

Enel SLBs: fortes fortuna juvat[1]

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On 23 Apr 2024 a significant event occurred in the Sustainability-Linked Bond (SLB) market when Enel, an Italian utility, published its 2023 sustainability report,[2] confirming that it would not achieve its emissions intensity target. This KPI is referenced in ten SLBs, all of which will now pay an extra 25bps coupon (for full details of the bonds please see Table 1).

This event will test a developing market, but can also deliver a vote of confidence on the structure.

The step-up coupon in an SLB is an option, so before the target miss was confirmed we would expect a probability-weighted value of the increased coupon to be included in the price. Our earlier analysis concluded that Enel's intensity target would be hard to achieve, but nevertheless the SLBs were pricing only slightly tighter than their vanilla counterparts, suggesting the market assigned a low chance of the target being missed.[3]

The price reaction over the past two days has been swift. The last five trading days are shown in Figure 1 and Figure 2 overleaf, and Table 1 provides a summary of the price moves. Affected EUR and USD SLBs have rallied on average 0.43% and 0.63% respectively, both significantly outperforming unaffected bonds.

This dramatic price reaction also shows how a step-up coupon can provide a valuable hedge for investors . **As this option has been shown to have value for investors, this should lead to ambitious SLBs being well-received by the market at attractive funding levels for issuers.**

Table 1. Enel SLB price moves over five trading days, and estimated step-up value. Source: Bloomberg, AFII, accessed 25 Apr 2024.

Description	ISIN	Maturity	Currency	Amount Outstanding	Step-up coupon accrual start date	Estimated PV of step-up	5-day move	Estimated 5-day outperformance
ENELIM €0.25 25s	XS2432293673	17-Nov-25	EUR	1,250,000,000	17-Nov-24	0.23%	0.26%	0.25%
ENELIM €0 26s	XS2390400633	28-May-26	EUR	1,250,000,000	28-May-24	0.45%	0.35%	0.54%
ENELIM €0 27s	XS2353182020	17-Jun-27	EUR	1,000,000,000	17-Jun-24	0.65%	0.47%	0.69%
ENELIM €0.375 29s	XS2390400716	28-May-29	EUR	1,000,000,000	28-May-24	1.02%	0.25%	0.86%
ENELIM €0.5 30s	XS2353182293	17-Jun-30	EUR	1,250,000,000	17-Jun-24	1.19%	0.81%	1.31%
ENELIM $4.25 25s	US29278GAV05	15-Jun-25	USD	750,000,000	15-Jun-24	0.23%	0.41%	0.33%
ENELIM $6.8 25s	US29278GAZ19	14-Oct-25	USD	750,000,000	14-Oct-24	0.24%	0.11%	0.04%
ENELIM $1.375 26s	US29278GAM06	12-Jul-26	USD	1,250,000,000	12-Jul-24	0.44%	0.46%	0.38%
ENELIM $1.875 28s	US29278GAN88	12-Jul-28	USD	1,000,000,000	12-Jul-24	0.80%	0.58%	0.28%
ENELIM $2.25 31s	US29278GAP37	12-Jul-31	USD	1,000,000,000	12-Jul-24	1.24%	1.60%	1.22%

[1] "Fortune favours the bold", Terence, Phormio, 161 BC.
[2] "Sustainability Report 2023", Enel, accessed 25 Apr 2024.
[3] For all our earlier work on Enel please see here and "An option pricing approach for Sustainability-Linked Bonds", AFII, 8 Nov 2023.

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Introduction

Enel's missed Sustainability Performance Target (SPT) is a major event for the developing SLB market. This is the most significant penalty yet incurred by an SLB, and from its most prolific issuer.[4]

To have missed a target does not necessarily suggest that Enel's transition is off-track. It confirms the target had a degree of ambition, which in this situation was not achieved. Enel confirms in its report that its emissions intensity remains in line with a 1.5°C warming trajectory, and reiterates its commitment to further decarbonisation.

Ultimately investors must decide how this may affect Enel's creditworthiness, but the SLB has put sustainability firmly on the investor dialogue, and can be said to have positively supported engagement activity.

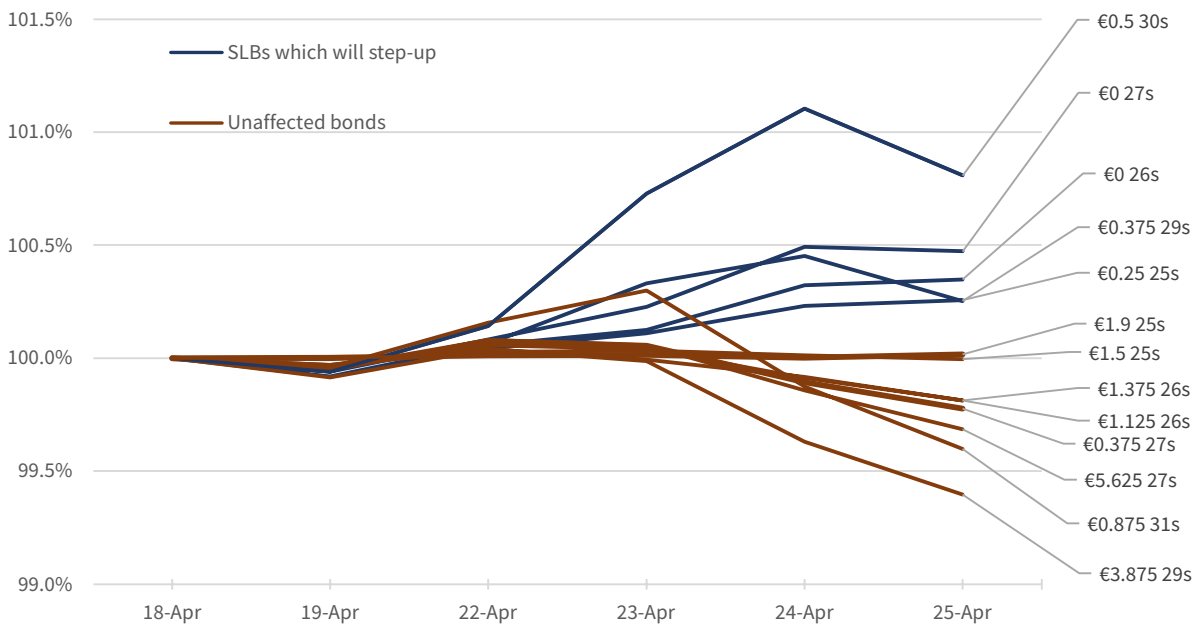
However, the target miss creates a structural difference between Enel's outstanding bonds. Ten will now receive an increased coupon of 25bps, while the others will not. We review the relative price moves across these bonds to analyse implications for the broader SLB market.

