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Pressure-Testing Corporates' Transition Planning

Westminster Energy Forum

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Transition Assessment - Overview

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Sustainable Fitch Operationalises the SMI Energy Transition Task Force's Transition Framework

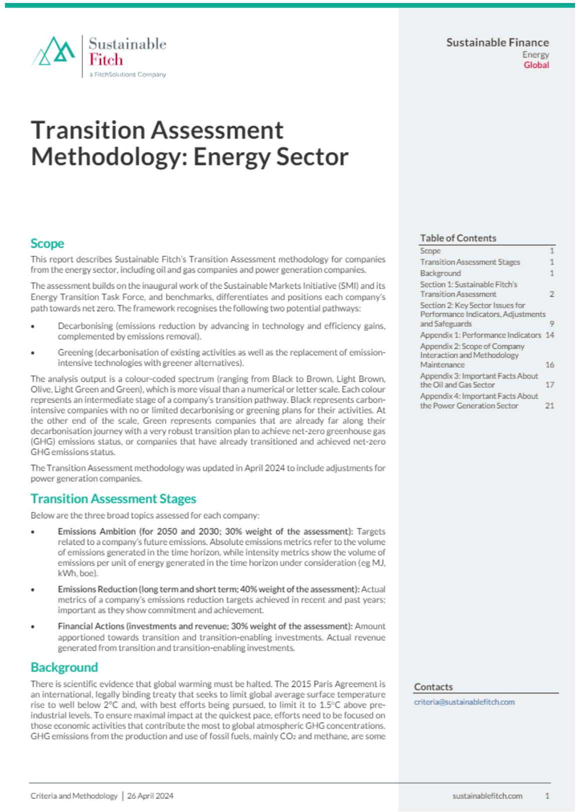
Sustainable Markets Initiative's Energy Transition Task Force

The taskforce published a transition framework at COP27 in 2022 to support global progress towards **net zero greenhouse gas emissions.**

- It recognises that the energy transition needs to engage incumbents in in high-emitting sectors– including those who are not 'green' today but pursuing net zero in the future – to deploy their resources, capabilities, and capital to help accelerate global progress towards this goal.
- Despite growing momentum for net zero ambitions, there remains a **notable gap in the available tools** to enable investment in transitioning companies delivering progress across the near-, medium-, and long-term.
- The framework and its underlying principles aims to help stakeholders identify, assess, rank, and track companies driving the transition.

Sustainable Fitch Operationalises SMI Energy Transition Task Force 's Framework

SMI selected Sustainable Fitch to utilise the framework to develop a transition assessment to chart the spectrum of companies in the undefined space between carbon intensive and net zero today.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Transition Assessment Methodology: Energy Sector

Scope

This report describes Sustainable Fitch's Transition Assessment methodology for companies from the energy sector, including oil and gas companies and power generation companies.

The assessment builds on the inaugural work of the Sustainable Markets Initiative (SMI) and its Energy Transition Task Force, and benchmarks, differentiates and positions each company's path towards net zero. The framework recognises the following two potential pathways:

- Decarbonising (emissions reduction by advancing in technology and efficiency gains, complemented by emissions removal).
- Greening (decarbonisation of existing activities as well as the replacement of emission-intensive technologies with greener alternatives).

The analysis output is a colour-coded spectrum (ranging from Black to Brown, Light Brown, Olive, Light Green and Green), which is more visual than a numerical or letter scale. Each colour represents an intermediate stage of a company's transition pathway. Black represents carbon-intensive companies with no or limited decarbonising or greening plans for their activities. At the other end of the scale, Green represents companies that are already far along their decarbonisation journey with a very robust transition plan to achieve net-zero greenhouse gas (GHG) emissions status, or companies that have already transitioned and achieved net-zero GHG emissions status.

The Transition Assessment methodology was updated in April 2024 to include adjustments for power generation companies.

