

S&P Global Ratings

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Second Party Opinion



CAP Group Sustainability-Linked Financing Framework

Dec. 4, 2023

Editor's note: This SPO report is based on S&P Global Ratings' "[Analytical Approach: Second Party Opinions and Transaction Evaluations](#)" dated Dec. 7, 2022, which was partly superseded by S&P Global Ratings' "[Analytical Approach: Second Party Opinions: Use of Proceeds](#)," dated Jul. 27, 2023, following the launch of our integrated use-of-proceeds SPOs.

CAP Holding S.p.A. is an Italian water utility company founded in 1928 and based in Milan. It is owned by local authorities. It provides integrated water management services (96% of 2022 revenues) in the municipalities of the Metropolitan City of Milan and in other municipalities located in the provinces of Monza and Brianza, Pavia, Como, and Varese. The group provides water to about 2.5 million inhabitants through its purification and drainage system. It also operates water kiosks, offers sewer and wastewater treatment services, and produces bio-methane from sludge and wastewater. Moreover, it is active in waste processing and renewable energy production, either through photovoltaic plants or gas production in sewage treatment plants.

In our view, Cap Group's Sustainability-Linked Financing Framework, is aligned with:

-  Sustainability-Linked Bond Principles, ICMA, 2023
-  Sustainability-Linked Loan Principles, LMA/LSTA/APLMA, 2023

Issuer's Sustainability Objectives

As a provider of integrated water services, the company aims to contribute to climate change mitigation and economic development while promoting water quality and water control. CAP Group's long-term sustainability strategy strives to understand how future scenarios could evolve and anticipate the effects of key social, environmental, and economic trends. In line with its decarbonization strategy, the company has committed to the Science-Based Targets initiative (SBTi) and to keeping global temperature increases below 1.5°C compared to pre-industrial levels.

The group has developed its Sustainability-linked Financing Framework (the framework) to align its financing and sustainability strategy and support the U.N.'s Sustainable Development Goals (SDGs), as well as the EU Taxonomy's environmental objective of climate change mitigation. CAP Holding (the larger operating entity of the group) holds a stake in four different entities--ZeroC (80%), Pavia Acque (10%), Neutalia (33%), and Amiacque (100%)--together referred to as CAP Group. While the scope of the framework applies to all of CAP Group, the perimeter for the various KPIs only applies to CAP Holding and wholly consolidated subsidiary Amiacque, in line with CAP Group's reporting in its non-financial report. CAP Group confirms that future issuances done under the framework will be issued exclusively at the CAP Holding level. Nonetheless, we understand that proceeds can be transferred to all subsidiaries that are charged with delivering the relevant investments, via intercompany loans or equity capital. CAP Group's total revenues were about €433 million in 2022, almost entirely attributable to CAP Holding S.p.A.

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Selected Key Performance Indicators (KPIs) And Sustainability Performance Targets (SPTs)


KPI	SPT	Baseline	2022 performance
Absolute scopes 1 and 2 GHG emissions calculated as tCO ₂ eq	42% reduction of absolute scopes 1 and 2 GHG emissions in 2030 versus a 2021 base year	120.838,3 tCO ₂ e (2021)	116.852 tCO ₂ e
Absolute scope 3 GHG emissions calculated as tCO ₂ eq.	25% reduction of absolute scope 3 GHG emissions in 2030 versus a 2021 base year	54.466 tCO ₂ e (2021)	72.080 tCO ₂ e
Water leaks (M1b)	17% real water leaks by 2027 versus a 2018 base year	24% (2018)	20.49%

Second Party Opinion Summary


Selection of key performance indicators (KPIs)

Alignment	 CAP Group's Sustainability-Linked Financing Framework is aligned with this component of the Sustainability-Linked Bond Principles and Sustainability-Linked Loan Principles (SLBP and SLLP).				
KPI 1	Absolute scopes 1 and 2 GHG emissions calculated as tCO ₂ eq	Not aligned	Aligned	Strong	Advanced
KPI 2	Absolute scope 3 GHG emissions calculated as tCO ₂ eq.	Not aligned	Aligned	Strong	Advanced
KPI 3	Water leaks (M1b)	Not aligned	Aligned	Strong	Advanced

