.1	85.2	4.1
Bloomberg BBB EUR Composite 5y	78.0	83.9	5.9
ENELIM $3.5 28s	108.9	107.1	-1.7
ENELIM $4.875 29s	106.1	102.3	-3.9
ENELIM $5 32s	164.2	173.2	9.0
Bloomberg BBB USD Composite 5y	112.5	118.5	6.1

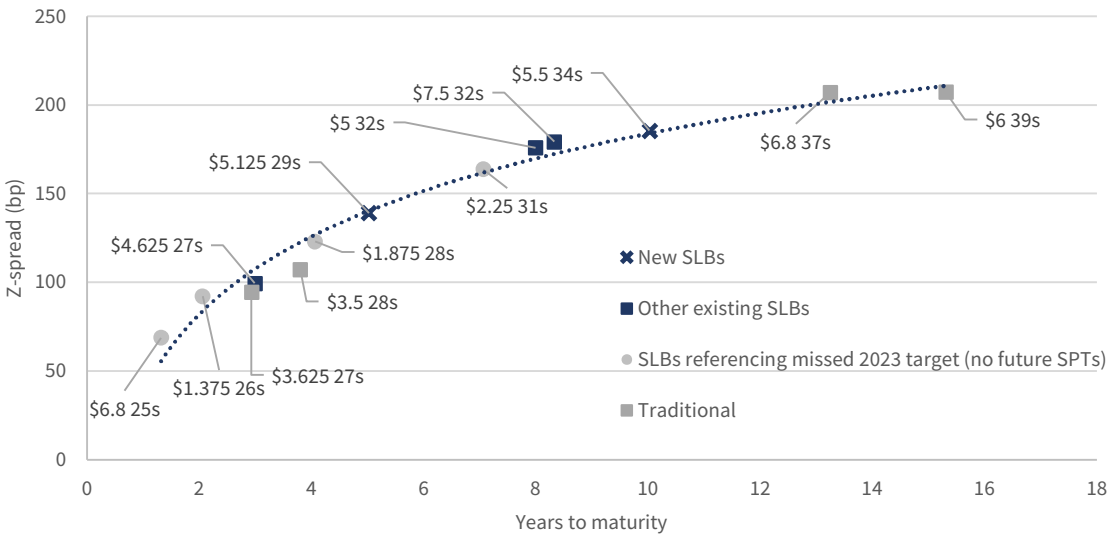
This presents a mixed picture in terms of recent performance. The derivative outperformance suggests no material deterioration in the market's perception of Enel's credit risk, but the slight bond underperformance could be driven by some issuer divestment.

Enel's new USD issuance

In terms of Enel's bond spreads, it is perhaps more interesting to review the ease with which it is able to access new capital via the primary market, by analysing the pricing of its recent new USD SLB.

Figure 2 shows current pricing on Enel's USD bonds. Even though Enel has only issued SLBs as bullet paper since 2019, the five bonds which reference the recent missed target, are in effect vanilla bonds now, as they have no future SPTs.

Figure 2. Enel USD bond spreads. Source: Bloomberg, accessed 20 Jun 2024.



[10] Bloomberg composite spreads are calculated by removing the swap rate from the yields. Included bonds are those around 5y maturity which did not reference the recent SPT miss.

The new bonds reference Enel's KPI of Scope 1 GHG emissions intensity related to power generation, with the 5y bond targeting a reduction to 125gCO_2e/kWh by 2026 and the 10y bond targeting a reduction to 72gCO_2e/kWh by 2030.[11] The 2030 target is already referenced by some of Enel's existing SLBs, including the $5 32s and $7.5 32s.[12]

It was reported that average new issue premium was 4bp, i.e. issuers needed to pay 4bp more than their secondary curve for primary issuance, on the day these bonds were priced. The Enel SLBs were reported to have priced 5-8bp inside the secondary curve, suggesting a material pricing benefit was given to Enel.[6]

The current pricing shown in Figure 2 also suggests that the new SLBs are slightly tighter than the closest comparable 2032 maturity bonds, giving more evidence that these bonds were well received by investors.

Conclusions

Enel's SPT miss in April was a significant event for the SLB market; the flagship issuer missing a target referenced by such a significant population of bonds. The immediate outperformance of the affected bonds which receive the 25bp step-up coupon was expected and swift.[4]

The natural follow-up question is how such an event will impact Enel's ongoing funding, both in terms of secondary price moves on unaffected bonds, and also primary market activity.

Enel has done a good job communicating its ongoing commitment to sustainability. The miss to its 2023 target does not seem to have affected the temperature alignment of its pathway, and our analysis suggests it will likely achieve the 2024 target on the same KPI.

Recent market moves give a mixed picture. Its derivative spread has outperformed the index in a benign environment, suggesting no material change to investor perception of its credit-worthiness. There has been some slight underperformance of its EUR bonds, which may be due to some investor divestment.

However what is more important for Enel, is its ongoing primary market access. Its recent $2bn SLB deal, the first since the target miss was announced, was strong. It was reported to price tight to the secondary curve, despite the average deal requiring a 4bp new issuance premium,[6] and is still pricing slightly tighter than existing bonds. This implies the market is rewarding Enel with attractive primary funding spreads, and should assuage concerns that a missed target will automatically drive poor investor relations.

That Enel remains committed to SLB issuance also gives a strong vote of confidence for this product.

[11] "Enel successfully places a multi-tranche 2 billion U.S. dollar Sustainability-Linked Bond", Enel, 19 Jun 2024.
[12] Please see "Enel: A case study in transition finance using SLBs", AFII, 25 Jun 2022.

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