Transition Assessment Stages

Below are the three broad topics assessed for each company:

- **Emissions Ambition (for 2050 and 2030; 30% weight of the assessment):** Targets related to a company's future emissions. Absolute emissions metrics refer to the volume of emissions generated in the time horizon, while intensity metrics show the volume of emissions per unit of energy generated in the time horizon under consideration (eg MJ, kWh, boe).
- **Emissions Reduction (long term and short term; 40% weight of the assessment):** Actual metrics of a company's emissions reduction targets achieved in recent and past years; important as they show commitment and achievement.
- **Financial Actions (investments and revenue; 30% weight of the assessment):** Amount apportioned towards transition and transition-enabling investments. Actual revenue generated from transition and transition-enabling investments.

Background

There is scientific evidence that global warming must be halted. The 2015 Paris Agreement is an international, legally binding treaty that seeks to limit global average surface temperature rise to well below 2°C and, with best efforts being pursued, to limit it to 1.5°C above pre-industrial levels. To ensure maximal impact at the quickest pace, efforts need to be focused on those economic activities that contribute the most to global atmospheric GHG concentrations. GHG emissions from the production and use of fossil fuels, mainly CO_2 and methane, are some

Table of Contents

Contacts

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Criteria and Methodology | 26 April 2024

sustainablefitch.com 1

Sustainable Fitch Transition Assessment

Translating performance to a colour

Paths – Approaches to transition

Decarbonising
To achieve net zero through decarbonising activities or products

Reduce
activities or products that give rise to emissions

+

Remove
emissions from activities or products

Net zero

Greening
To achieve net zero through decarbonising and build out of green activities or products