Calibration of sustainability performance targets (SPTs)

Alignment	 CAP Group's Sustainability-Linked Financing Framework is aligned with this component of the Sustainability-Linked Bond Principles and Sustainability-Linked Loan Principles (SLBP and SLLP).				
SPT 1	42% reduction of absolute scope 1 and 2 GHG emissions in 2030 versus a 2021 base year	Not aligned	Aligned	Strong	Advanced
SPT 2	25% reduction of absolute scope 3 GHG emissions in 2030 versus a 2021 base year	Not aligned	Aligned	Strong	Advanced
SPT 3	17% real water leaks by 2027 versus a 2018 base year	Not aligned	Aligned	Strong	Advanced


Instrument characteristics

Alignment  CAP Group's Sustainability-Linked Financing Framework is aligned with this component of the Sustainability-Linked Bond Principles and Sustainability-Linked Loan Principles (SLBP and SLLP).

If CAP Group does not achieve the SPTs by the target observation date or fails to report on the applicable KPI of the respective sustainability-linked financing instrument, a so-called trigger event will occur. This will result in a change in the instrument's financial characteristics. Then, any instrument the company issues under this framework will be subject, but not limited, to a coupon step-up, margin adjustment and/or a higher or a lower redemption price payable. Furthermore, the issuer defines a fallback mechanism if the performance of the SPT against each KPI cannot be calculated or observed in a satisfactory manner.

Reporting

Second Party Opinion


Alignment  CAP Group's Sustainability-Linked Financing Framework is aligned with this component of the Sustainability-Linked Bond Principles and Sustainability-Linked Loan Principles (SLBP and SLLP).

Score Not aligned Aligned **Strong** Advanced

CAP Group commits to publish annually the absolute performance of each relevant KPI, any potential recalculations, and the measures it is taking to progress toward its SPT, on its website and/or in its sustainability report.

The reporting may also disclose information on the reassessment and restatement of the SPT as well as potential contributors to the evolution of the KPI's performance.

Post-issuance review


Alignment  CAP Group's Sustainability-Linked Financing Framework is aligned with this component of the Sustainability-Linked Bond Principles and Sustainability-Linked Loan Principles (SLBP and SLLP).

CAP Group commits to have an annual independent and external verification of its performance against the KPI, and a verification assurance issued on the observation date(s) as to whether the relevant SPTs have been achieved. The issuer will integrate these in its sustainability report and/or on its website.

Framework Assessment

Selection of key performance indicators (KPIs)

The Principles make optional recommendations for stronger structuring practices, which inform our relevancy opinion as aligned, strong, or advanced. For each KPI, we consider how relevant the KPI is for sustainability by exploring the clarity and characteristics of the defined KPI; its significance for the issuer’s sustainability disclosures; and how material it is to the issuer’s industry and strategy.

 CAP Group's Sustainability-Linked Financing Framework is aligned with this component of the Sustainability-Linked Bond Principles and Sustainability-Linked Loan Principles (SLBP and SLLP).

KPI 1	Absolute scopes 1 and 2 GHG emissions calculated as tCO ₂ eq	Not aligned	Aligned	Strong	Advanced
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We consider the selected KPI to be strong given that the scope, objective, and calculation methodology are clearly articulated in the framework. The KPI addresses a highly relevant matter for the water utility sector, which is also embedded in the company’s sustainability strategy. The KPI, aimed at an absolute reduction in scopes 1 and 2 emissions from own operations, contributes to the global effort to address climate change.

We view favorably that the selected KPI is directly linked to the issuer's sustainability strategy and the group's overarching goal of reducing emissions in line with the 2015 UN Paris Agreement. It is one of the most frequently used KPIs in the market, allowing for external benchmarking. Furthermore, the issuer has calculated the KPI in line with the GHG Protocol and GRI Standards, the most widely used international standards.