EUR bond moves

Figure 1 shows prices for the last five trading days for Enel's EUR bonds. SLBs which will receive a step-up due to the 2023 Sustainability Performance Target (SPT) miss are shown in blue, with other unaffected bonds in red.

The consistency of outperformance is strong, and the move largely began the day of the announcement, indicating that the step-up was the influencing factor.

Figure 1. Enel EUR bond price moves. Source: Bloomberg, accessed 25 Apr 2024.

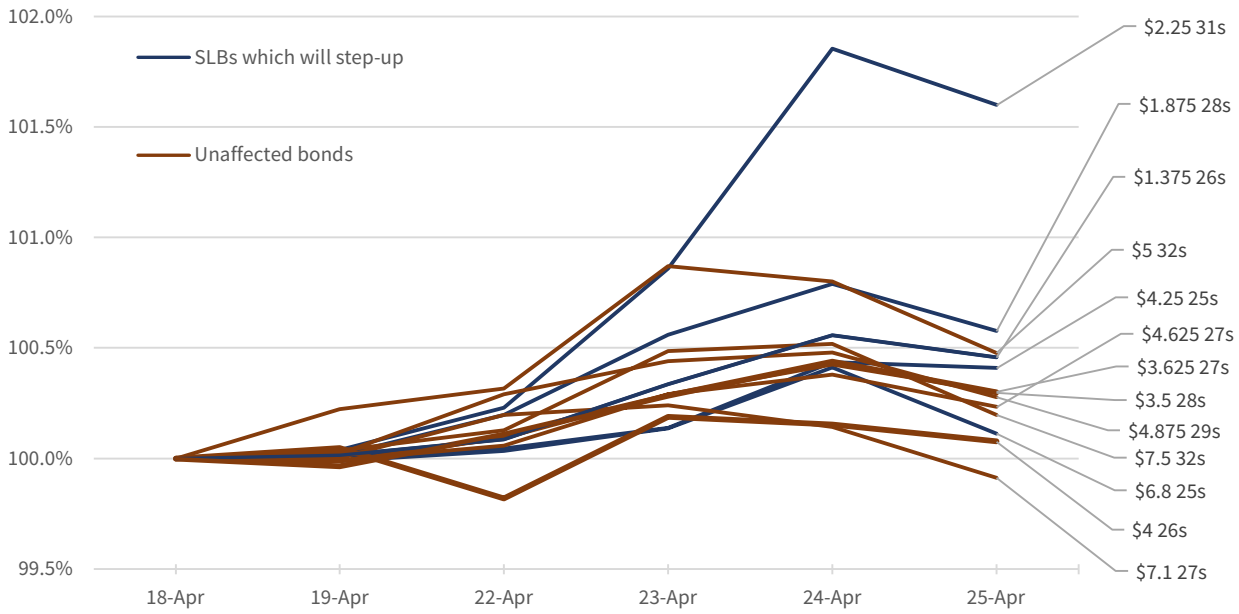


[4] "Enel Forced to Raise Coupons on $11 Billion of ESG Bonds", Bloomberg, 23 Apr 2024.

USD bond moves

Enel's USD bond moves are shown in Figure 2. The picture here is a little more muddled than it is for EUR, driven by underlying rate volatility. When pairing the affected bonds to their closest duration equivalent in order to calculate the estimated outperformance in Table 1, the $1.375% 26s and $1.875% 28s stand out as having moved the least compared to their calculated option value.

Figure 2. Enel USD bond price moves. Source: Bloomberg, accessed 25 Apr 2024.



Conclusions

Even though Enel's H1 sustainability report, and its Q4 generation figures suggested its 2023 emissions intensity target was going to be hard to achieve, confirmation that it was missed seems to have taken the market by surprise.

Bond pricing moves for those SLBs which will receive a step-up coupon have been dramatic, with an average outperformance of 0.59% in the last five trading days. The move has been so fast, as the market digests the coupon step-ups, that the outperformance has not been uniform, and there are some USD bonds that may not yet have fully incorporated the higher coupon into pricing.

This is an important event for the SLB market. As targets are missed, so concerns around their lack of ambition can be assuaged.

However this missed targets affects investors' views of Enel's sustainability commitment, there is a clear structural difference between how its bonds are performing, with affected SLB bondholders being supported by the step-up coupon. Now the market has demonstrated the value of this hedge, it is more likely that future SLBs with ambitious targets will be well-received, and enjoy attractive pricing.

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