Reduce
activities or products that give rise to emissions

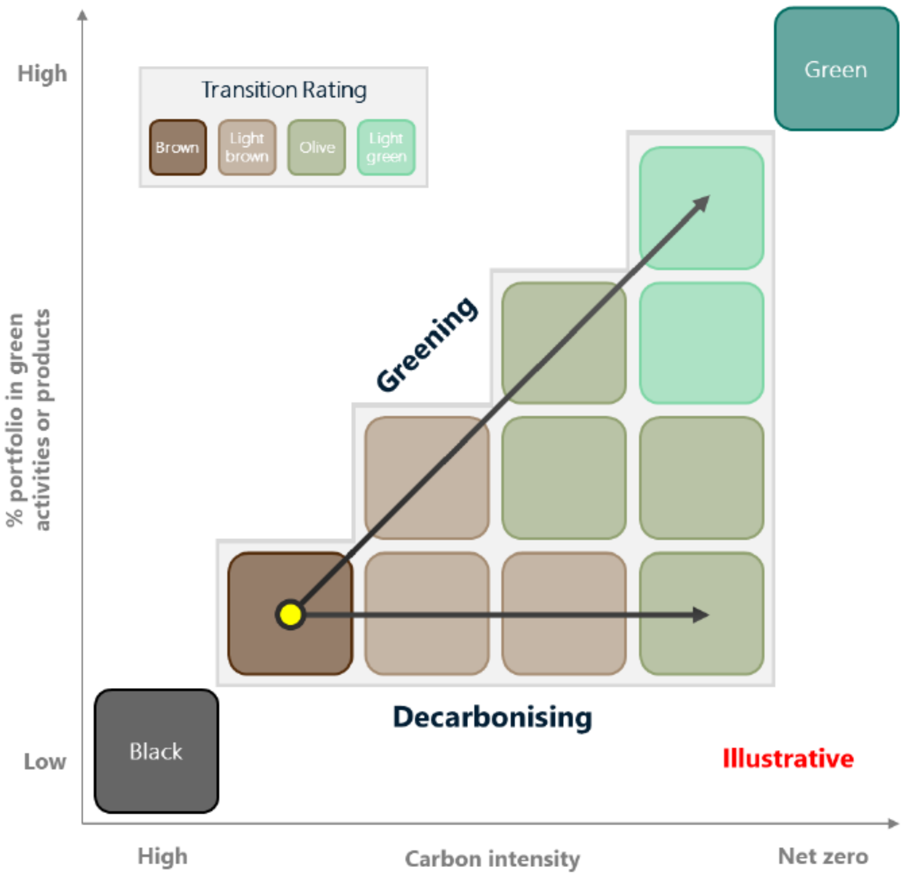
+

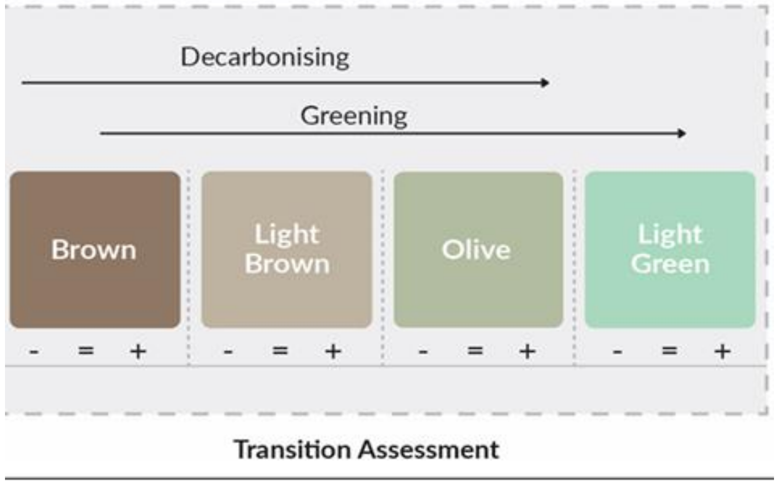
Remove
emissions from activities or products

+

Replace
activities or products giving rise to emissions with green alternatives

Net zero





Analytical Process – 3 Stages, Full Transparency on the Methodology

Stage 1

A – Performance indicators

- We analyse a series of metrics including emissions reduction targets, delivered emissions reduction and financial actions to enable the transition.
- The outcome from this section is a score on a spectrum from 1 to 100, an associated color-coded banding and a granular qualifier.

Emissions Ambition – 30%
- 2050 Aim
- 2030 Aim

Emissions Reduction – 40%
- Long-Term
- Short-Term

Financial Actions – 30%
- Transition Investments
- Transition Revenues

Stage 2

B – Adjustments

- We check and apply a series of adjustments related to systemic change, emissions, governance and scale. We have capped this phase to a max adjustments of two notches.
- The outcome from the previous phase is therefore adjusted to obtain a new color-coded band with an associated qualifier.

Stage 3

C – Safeguards

- To avoid misrepresentation of actual transition, we have identified certain pre-requisites to access the various transition stages (color-coded bands)
- The outcome from the previous phase can be changed as per the safeguards to obtain a new color-coded band with associated qualifiers.

Category		Weight	Metrics	
Emissions Ambition	2050 Aim	2.5%	1.1	**Absolute** Scope 1 and Scope 2
		2.5%	1.2	**Absolute** Scope 3
		5%	1.3	**Intensity Lifecyle** Scope 1, Scope 2 and Scope 3
	2030 Aim	5%	1.4	**Absolute** Scope 1 and Scope 2
		5%	1.5	**Absolute** Scope 3
		10%	1.6	**Intensity Lifecycle** Scope 1, Scope 2 and Scope 3
Emissions Reduction	Long-term reduction	5%	2.1	**Reduction in Absolute** Scope 1 and Scope 2
		5%	2.2	**Reduction in Absolute** Scope 3
		10%	2.3	**Reduction in Intensity Lifecyle** Scope 1, Scope 2 and Scope 3
	Short-term Reduction	5%	2.4	**Reduction in Absolute** Scope 1 and Scope 2
		5%	2.5	**Reduction in Absolute** Scope 3
		10%	2.6	**Reduction in Intensity Lifecycle** Scope 1, Scope 2 and Scope 3
Financial Actions	Transition Investments (Tracked data)	n.a	3.1	**Decarbonising** % (of total annual investments)
		n.a	3.2	**Green** % (of total annual investments)
	Transition Investments	15%	3.3	**Total Green and Decarbonising** % (of total annual investments)
		5%	3.4	**Green/Decarbonising** Investment ratio
	Transition Revenues	5%	3.5	**Green and Decarbonising** Annual revenue growth (%)
		5%	3.6	**Green and Decarbonising** Annual revenue (% of total revenue)

