

# Green is The New Gold

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Intermonte Research Team

## Green is The New Gold

This report describes the measures under consideration in Europe for the promotion of sustainable investments. Sustainability, as measured by observation of environment, social and governance (ESG) factors, is destined to become an increasingly important element of traders' investment decisions and of the choices made by issuers in terms of both the investments they make and how they communicate to the market.

The report analyses the main instruments announced by the EU, which plans to mobilise over Eu1tn of resources over the next ten years through Next Generation EU, the European Green Deal and the Action Plan. The aim is to bring some clarity within a rapidly-evolving process and raise the awareness of listed companies and investors of the importance of these instruments in shaping future investment decisions.

- **Europe to promote massive investments over the next 10 years: taxonomy is the key.** In a nutshell, the EU Commission is working on a wide and unprecedented package of measures, amounting to over Eu1tn, to relaunch the EU economy through sustainable, green investments. The combination of public and private capital that will be allocated to these investments represents a major opportunity that cannot be missed. The pandemic accelerated the process, with the urgent launch of the Next Generation EU plan building on the flagship Green Deal announced by the new EU Commission President Von der Leyen in December 2019 and the Action Plan. Our report delves into the details of these plans and the Taxonomy. An economic activity is deemed to be taxonomy-aligned if it satisfies three conditions: 1) it substantially contributes to at least one of the six environmental objectives defined in the Regulation, the first two of which, Climate Change Adaptation and Climate Change Mitigation, will be implemented at the end of 2021; 2) it does no significant harm to any of the other five environmental objectives; 3) it complies with minimum social safeguards. There is no doubt that this represents a key element for the understanding, implementation and success of the EU's plans.
- **Sustainability, in particular ESG themes, will become increasingly crucial for listed companies and investors.** These themes are increasingly pervasive within the investment community. In our view, the crucial advantages for listed companies with a strong ESG focus will be: *i) increased resilience and more sustainable growth profile; ii) reduced cost of capital; iii) gaining access to new investors and flows; iv) enhanced reputation.* We expect Italian companies to place increasing focus on these factors, which will entail enhancing their efforts in terms of investing in sustainability, repositioning some businesses, and improving non-financial disclosure.
- **Exponential growth in ESG investments and introduction of sustainable investment criteria by the EU.** ESG investments are riding a surge in popularity: in 2018, AuM in North America, Europe and Japan exceeded USD30.7tn (+34% in the 2016-18 period) according to the 2018 Global Sustainable Investment Alliance survey. Retail investors' interest in sustainable investments is also growing, with the SRI asset breakdown reported in the 2018 European SRI study showing an increase in the share pertaining to retail investors from 3.40% in 2013 to 30.77% in 2020. The EU Action Plan introduces the need to incorporate sustainability into financial advice and instructs institutional investors and asset managers to specify whether they take ESG factors into consideration in their investment decisions, and how such factors are integrated into their risk management approach. These factors are therefore destined to become of increasing relevance and importance for all financial market players.
- **Our Selected List.** We have shortlisted 10 Italian stocks that we think have positive green investment angles and which, in our view, could deserve higher valuations and offer interesting upside potential. We have also tried to focus on stocks in the mid-small cap universe in order to highlight the potential hidden opportunities offered by some Italian stocks on these themes. Our preferred list includes Snam, A2A, Hera, ERG, STM, Saes Getters, Tinexta, Reno de Medici, Salcef, and Lu-Ve.

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## Executive Summary

**This report describes the measures under consideration in Europe for the promotion of sustainable investments. Sustainability, as measured by observation of environment, social and governance (ESG) factors, is destined to become an increasingly important element of traders' investment decisions and of the choices made by issuers in terms of both the investments they make and how they communicate to the market. The aim is also to raise the awareness of listed companies, especially mid/small caps, of these issues in order to highlight the opportunities thrown up by the likely developments in industrial policy, especially in Europe, over the coming years.**

**We analyse the main instruments announced by the EU, which plans to mobilise over Eu1tn of resources over the next ten years through Next Generation EU, the European Green Deal and the Action Plan. We seek to bring some clarity on these issues within a rapidly-evolving process that we believe will also lead to a significant permanent shift in the world of financial investment.**

**Europe to promote massive investments over the next 10 years: taxonomy is the key.** In a nutshell, the EU Commission is working on a wide and unprecedented package of measures, amounting to over Eu1tn, to relaunch the EU economy through sustainable, green investments. The combination of public and private capital that will be allocated to these investments represents a major opportunity that cannot be missed. The pandemic accelerated the process, with the urgent launch of the Next Generation EU plan building on the flagship Green Deal announced by the new EU Commission President Von der Leyen in December 2019 and the Action Plan. Our report delves into the details of these plans and the Taxonomy. An economic activity is deemed to be taxonomy-aligned if it satisfies three conditions: 1) it substantially contributes to at least one of the six environmental objectives defined in the Regulation, the first two of which, Climate Change Adaptation and Climate Change Mitigation, will be implemented at the end of 2021; 2) it does no significant harm to any of the other five environmental objectives; 3) it complies with minimum social safeguards. There is no doubt that this represents a key element for the understanding, implementation and success of the EU's plans.