Scope 1 emissions result from CAP Group's own sources of emissions, while indirect scope 2 emissions stem from the generation of purchased electricity consumed for plants and offices, taking a location-based approach. We acknowledge that reducing scopes 1 and 2 emissions is necessary for the group to achieve its sustainability objectives. The scope of this KPI represents about 62% of total GHG emissions (scopes 1, 2, and 3) in 2022, making it a key indicator to address. In 2022, CAP Group submitted to the SBTi its target for scopes 1 and 2 emissions, by which it aims to align with the 1.5 °C scenario. The SBTi is still validating this target. We understand that CAP Group’s definition of scope 1 emissions in this KPI is wider than it previously disclosed in its public verified reporting. This reflects its inclusion of new minor activities, among others, for the sake of the SBTi's validation processes. Therefore, the historical trajectory of scope 1 and 2 emissions presented in the framework has not been externally verified. From 2023 onward, the group will report its emissions according to SBTi calculations.

KPI 2	Absolute scope 3 GHG emissions calculated as tCO ₂ eq	Not aligned	Aligned	Strong	Advanced
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We consider the second KPI selected by CAP Group to be strong considering the scope, objective, and calculation, which are clearly articulated in the framework. The KPI addresses a highly relevant matter for the water utility sector, which is also embedded in the group’s sustainability strategy.

We believe this KPI will allow CAP Group to measure its progress toward its strategic goal of reducing its environmental footprint. Scope 3 emissions accounted for 38% of the group's total reported greenhouse gas emissions in 2022. Not all scope 3 categories are included in the KPI; CAP Group decided to include the categories it deems relevant and in which it has the power to reduce emissions through reduction strategies. The emissions mainly relate to the GHG Protocol categories of purchased goods and services (3.1), capital goods (3.2), fuel- and energy-related activities (3.3), upstream transportation and distribution (3.4), waste generated in operations (3.5), employee commuting (3.7), and use of sold products (3.11).

Second Party Opinion

The method of calculating scope 3 emissions defined in this KPI differs from the scope 3 emissions the group previously disclosed in its public verified reporting. Specifically, for the SBTi validation, the KPI follows the location-based approach, whereas the group has historically disclosed scope 3 emissions in line with the market-based approach. Therefore, the historical trajectory of scope 3 emissions presented in the framework has not been externally verified. From 2023 onward, CAP Group will include location-based values for each scope.

The difference in values between both approaches lies in the calculation of Category 3 (one of the scope 3 categories), which encompasses "Fuel- and energy-related activities (not included in scope 1 or scope 2)". This category covers the upstream emissions associated with the electricity purchased by a reporting company, which includes the extraction, production, and transportation of fuels used in electricity generation, as well as emissions from transmission and distribution (T&D) losses during electricity transmission. These emissions are determined based on the kilowatt-hours (kWh) consumed by the organization.

KPI 3 Water leaks (M1b)

Not aligned

Aligned

Strong

Advanced

We believe the selected KPI is aligned with the Principles given that the scope, objective, and calculation methodology are clearly articulated in the issuer's framework. We consider the selected KPI to be relevant, core, and material to the issuer's operations.


The underlying metric for this KPI, M1b, measures the ratio of the total volume of real water leaks to the total volume of water entering the aqueduct system in the year under consideration. It is an indicator defined by ARERA, the Italian Regulatory Authority for Energy, Networks and Environment, and is used by water utilities in Italy and Europe. This makes it possible to externally benchmark the issuer's performance.