TRANSITION ASSESSMENT – ANALYTICAL PROCESS

	Metric	Weight	Thresholds 0	1	2	3	4	5
Emissions Ambition								
2050 Aim								
1.1	Reduction in absolute Scopes 1 and 2 emissions	2.5%	No target/No data	Aiming to reduce but not net-zero target	Net-zero target with only partial coverage	Net-zero target with partial but significant coverage	Net-zero target with full coverage	-
1.2	Reduction in absolute Scope 3 emissions	2.5%	No target/No data	Aiming to reduce but not net-zero target	Net-zero target with only partial coverage	Net-zero target with partial but significant coverage	Net-zero target with full coverage	-
1.3	Reduction in intensity life cycle (Scopes 1, 2 and 3 emissions)	5%	No target/No data	Aiming to reduce but not net-zero target	Net-zero target with only partial coverage	Net-zero target with partial but significant coverage	Net-zero target with full coverage	-
2030 Aim								
1.4	Reduction in absolute Scopes 1 and 2 emissions	5%	No target/No data/0%–5% reduction	5%–15% reduction	15%–25% reduction	25%–40% reduction	40%–55% reduction	55%–net-zero reduction
1.5	Reduction in absolute Scope 3 emissions	5%	No target/No data/0%–5% reduction	5%–15% reduction	15%–25% reduction	25%–40% reduction	40%–55% reduction	55%–net-zero reduction
1.6	Reduction in intensity life cycle (Scopes 1, 2 and 3 emissions)	10%	No target/No data/0%–5% reduction	5%–15% reduction	15%–25% reduction	25%–35% reduction	>= 35% reduction	-
Emissions Reduction								
Long-Term								
2.1	Reduction in absolute Scopes 1 and 2 emissions	5%	No data/0%–5% reduction achieved/increase	5%–15% reduction achieved	15%– 25% reduction achieved	25%–40% reduction achieved	40%–55% reduction achieved	55%–net-zero reduction achieved
2.2	Reduction in absolute Scope 3 emissions	5%	No data/0%–5% reduction achieved/increase	5%–15% reduction achieved	15%–25% reduction achieved	25%–40% reduction achieved	40%–55% reduction achieved	55%–net-zero reduction achieved
2.3	Reduction in intensity life cycle (Scopes 1, 2 and 3 emissions)	10%	No data/0%–5% reduction achieved/increase	5%–15% reduction achieved	15%–25% reduction achieved	25%–35% reduction achieved	>= 35% reduction achieved	-
Short-Term								
2.4	Reduction in absolute Scopes 1 and 2 emissions	5%	No data/0%–2.5% reduction achieved/increase	2.5%–7.5% reduction achieved	7.5%–12.5% reduction achieved	12.5%–20% reduction achieved	20%–27.5% reduction achieved	27.5%–net-zero reduction achieved
2.5	Reduction in absolute Scope 3 emissions	5%	No data/0%–2.5% reduction achieved/increase	2.5%–7.5% reduction achieved	7.5%–12.5% reduction achieved	12.5%–20% reduction achieved	20%– 27.5% reduction achieved	27.5%– net-zero reduction achieved
2.6	Reduction in intensity life cycle (Scopes 1, 2 and 3 emissions)	10%	No data/0%–2.5% reduction achieved/increase	2.5%–7.5% reduction achieved	7.5%–12.5% reduction achieved	12.5%– 17.5% reduction achieved	17.5%– net-zero reduction achieved	-