**Sustainability, in particular ESG themes, will become increasingly crucial for listed companies and investors.** These themes are increasingly pervasive within the investment community.

**In our view, the crucial advantages for listed companies demonstrating a strong ESG focus will be:**

- **increased resilience and more sustainable growth profile**
- **reduced cost of capital**
- **gaining access to new investors and flows**
- **enhanced reputation**

For listed companies, this will ultimately offer the opportunity to capture additional flows and investors while benefiting from higher valuations and multiples on an absolute and relative basis. A few Italian companies, such as ENEL and Falck Renewables, are clearly already benefiting from being included as must-haves for sustainable investors, demonstrating how these factors can impact price performance. We expect Italian companies to place increasing focus on these factors, which means enhancing their efforts in terms of investing in sustainability, repositioning some businesses, and improving non-financial disclosure. Six European agencies representing banks, insurers and investment firms are asking the EU to establish a common set of practices on these themes that should allow companies to prepare better and interact more effectively with investors.

**Italian market playing catch up.** According to Bloomberg the Taxonomy eligibility of the Italian index (FTSE MIB) comes to c.29.4% of its market cap. This expresses the percentage of revenue of underlying assets that sit within a Taxonomy-eligible activity (Bloomberg definition), with reference to the first two environmental objectives (climate change mitigation and adaptation). This is lower than the average for the main European indices: for the German (DAX) and Spanish (IBEX) indices the eligibility percentages are c.38.10% and c.37.80% respectively. There is growing focus on these subjects, and we are convinced that Italian companies will not spurn the opportunity to transform, adapt and communicate their efforts to investors in the future in order to take advantage of EU investment plans as well as to attract investors' interest.

**Exponential growth in ESG investments and introduction of sustainable investment criteria by the EU.** ESG investments are riding a surge in popularity: in 2018, AuM in North America, Europe and Japan exceeded USD30.7tn (+34% in the 2016-18 period) according to the 2018 Global Sustainable Investment Alliance survey. Retail investors are also showing a growing interest in sustainable investments (going from 3.40% of the total in 2013 to 30.77% in 2017 according to the 2018 annual report published by PRI). In this report we have therefore analysed the EU Action Plan, which introduces the need to incorporate sustainability into financial advice. We have also researched the main changes in this area, including amendments to the MIFID II Directive. The Commission also requires institutional investors and asset managers to specify whether they take ESG factors

into consideration in their investment decisions, and how such factors are integrated into their risk management approach. These aspects refer to Action 7 of the Action Plan. It should also be kept in view that for institutions for occupational retirement provision (IORP), Directive (EU) 2016/2341 came into effect on 1<sup>st</sup> February 2019. Among other things the Directive, dubbed IORP II, contains an increased focus on consideration of ESG matters in the investment policies of the target funds.

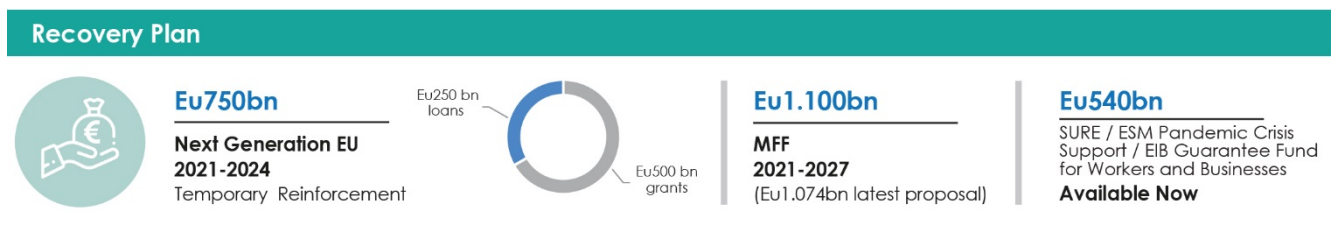
### Increasing EU focus on sustainability

We have therefore sought to trace the European path towards sustainable finance and the potential implications for investments, listed companies and investors. The Green Deal, with its multiyear investment plan, sets ambitious goals and is set to mobilise Eu1tn of investments over the next decade to make Europe a zero-emissions continent by 2050. It comes at a time of great turbulence on investment markets, with exponential growth of funds focused on sustainability, and ESG in particular.

The combination of the Green Deal and the increased focus on ESG will have extremely significant repercussions for all sectors of the economy; for listed companies it will particularly affect the issue of debt securities and access to credit, as well as the management of investments in the coming years.

With this report we attempt to provide a schematic explanation of the opportunities and challenges arising from the launch of the Green Deal and how taking these issues on board will be crucial for long-term value creation.