The selected KPI aligns with the issuer's strategic objectives and the environmental and social priorities the group aims to address by 2033. This includes reducing overall water consumption by improving network efficiency, as well as safeguarding water resources. Reducing water leakage and loss is particularly relevant in the context of Italy's water crisis, which has accelerated in recent years. According to the country's National Institute of Statistics (ISTAT), Italy has become increasingly vulnerable to draughts given its old and leaky aqueduct system and now needs to draw more water from its rivers, lakes, and reservoirs than any other country within the EU. In 2020, Italy's aqueducts lost more than 40% of the water they carried, according to the institute. For further information on the challenges to water infrastructure in Italy and globally, please refer to "[Sustainability Insights Research: Lost Water: Challenges And Opportunities](#)", published Sept. 6, 2023.

While the ICMA SLB KPI registry defines the selected metric as of secondary relevance to water utilities, we consider water leakage to be a relevant and material metric for CAP group given the context described above and the KPI's alignment with the issuer's sustainability strategy.

Calibration of sustainability performance targets (SPTs)

The Principles make optional recommendations for stronger structuring practices, which inform our ambition opinion as aligned, strong, or advanced. We consider the level of ambition for each target by assessing its clarity and characteristics, how the issuer defines the target with reference either to its past performance, or to external or competitor benchmarks, and how it explains what factors could influence future performance.

 CAP Group's Sustainability-Linked Financing Framework is aligned with this component of the Sustainability-Linked Bond Principles and Sustainability-Linked Loan Principles (SLBP and SLLP).

SPT 1 42% reduction of absolute scope 1 and 2 GHG emissions in 2030 versus a 2021 base year

Not aligned

Aligned

Strong

Advanced

Second Party Opinion

We consider the ambition, clarity, and characteristics of SPT 1 to be aligned with the requirements of the Principles. The issuer's framework outlines the strategy to reach the target and presents relevant information on future projects it plans to undertake. It also clarifies the expected observation date and trigger events. Specifically, a 42% reduction of absolute scopes 1 and 2 GHG emissions is targeted for Dec. 31, 2030. Furthermore, the issuer commits to provide annual SPTs (if required) in the context of loan transactions for all SPTs under the framework.

With respect to historic performance, between 2020 and 2022, CAP Group's scopes 1 and 2 emissions increased by a 1.4% average annual (6% increase between 2020 and 2021 and 3% reduction between 2021 and 2022). The increase in emissions was driven mainly by higher natural gas combustion in 2021, versus 2020. The annualized rate of reduction required to reach the target by 2030 is 5.9%. We understand that the issuer has not conducted a separate benchmark assessment to calibrate the target in relation to peers' targets.

The company discloses in the framework the steps it needs to take to reach the target. Specifically, it has developed an internal decarbonization strategy. Planned actions include the partial electrification of the group's fleet of vehicles and the installation of photovoltaic panels for on-site energy generation. Additional measures include installing more-efficient monitoring systems at all wastewater treatment plants, among others. The strategy also relies on external factors outside the issuer's control, such as the expected decarbonization of Italy's energy mix.

Currently, CAP Group annually offsets 100% of its market-based certified emissions by acquiring dedicated carbon credits. However, in accordance with ISO 14064-1 standards and the SBTi, CAP Group is not factoring its carbon credit offsets into its emissions calculations. We view this as a positive move alongside its other decarbonization measures.

In 2022, CAP Group submitted to the SBTi its target for scopes 1 and 2 emissions reductions as being in line with the 1.5 °C scenario and scope 3 aligned with the well-below 2 °C scenario, based on reductions of 42% and 25%, respectively. The SBTi is still validating the target, which is expected before the end of the year, but we view the commitment positively. Based on SBTi data as of October 2023, of the 23 companies in CAP Group's sector that have a public commitment in place to set science-based targets, only 11 have obtained an SBTi validation so far.

SPT 2 25% reduction of absolute scope 3 GHG emissions in 2030 versus a 2021 base year

Not aligned

Aligned

Strong

Advanced

We consider the ambition, clarity, and characteristics of the SPT 2 to be aligned with the requirements of the Principles given that the issuer clearly outlines the target's timeline, the observation date, the trigger events, and the strategy to reach the target.