Financial Actions								
Transition Investments – Tracked Data (No Weighting)								
3.1	Decarbonising percentage (of total annual investments)	-	-	-	-	-	-	-
3.2	Green percentage (of total annual investments)	-	-	-	-	-	-	-
Transition Investments								
3.3	Total green and decarbonising percentage (of total annual investments)	15%	No investments	Evidence of green and decarbonising but with insufficient detail, or less than 1%	1%–25%	25%–50%	50%–75%	>= 75%
3.4	Green-to-decarbonising investment ratio	5%	No investments	Evidence of green and decarbonising but with insufficient detail to determine ratio	0– 0.5	0.5–1	1–5	> 5
Transition Revenue								
3.5	Green and decarbonising annual revenue growth (%)	5%	No investments	Evidence of green and decarbonising but with insufficient detail, or less than 1%	1%–25%	25%–50%	50%– 100%	above 100%
3.6	Green and decarbonising annual revenue (percentage of total revenue)	5%	No investments	Evidence of green and decarbonising but with insufficient detail, or less than 1%	1%–10%	10%–20%	20%–30%	>= 30%

Source: Sustainable Fitch

Transition Assessment – Key Findings

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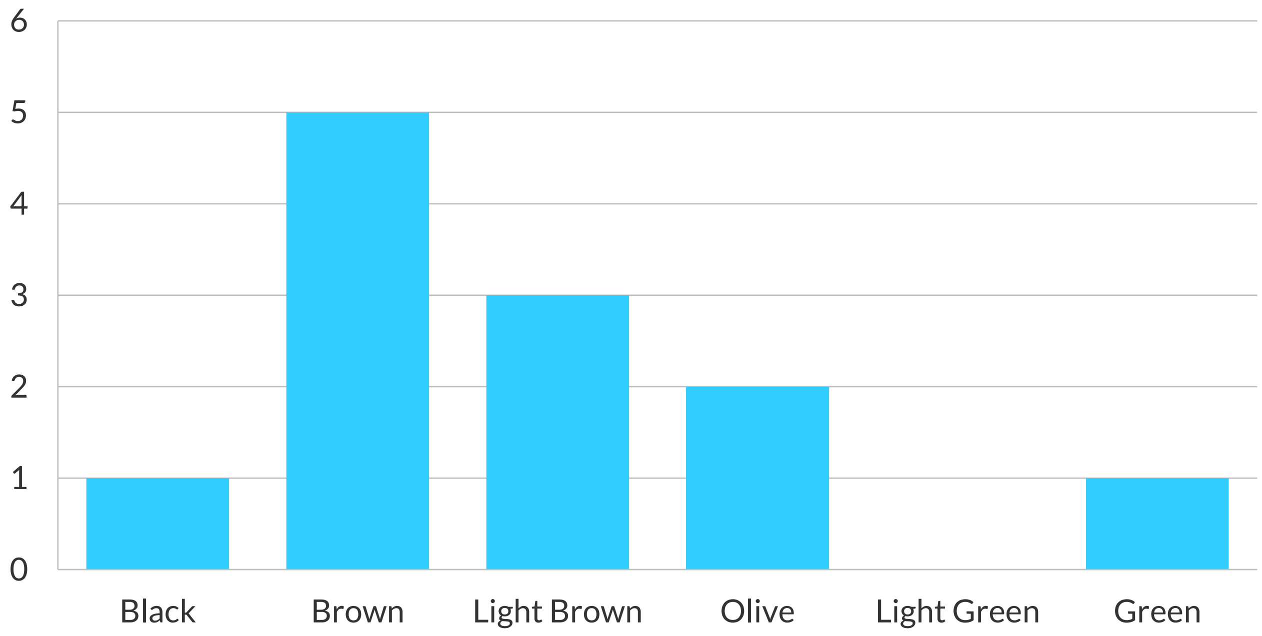
Assessments Flag Limits in Energy Firms Transition Plans

Plurality of Assessed Companies Receive Second-Lowest Grade

Number of companies assessed per TA grade (January 2024)



Note: Individual TA company reports include '+' and '-' sub-grades to provide additional granularity; n = 12 TAs
Source: Sustainable Fitch

Progress on Net Zero Transition is Limited

- Six of the 12 energy companies assessed achieve one of the two lowest grades, which indicate inadequate plans and limited real-world progress on transitioning to net zero through greening and decarbonising.