## EU Green Plans Wrap-up



Source: EU Commission and Intermonte SIM

### Covid-19 impact on European plans

In light of the ongoing public health emergency and economic crisis caused by the outbreak of the Covid-19 pandemic, on 27 May the European Commission presented a package of extraordinary measures to a plenary session of the European Parliament. The measures seek to repair the economic damage caused by the virus. This recovery tool, named Next Generation EU, is a Eu750bn package, Eu500bn of which comes in the form of grants and Eu250bn in loans. On top of this figure there is a further Eu1.1tn from the EU Budget, as well as Eu540bn of measures have already been approved, bringing the overall remaining firepower of the Recovery Plan to Eu1.85bn. The Eu750bn from Next Generation EU will be divided between Member States based on pro-capita revenues and the damage caused to their industrial fabric by the pandemic. As one of the most heavily-affected countries, Italy is set to receive one of the highest amounts. According to reports in the Italian press, the country will receive Eu172bn, of which Eu82bn in grants and Eu90bn in loans, corresponding to 10% of Italian GDP in total. This figure differs from those contained in official EU Commission documents. Assuming that the contribution of each State to Next Generation EU is proportional to their share of European GDP, the Commission has drawn up a table for all European Member States (reproduced in this report) according to which Italy will receive Eu153bn, of which Eu88.4bn in budget transfers, Eu51bn in loans and Eu13.6bn in guarantees.

### European Recovery Plan: Next Generation EU

The first section of this report is therefore dedicated to a succinct analysis of the Recovery Plan presented by the EU Commission: we investigate the tools at its disposal, how it will be financed and how resources will be disbursed to Member States.

According to the estimates provided by the EU Commission, roughly Eu595bn per year is needed for the relaunch of the European economy and the delivery of green and digital transitions (Eu1,190bn over the next two years, according to projections). It is estimated that Eu470bn per year will be needed in order to hit Europe's 2030 climate goals and the sectors that will be the main beneficiaries of this green wave will be: transport, buildings, renewable energy and hydrogen.

The Commission intends the Next Generation EU plan to be used to repair the short-term damage caused by the pandemic, but also to build a better future, based on a resilient, circular economy. The tool that will allow this to happen is the Green Deal, Von Der Leyen's green manifesto.

The financing of Next Generation EU will come about through EU bond issues on the markets, with the funding gathered to be distributed to beneficiary countries through the various Next Generation EU programmes. Further funding may also come from 4 proposed new taxes, which are expected to bring in c.Eu35bn of tax income per year over the next 7 years. If these taxes are rapidly approved and implemented, then Eu500bn of funding could come through bond issues and the remainder from the income from the new taxes. Commission discussions and the official documents released clearly specified that Europe's economic recovery will be based on green and digital transitions. The funds raised by the Commission will be channelled to EU programmes that were already on the agenda prior to the Covid-19 outbreak, including the Green Deal. This represents the link between the 2020 Recovery Plan and the previous Green Deal from 2019.

### **The Green Deal**

In the second part of this report, we therefore step backwards to analyse the Green Deal, which is no more or less than a roadmap with specific actions aimed at promoting the efficient use of resources to create a more resilient economy, restore biodiversity and reduce pollution. The final aim is to make Europe the first climate-neutral bloc by 2050. In order to hit its ambitious targets, the Green Deal underlines that action will need to be taken in all sectors of the economy: from the energy sector, which represents 75% of EU GHG emissions, and which will need to drive decarbonisation by promoting the use of renewable energy sources; the building sector (40% of energy consumption) which will be involved in the so-called Renovation Wave that, according to the Adjusted Commission Work Programme, will be unveiled in more detail in the third quarter of 2020; and finally the European industrial sector, in which at the moment only 12% of the materials used are recycled, and transport, responsible for 25% of GHG emissions, which will be tackled by the green wave.

The financing of the Green Deal goes through a well-structured plan, the Green Deal Investment Plan presented on 14 January 2020, which mobilises Eu1tn of investments for projects dedicated to tackling climate change and improving the environment. Part of our analysis is therefore devoted to the financing of this plan, which in addition to the ECB also involves the EIB and private sector operators from the industrial and finance sectors. We also considered it essential to analyse the Just Transition Mechanism, which has funds for a fair and just transition, to ensure that the switch to a clean economy involves the entire continent, with no one being left behind. The dedicated Just Transition Fund is intended to alleviate the socio-economic impact of the green transition in countries that are more heavily dependent on fossil fuels.

### **The Action Plan**

The foundation stone of European sustainability legislation is the Action Plan on Sustainable Finance. The plan, adopted by the European Commission in March 2018, has 3 main objectives: 1) reorient capital flows towards sustainable investment, in order to achieve sustainable and inclusive growth; 2) manage financial risks stemming from climate change, environmental degradation and social issues; 3) foster transparency and long-termism in financial and economic activity. In more detail, it is a policy manifesto containing 10 actions that embrace and involve the entire financial market value chain. The Action Plan was drawn up by the High Level Expert Group on Sustainable Finance with two fundamental objectives: improve the contribution of finance to sustainable and inclusive growth, and incorporate ESG considerations into investment decisions. We have only gone into more detail on the most significant of the 10 Action Plan points, in particular the European Taxonomy, the green vocabulary of sustainable investment, to which we have dedicated a more in-depth analysis.