With respect to historic performance, between 2020 and 2022, the company reports an average increase in emissions of 22% (11% increase between 2020 and 2021 and 32% increase between 2021 and 2022). The increasing trajectory of scope 3 emissions through the years derives from a combination of different elements: an increase in volumes of sludge disposed, perimeter expansion, and an improvement in reporting standards, such as replacing modelled inputs with actual data. However, the company confirms that the methodology used to calculate scope 3 emissions remained consistent between 2020 and 2022.

The group would need to achieve a 25% reduction in scope 3 emissions by 2030, compared to 2021, to meet its target, requiring an approximate annual reduction of 3.15%. This represents an improvement compared to a business-as-usual trajectory, which strengthens the target's ambition, in our view.

The framework includes some information on the strategy for achieving the target. The group's primary focus is on improving energy efficiency and operational performance, including the optimization of chemicals used in wastewater treatment, among other measures.

Like for SPT1, in 2022 CAP Group submitted to the SBTi its target for scope 3 emissions reductions as being well below the 2°C scenario. The target is still pending validation, which is expected to occur before the end of the year, but we view the commitment positively. Based on SBTi data as of October 2023, of the 23 companies in CAP Group's sector that have a public commitment in place to set science-based targets, only 11 have obtained an SBTi validation so far.

Second Party Opinion

SPT 3 17% real water leaks by 2027 versus a 2018 base year

Not aligned

Aligned

Strong

Advanced

We believe the ambition, clarity, and characteristics of SPT 3 are aligned with the Principles.

The issuer clearly outlines the timeline for achieving the target, the target observation date, the trigger events, potential risk factors, and the strategy to reach the target.

While we understand that the issuer has not conducted a peer benchmarking exercise, it has calibrated the target against its 2020-2022 performance. This was when CAP Group managed to reduce its water leakage rate (M1b) from 21.00% to 20.49%, resulting in a 0.2% reduction per year on average. To achieve the objective of 17% by 2027, from the 24% baseline in 2018, the group will need to reduce its leakage rate by 0.78% each year, which is more than the historic trend.


Nonetheless, we note that there are several external factors that could impact the reduction trend to 2027. These include regulatory pressures and constraints as well as dry periods and increased water demand. The issuer managed to reduce M1b to 21% by 2020, from the 2018 24% baseline. This means it has already achieved a significant reduction, which somewhat limits the ambition of the target, in our view.

To further contextualize the objective, we note that in a 2020 report ARERA found that the average aqueduct leakage rate across a sample of 85 operators was 41.2%. While the study confirms that leakages are generally lower in Italy's north (where CAP Holding operates) than in the center and south (where nearly half the water injected into the aqueduct systems is lost), we believe that this report highlights the target as ambitious, albeit somewhat limited as we note above.

To reach the calibrated target, the issuer plans various strategic initiatives to improve water leakage. These include investments to identify and reduce losses by means of innovative systems (for example, satellite monitoring), increasing the coverage of smart metering, and better allocating capital expenditure for network replacement. The strategy carries various constraints and risks, including regulatory considerations and a tariff structure that currently does not allow for a pipe replacement rate of more than 1% per year.

Instrument characteristics

The Principles require disclosure of the type of financial and/or structural impact involving trigger event(s), as well as the potential variation of the instrument's financial and/or structural characteristics.

 CAP Group's Sustainability-Linked Financing Framework is aligned with this component of the Sustainability-Linked Bond Principles and Sustainability-Linked Loan Principles (SLBP and SLLP).

The issuer commits to include, within the final terms and conditions of each sustainability-linked instrument, a description of the trigger event that will take place if the company fails to meet one or more SPTs by the relevant observation dates, or if it fails to publicly report information on the performance against the targets for each KPI.