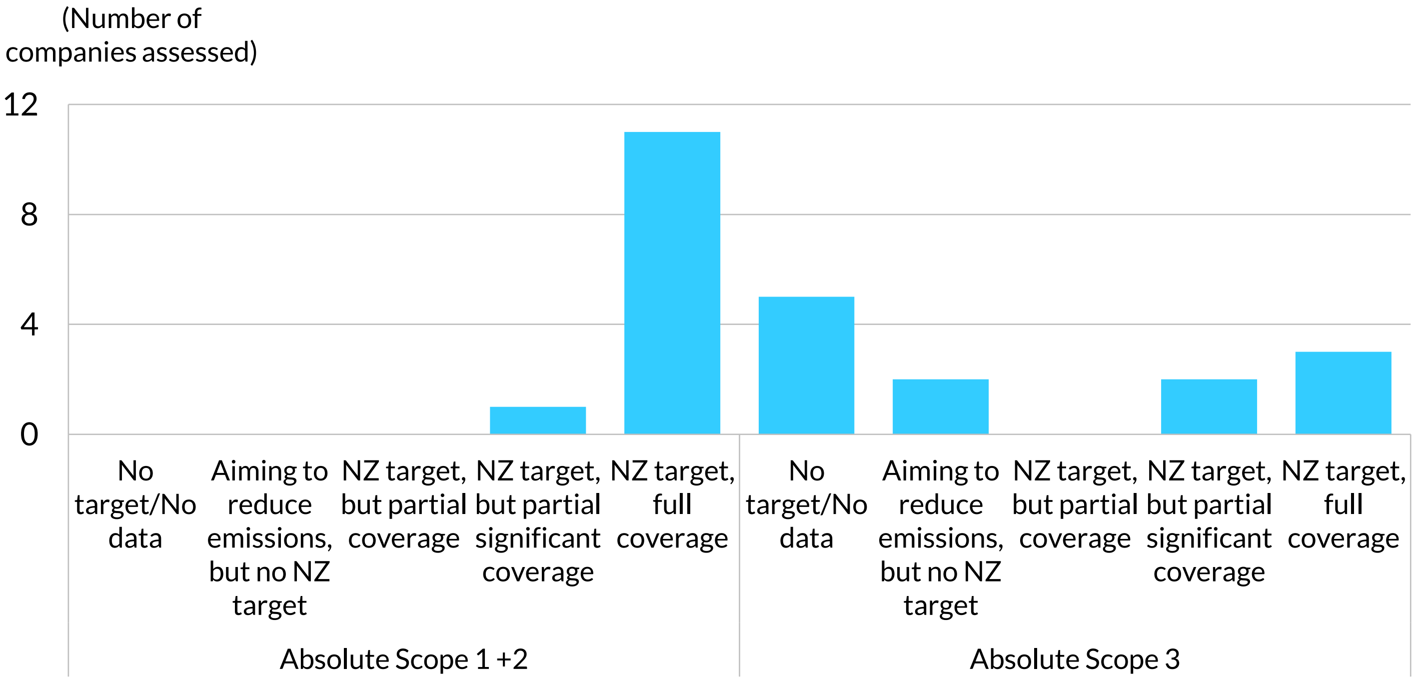
Company Profiles Tend to Correspond with Grades

- International oil companies (IOC) generally indicate higher levels of ambition and more progress in transitioning.
- National oil companies (NOC) and independents mostly score in the brown range.
- Just one TA resulted in a green grade – an energy company with an electricity business with significant renewables capacity.

Emissions Targets Common But Patchy

More Ambition Needed on Absolute Scope 3 2050 Targets

Companies Assessed under TA - 2050 Net Zero (NZ) Targets



Source: Sustainable Fitch Transition Assessment Data (January 2024)

All Firms Assessed Have Scope 1&2 Targets

- These are the 'low hanging fruit' – they are small share of energy companies carbon footprints and don't involve making substantial changes to their business models.
- Minority of companies have Scope 3 targets with full coverage; Scope 3 the largest share of overall footprint for energy companies (Category 11 – use of sold products).