## Our Selected List on Green Wave

The main focus of this report is on green plans to support sustainable investments and industrial transition, and to achieve the ambitious EU goals on emissions. We are in the process of stepping-up our analysis of these themes along with ESG for Italian listed stocks. We will focus on mid-small caps, which are currently much less under the spotlight regarding these trends, with the exception of some specific situations. In our preliminary screening, stocks pertaining to the utilities sector appear to be the clear beneficiaries of green investments. However, we believe that in the future, with greater knowledge and details of the plans, the universe of investable stocks for green issues will increase significantly. Among sectors, we see opportunities for tech, industrials and some consumers in particular. We have shortlisted 10 Italian stocks that we think have positive green investment angles and which, in our view, could deserve higher valuations and offer interesting upside potential. We have also tried to focus on stocks in the mid-small cap universe in order to highlight the potential hidden opportunities offered by some Italian stocks on these themes.

Among our preferred list we include some utilities such as Snam (hydrogen), A2A and Hera (hydro and waste), and ERG (renewables). We also include a large-cap tech stock such as STM, whose products are functional to the environmentally friendly transition to electric mobility, and in general for industrial processes. We have also listed some Italian mid-small caps that we like for their positive green angles such as Saes Getters, Tinexta, Reno de Medici, Salcef, and Lu-Ve.

### Our Selected List on Green Wave - Target Price and Recommendation

Company	Sector	Mkt Cap	Price	TP	Upside	Recommendation
STMICROELECTRONICS	Industrials	22550	24.78	25.80	4.1%	OUTPERFORM
SNAM	Utilities	15053	4.48	4.90	9.4%	OUTPERFORM
HERA	Utilities	4787	3.21	4.20	30.7%	OUTPERFORM
A2A	Utilities	3875	1.24	1.70	37.4%	OUTPERFORM
ERG	Utilities	3145	20.92	21.00	0.4%	OUTPERFORM
TINEXTA	Industrials	653	14.10	16.00	13.5%	BUY
SALCEF GROUP	Industrials	506	11.95	12.90	7.9%	OUTPERFORM
SAES GETTERS	Industrials	477	24.35	30.00	23.2%	OUTPERFORM
RENO DE MEDICI	Industrials	281	0.75	1.00	34.2%	OUTPERFORM
LU-VE	Industrials	262	11.80	12.50	5.9%	OUTPERFORM

Source: Intermonte SIM

### Our Selected List on Green Wave – Multiples

Company	EV/EBITDA 20	EV/EBITDA 21	EV/EBITDA 22	P/E 20	P/E 21	P/E 22	ND/EBITDA 20	ND/EBITDA 21	ND/EBITDA 22
STMICROELECTRONICS	13.5.x	9.2.x	6.9.x	32.7.x	19.7.x	15.8.x	0.4.x	0.7.x	0.9.x
SNAM	11.0.x	10.7.x	10.8.x	14.0.x	13.3.x	13.4.x	-5.7.x	-5.6.x	-5.8.x
HERA	7.4.x	7.0.x	6.8.x	16.9.x	15.0.x	14.2.x	-3.0.x	-2.8.x	-2.6.x
A2A	6.6.x	6.5.x	6.2.x	12.7.x	12.0.x	10.7.x	-2.9.x	-2.9.x	-2.8.x
ERG	9.4.x	8.9.x	8.4.x	35.7.x	31.4.x	30.3.x	-3.0.x	-2.8.x	-2.5.x
TINEXTA	10.5.x	8.8.x	7.7.x	18.0.x	15.0.x	13.6.x	-1.5.x	-0.8.x	-0.3.x
SALCEF GROUP	6.0.x	5.1.x	4.6.x	12.9.x	11.7.x	11.0.x	0.8.x	1.1.x	1.4.x
SAES GETTERS	12.5.x	9.3.x	7.6.x	55.2.x	25.5.x	20.4.x	3.8.x	3.0.x	2.8.x
RENO DE MEDICI	4.7.x	3.9.x	3.5.x	13.2.x	9.9.x	9.3.x	-0.5.x	-0.1.x	0.2.x
LU-VE	8.6.x	6.1.x	5.2.x	20.7.x	11.7.x	9.4.x	-2.5.x	-1.4.x	-0.9.x

Source: Intermonte SIM

### Action on the Stocks

- STM (OUTPERFORM TP Eu25.80):** STMicroelectronics has been a signatory to the United Nations Global Compact since 2000, and has contributed to 10 of the 17 SDGs. The company is positively exposed to long-term environmental trends reshaping society: STM technologies and products are key enablers of safer, greener mobility, and advanced power & energy management across all types of systems and devices. Company solutions address four end markets: Automotive (~30% of turnover); Industrial (~30% of turnover), Personal Electronics (~25%) and Communications (~15%). The company has also set ambitious environmental targets for 2020, such as tripling the percentage of revenues generated by responsible products vs 2016; as of 2019, 62% of new manufactured products were classed as sustainable technology. Despite the short-term challenges due to Covid-19, we think that the current emergency is reinforcing the pre-existing secular growth trends in the sector. More importantly, we see STM products gaining traction, which suggests technological and commercial leadership. On top of that, we continue to appreciate the balanced exposure by end-market, and the strong relationships with industry leaders such as Apple,

Huawei, Samsung, Tesla, Bosch, Continental, Mobileye, HP and Ciena. We value the company through an 2021/22 EV/IC approach, which better reflects returns on capital, risks and growth, incorporating a **8.3% WACC and 3% terminal growth rate.**