Following a trigger event, the financial characteristics of the relevant sustainability-linked instrument will change. This could occur through, for example, a revision of the interest rate, such as a step-up. It could also occur through the payment of a higher or lower amount upon redemption of the sustainability-linked instrument. The possible changes occurring upon a trigger event will be specified within the final terms and conditions of each bond/loan issued. Furthermore, the issuer defines a fallback mechanism if the performance of the SPT against each KPI cannot be calculated or observed in a satisfactory manner.

The framework includes target observation dates linked to all KPIs. In addition, the issuer commits to have annual targets (if applicable) based on the expected SPT trajectories linked to any loans issued under the framework, in line with the requirements of the Sustainability-Linked Loan Principles.

Second Party Opinion

Reporting

The Principles make optional recommendations for stronger disclosure practices, which inform our disclosure opinion as aligned, strong, or advanced. We consider plans for updates on the sustainability performance of the issuer for general purpose funding, or the sustainability performance of the financed projects over the lifetime of any dedicated funding, including any commitments to post-issuance reporting.

- ✓ CAP Group's Sustainability-Linked Financing Framework is aligned with this component of the Sustainability-Linked Bond Principles and Sustainability-Linked Loan Principles (SLBP and SLLP).

Disclosure score

Not aligned

Aligned

Strong

Advanced

We consider CAP Group's overall reporting practices to be strong.

CAP Group commits to disclose the performance of the relevant KPI against the respective SPTs, as well as any relevant information for the assessment of the KPI's performance, including the application of any recalculation procedure, where applicable, and the measures the issuer takes to progress the KPI toward its respective SPT annually on its website and/or sustainability report. Further, CAP Group will disclose information on the sustainability-linked impact and its timing on the instrument's economic characteristics. We view positively that the issuer commits to provide annual information on the drivers that could affect the KPIs' performance; illustrate the positive sustainability impacts of its performance improvement; and clarify potential reassessments of KPIs and/or restatements of SPTs, if relevant.

CAP Group commits to make the external verification report (limited assurance), which covers the performance of the stated KPI, publicly available. We view positively that the issuer will disclose the information regarding potential material changes to its corporate and sustainability strategy, as well as show the positive sustainability impacts achieved as the KPIs progress toward the SPTs. The issuer has also clearly defined potential recalculation events. Moreover, the issuer commits to provide annual SPTs in case of loan transactions.

Post-issuance review

The Principles require post-issuance review commitments including the type of post-issuance third-party verification, periodicity, and how this will be made available to key stakeholders. Our opinion describes whether the documentation is aligned or not aligned with these requirements. Please note, our second party opinion is not itself a post-issuance review.

- ✓ CAP Group's Sustainability-Linked Financing Framework is aligned with this component of the Sustainability-Linked Bond Principles and Sustainability-Linked Loan Principles (SLBP and SLLP).









CAP Group commits to have its performance against all SPTs verified annually and included on its website and/or in its sustainability report. The issuer commits to make the assurance statement readily available to investors. Every year, an external independent auditor will verify the company's annual report, including the performance against the SPTs for each KPI in the framework. The framework will benefit from a verification assurance certificate issued on the observation date(s) confirming whether the performance of the KPI meets the relevant SPT, which CAP Group will then publish on its website following the target observation date.

Mapping To The U.N.'s Sustainable Development Goals

Second Party Opinion

The Sustainable Development Goals (SDGs), which the United Nations (U.N.) set up in 2015, form an agenda for achieving sustainable development by 2030.

CAP Group's Sustainability-Linked Financing Framework intends to contribute to the following SDGs:

KPI	SDGs
Absolute Scope 1 & 2 GHG emissions calculated as tCO ₂ eq.	   9. Industry, innovation and infrastructure§ 11. Sustainable cities and communities§ 13. Climate action§
Absolute Scope 3 GHG emissions calculated as tCO ₂ eq.	   9. Industry, innovation and infrastructure§ 11. Sustainable cities and communities§ 13. Climate action§
Water leaks (M1b)	  6. Clean water and sanitation§ 13. Climate action§

§The KPI is likely to contribute to the SDGs.

Second Party Opinion

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