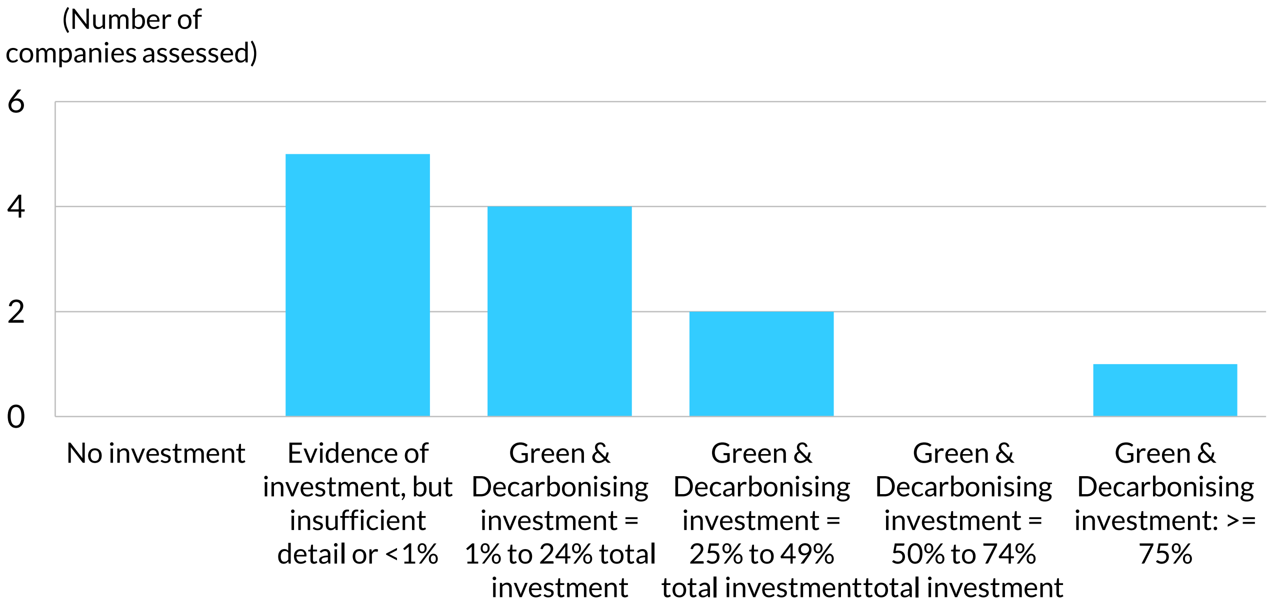
Scope 3 Reporting Remains Challenging

- Scope 3 disclosures usually limited – e.g. doesn't include all relevant categories; where data reported, roughly even split between firms with rising and falling Scope 3 emissions.
- Reductions more consistent for Scope 1&2, reflecting efficiencies in own operations.

Disconnect Between Targets and Core Strategy

Green Capex Remains Very Low for Most Energy Entities Assessed

TA - Greening and Decarbonising Investment Metrics



Source: Sustainable Fitch Transition Assessment Data (January 2024)

Various Approaches to Greening…

- Strategies for greening/decarbonising companies vary; often involve investing in and building out renewables or low-carbon business areas.

… But Limited Evidence of Concrete Steps

- Overall, companies' climate goals are not adequately reflected in their capex plans.
- Just one O&G company has committed to materially decreasing hydrocarbon production; in most cases, no evidence of structural shift away from fossil fuels.

'Green' Investment Data Sometimes Opaque

- Capex for greening and decarbonizing often not identifiable. Where it is disclosed, the indicators used are sometimes opaque, raising the possibility that non-green technologies are included.

Related Research

Sustainable Markets Initiative's Transition Framework press release, November 2022

BP Transition Assessment, July 2023

Insights into the data - Transition Assessments Flag Hurdles for Energy Companies, February 2024

Iberdrola Transition Assessment, March 2024

Sustainable Fitch's Transition Assessment Methodology, April 2024

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