- **SNAM (OUTPERFORM, TP Eu4.90):** Looking at environmental protection, the investments announced in the company's business plan include targets to reduce methane emissions, with ongoing work to reduce overall emissions and maximise energy efficiency and the development of new businesses, such as bio-methane, CNG and SSLNG. Specifically, Snam also intends to investigate the potential of hydrogen as an energy storage solution to favour more efficient usage of intermittent renewable energy sources. The clean hydrogen theme could represent an interesting investment opportunity as it could be the missing energy transition link, greatly reducing the stranded assets risk for the existing network and providing new investment opportunities.
- **HERA (OUTPERFORM, TP Eu4.20):** the group has long been one of the most focused on sustainability matters. 70% of the growth projects in the 2023 business plan contribute to the UN's Sustainable Development Goals (SDG). Investments of over Eu955mn are planned in technological developments for smarter cities; for projects in areas such as energy efficiency, recovery and reuse of materials, and air quality; and for strengthening networks affected by climate change.
- **A2A (OUTPERFORM, TP Eu1.70).** The European Commission projects that applying ambitious circular economy measures in Europe could increase EU GDP by an additional 0.5% by 2030, creating around 700,000 new jobs. In particular, the focus is on the Waste sector and recycling. A2A's business plan is based on climate action, the circular economy and smart solutions. In the Waste segment, A2A aims to become a national leader in recycling, with a target of twelve new municipal solid waste treatment plants, nine of which have already been authorised. Despite the uncertainty related to the pandemic and the continuing macro headwinds in the form of weaker commodity prices, we believe A2A could benefit in the coming quarters from a return to 'more normalised' hydro conditions, very solid margins for thermal gas plants, and resilient figures at Networks and Waste. We confirm our positive view on the stock, currently trading at undemanding valuations (2020 EV/EBITDA 6.6x, P/E 12.8x) while offering an appealing dividend yield (6.4%).
- **ERG (OUTPERFORM, TP Eu21.00).** The recovery plan proposed by the EU Commission focuses on renewable energies and clean hydrogen in parallel, stating that both are needed for extreme decarbonisation. On renewables, rumours have hinted at a potential EU tendering scheme for renewable electricity projects amounting to 15 GW over 2 years, with a total capital investment of Eu25bn. Support for national schemes is planned, using EIB co-financing. In this context, we continue to see ERG as one of the most attractive 'pure plays' among European Renewables thanks to a solid pipeline of investment opportunities and a sustainable dividend yield of 3.6%. We expect more visibility on the planned repowering process of its Italian wind farms in the coming months, with a potential acceleration in the authorisation processes.
- **TINEXTA (BUY, TP Eu16.00)** The pandemic and its consequences for people's lives and the economy have once again highlighted the importance of digitalisation across all areas of business and society. In the long run, this is likely to trigger permanent structural changes in society and the economy: more teleworking, e-learning, e-commerce, e-government. Tinexta is exposed to these through its Digital Trust division (45% of Group revenues), which handles IT solutions for digital identity and the dematerialisation of processes according to applicable legislation (including the recent European eIDAS regulation), via products and services such as certified electronic mail, electronic archiving, digital signatures, electronic invoicing, and solutions for the secure and simplified transmission of legal and financial documents. In its recent Recovery Plan for Europe, the EU highlights the potential of developing a universally accepted e-ID - public electronic identity - to allow for simple, trusted and secure access to cross-border digital public services. In a similar vein, in its "Simplification Decree" the Italian government aims to expand public sector use of digital services through the existing public digital identity system (SPID), digital ID cards (CIE) and ApplO. Although we see no immediate positive impact on company numbers (Infocert basically offers SPID for free), we think the increased focus on issues such as the development of a digital identity infrastructure increases visibility on the Digital Trust business, which we foresee growing structurally at around 10% p.a. in the medium term. Our positive view on the stock is mainly based on expectations for: 1) a structural growth trend in the Digital Trust market; 2) cross-selling opportunities between different divisions and geographical areas; and 3) further accretive M&A deals to broaden the customer base and complete the product offering. Moreover, we think that a sound financial structure and solid cash generation are real advantages in times of uncertainty and will enable the company to avoid passing up potential acquisition opportunities arising on the market. The stock is still trading at attractive multiples: 15x P/E and 8.8x EV/EBITDA on 2021 figures, and offers a 8% FCF yield.
- **SALCEF (OUTPERFORM, TP Eu12.90):** The company is a national leader in rail infrastructure maintenance and is also expanding in Europe (growing subsidiary in Germany). Rail is poised to become a privileged green transportation mode for both passengers and freight thanks to its lower greenhouse gas footprint

compared to other forms of transport (railways only represented 0.5% of European greenhouse gas emissions in 2017 vs 72% from road, 14% from aviation, and 13% from maritime transportation, according to EEA data). Consequently, green investments from European funds for rail transport infrastructure upgrades are set to be substantial (€100bn per year, including a further €30bn per year for the core European rail TEN-T network). Salcef's core rail maintenance and construction business is set to benefit from the increased investments in rail infrastructure in the short term and from the potential rise in traffic in the long run.

- **SAES GETTERS (OUTPERFORM, TP Eu30.00):** Despite its modest current contribution to earnings, Packaging is a key strategic focus for SAES. In 2019, the company announced partnerships with Novamont (biomaterials) and Sacchital (converter) for the production of flexible packaging solutions that can be fully recycled or composted. Products (paper, mono-material plastics, biomaterials) use SAES's coating technology initially developed for OLED displays. In mid-June, the press reported that Colussi (Misura brand) had decided to adopt innovative packaging products based on this technology as part of a partnership also involving Novamont, IMA, Sacchital and TicinoPlast. Although this announcement has no material impact on 2020 estimates, it adds visibility on the reliability of the coating technology developed by SAES and we expect that it will boost its top-line growth in coming years. Taking the net cash position (Eu112mn) and treasury shares held by the company (Eu100mn at market price) into account, the stock trades below 6.0x EV/EBITDA FY21e, which in our view does not reflect the growth/cashflow profile of the group, and the defensive characteristic of SAES's business (half of EBIT is generated in the medical business, where both nitinol and the devices are subject to FDA approval). At target, we value SAES at 10x EV/EBITDA 2021e, which we think is supported by a SOP valuation (i.e. a 12.0x multiple in the medical business and a 8.0x multiple in the industrial business, each representing around half of the current business). This leaves the value creation opportunity in advanced packaging (we estimate sales to double by 2022) for free.
- **RENO DE MEDICI (OUTPERFORM, TP Eu1.00):** Reno De Medici is the second largest European player in white-lined chipboard (WLC), the production of Cartonboard from recycled fibers. WLC represents around 87% of the Group's installed capacity and is set to become even more important thanks to the exploitation of trends such as plastic substitution with cartonboard-based solutions. Studies are underway with other sector companies to develop new products that can substitute plastic in sectors such as Food and Pharma, which represent 70% of the company's end markets. Moreover, we highlight the fact that the company is actively pursuing the reduction of carbon and energy intensity, water usage and to minimise waste sent to landfill. In the last 3 years, the company has achieved a 25% decrease in Carbon Intensity (tCO<sub>2</sub>e/ton), of which -7.5% in the last year, and 19% in energy intensity (MWh/ton), of which -7% in the last year. In the coming years a continuation of these trends is to be expected thanks to planned investments. We confirm our positive view on the stock as we believe that in a deteriorating economic scenario, the company's exposure to end-markets that present limited cyclicality (Food and Pharma) coupled with its solid financial structure (net debt/EBITDA <0.5x at YE20) are solid elements backing up our positive stance on the stock. In the past 3 years the management has proven its ability in reducing the cyclicality of the company and has developed a solid track-record in acquisitions, which we expect to continue in the near future (management just confirmed for the next 3 years). Valuation remains attractive, with the stock trading at 4.0x EV/EBITDA and 10x P/E on 2021 numbers.
- **LUVE (OUTPERFORM, TP Eu12.50):** LuVe is a leading European player in the design and manufacture of air cooling and heat exchange systems for the refrigeration and air conditioning markets. The main growth driver in these core markets is the growing focus on environmental sustainability issues. Natural refrigerant fluids that are gradually being introduced such as carbon dioxide, ammonia and propane represent a valid alternative to hydrofluorocarbons (HFC) and enable a significant reduction of the greenhouse gases associated with climate change. However, solutions using natural refrigerant fluids are characterised by certain limitations that must be managed carefully in order to ensure performance and safety during use. LuVe is among the few global players able to comply with the strictest regulation and constantly invests in R&D in order to find solutions capable of minimising environmental impact and noise emissions of finished products. We confirm our positive view on the stock as we believe that in a volatile economic scenario, the Group's core business is exposed to sectors (such as the food supply cold chain) that should suffer more limited impact, while also being related to green investment themes. The financial structure appears solid, with good flexibility on covenants. The valuation remains relatively attractive, with the stock trading at 6.2x EV/EBITDA and 11.8x P/E on 2021 numbers.

The European Green Path



PARIS2015  
at the United Nations Conference  
COP21-CMP11

2015 – Adoption of the **Paris Agreement** on climate change and the **UN 2030 Agenda for Sustainable Development**

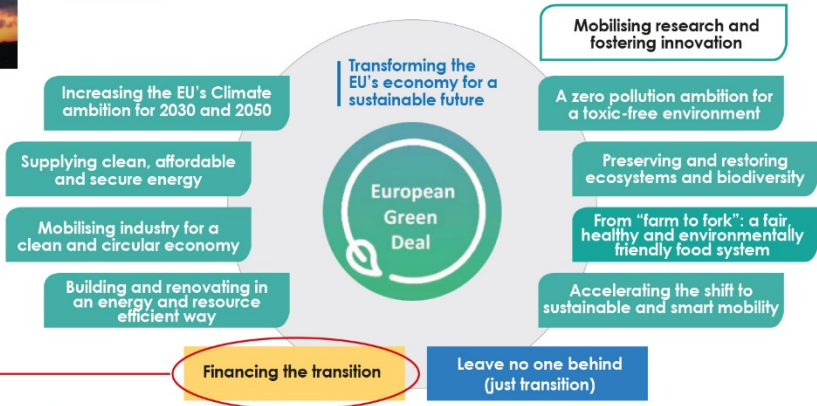
2016 – Appointment by the Commission of a **High-Level Expert Group on sustainable finance (HLEG)**

2018 – **Action Plan on Financing Sustainable Growth** based on the HLEG recommendation. **Ten coordinated actions** involving all financial market participant in an effort to strengthen the **sustainable finance**:

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|---|--|
| <ul style="list-style-type: none"> <li>1. EU Sustainable Taxonomy</li> <li>2. Standard and labels</li> <li>3. Facilitating investment in sustainable infrastructure projects</li> <li>4. Investment advice to integrate ESG (amendments to MIFID II)</li> <li>5. Developing Sustainability Benchmarks</li> <li>6. Credit rating to integrate ESG</li> </ul> | <ul style="list-style-type: none"> <li>7. Investors' duty to integrate ESG and increase disclosure (amendments to IORP II)</li> <li>8. Incorporating sustainability in prudential requirement for banks</li> <li>9. Strengthening corporate disclosure on sustainability</li> <li>10. Fostering more sustainable corporate governance</li> </ul> |
|---|--|

- 2 imperatives from the HLEG:**
1. improve the contribution of finance to sustainable growth;
  2. incorporate ESG factors into investment decision-making

2019 – **European Green Deal**, a programme of action for making the EU's economy sustainable:



January 2020 – Presentation of the **European Green Deal Investment Plan (EGIP)** aim to mobilise **Eu1tr.**

The EU as a global leader

A European Climate pact

January 2020 – Presentation of the **European Green Deal Investment Plan (EGIP)** aim to mobilise **Eu1tr.** At least 25% of the EU's long term budget will be dedicated to climate action and further support will be provided by the EIB

February/March 2020 – Sanitary emergency and economic crisis due to **Covid-19 outbreak**

27 May 2020 – The Commission presented its package of extraordinary measures aimed at tackling the economic crisis following the outbreak of Covid-19 pandemic: **the Recovery Plan**



Three Pillars to invest in a green and digital Europe:

1. Supporting Member States to Recover	2. Kick-starting the economy and helping private investment	3. Learning the lessons from the crisis
<b>Recovery &amp; Resilience Facility</b> <b>Eu560bn</b> (Eu310 grants and Eu250bn loans)	<b>Solvency Support Instruments</b> <b>Eu26bn</b>	<b>EU4Health</b> <b>Eu7.7bn</b>
<b>REACT-EU</b> <b>Eu50bn</b>	<b>Strengthened Invest EU programme</b> <b>Eu15.3bn</b>	<b>Reinforced rescEU</b> <b>Eu2bn</b>
<b>Reinforced Rural Development Programmes</b> <b>Eu15bn</b>	<b>Strategic Investment Facility</b> <b>Eu15bn</b>	<b>Neighbourhood, Development &amp; International Cooperation</b> <b>Eu10.5bn</b>
<b>Reinforced Just Transition Mechanism</b> <b>Eu30bn</b>		<b>Humanitarian aid</b> <b>Eu5bn</b>
		<b>Horizon Europe</b> <b>Eu13.5bn</b>

The **Recovery Plan** will help to repair the short-term damage from the crisis but also to build a better future

The majority of the money raised by means of Next Generation EU will channelled in the **European Green Deal** which represents the **bulk of the recovery**

\*these figures refer only to Next Generation EU, it is not included the possible EU financing budget

## Sustainable finance in Europe: the main actors and initiatives

Institution	Topic	Status	Participants
European Commission	Recovery Plan	To be approved	Companies, Member States, citizens
European Parliament	Green Deal	Approved on 14 January 2020	Companies, Member States, citizens
	Action Plan: <ul style="list-style-type: none"> <li>Taxonomy</li> </ul>	The European Parliament adopted new legislation on the Taxonomy as of 18 June 2020. The new law was published in the Official Journal of the European Union on 22 June 2020 and will come into effect on 12 July 2020. The law sets out six environmental objectives: in order for an economic activity by an investor or undertaking to be labelled as 'environmentally sustainable', the activity must contribute to at least one of the objectives without significantly harming any of the others, and it must also comply with minimum social safeguards. Delegated acts for the first two environmental objectives (climate change mitigation and adaptation) will be adopted by the end of 2020 and come into force by the end of 2021. Delegated acts for the remaining four environmental objectives will be adopted by the end of 2021 and come into force by the end of 2022	1) Companies with more than 500 employees; 2) Member States; 3) Financial market participants offering financial products in the EU (pensions and asset management, insurance, corporate & investment banking)
	<ul style="list-style-type: none"> <li>amendments to IORP II</li> </ul>	In force since 1 February 2019 (Legislative Decree 147/2018)	Pension Fund IORPs
	<ul style="list-style-type: none"> <li>amendments to MIFID II</li> </ul>	In early January 2020, the Commission published amendments to MIFID II. Once these acts have been examined by the Commission (within 6 months), they will be published in the Official Journal of the European Union	Consultants
ECB	<b>Strategic Review:</b> monetary policy framework review which will also take account of the fight against climate change. ECB purview covers four main areas: 1) Economic analysis 2) Banking supervision 3) Monetary policy 4) Financial stability	To be completed by mid-2021	All financial market participants
ECB Banking Supervision (SSM)	Guide to climate-related and environmental risks under the current prudential framework for banks.  The guide specifies how ECB Banking Supervision expects banks to consider climate-related and environmental risks in their governance and risk management frameworks and also when formulating and implementing their business strategies	On 20 May 2020, the ECB launched a public consultation period on its Guide, which is set to end on 25 September 2020	Banks

Source: Intermonte SIM and EU Commission

## Recovery Plan

At the plenary session of the EU Parliament on **27 May 2020**, the EU Commission presented a package of extraordinary measures aimed at tackling the economic crisis following the outbreak of the Covid-19 pandemic. The EU Commission's base case for the GDP trend in 2020 is a 7% decline (the worst case, involving a second wave of infection, would be as shocking as a 16% economic contraction). The extraordinary measures, entitled '**Next Generation EU**', amount to **Eu750bn, of which Eu500bn in the form of grants and Eu250bn in loans**. This amount comes on top of the **Eu1.1tn EU budget** and **Eu540bn in measures** already announced, bringing the overall total to **Eu1.85tn**.

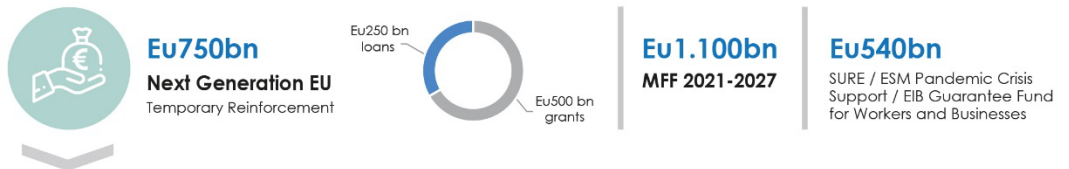
### EU budget recovery instruments

Instruments	Funding	Status
SURE / ESM Pandemic Crisis Support / EIB Guarantee Fund for Workers and Businesses	Eu540bn	Approved on 23 April 2020
Next Generation EU	Temporary Reinforcement Eu750bn	To be approved
Multiannual Financial Framework	Eu1,100bn	To be approved

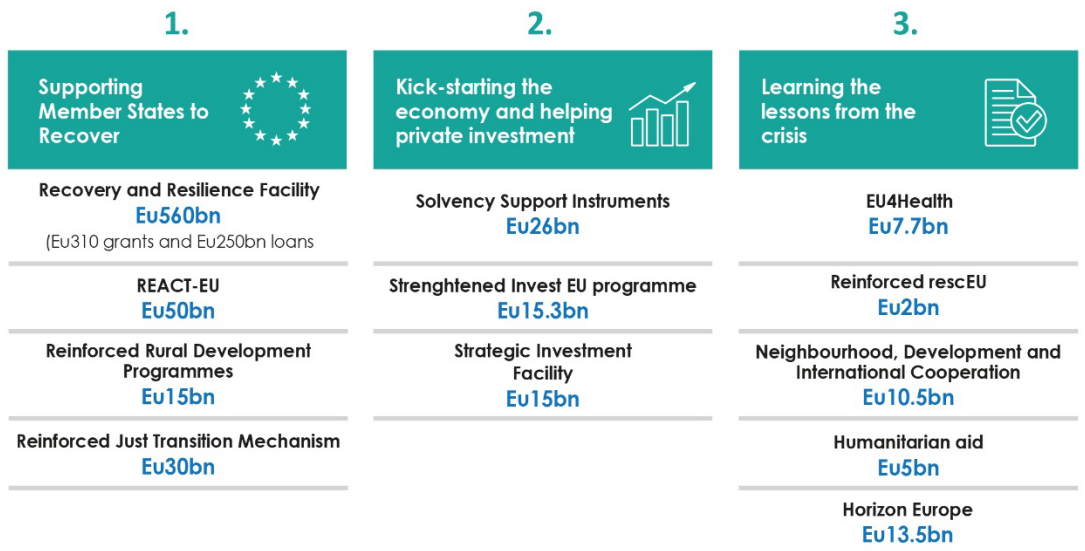
Source: EU Commission

### European Recovery Plan

#### Recovery Plan



Three Pillars to invest in a green and digital Europe:



\*these figures refer only to Next Generation EU, it is not included the possible EU financing budget

Source: EU Commission and Intermonte SIM

The plan is essentially based on the Franco-German proposal, with Eu250bn of additional loans to be repaid by 2058. The EU is planning to issue debt and also to study levies to finance a portion of the measures. These two items are not expected to be huge but certainly very relevant for the principle of cementing the EU's status as a supranational entity with autonomy to raise resources through taxes and the issuing of debt instruments. The **Next Generation EU funds are deemed to be unevenly distributed** among countries: **Italy** is set to be one of the **largest beneficiaries with Eu82bn in grants and Eu90bn in loans**; the total amount of Eu172bn is broadly equal to 10% of Italian GDP.

**Next Generation EU** will rest on **three main pillars**:

1. Instruments to support Member State efforts to recover, repair and emerge stronger from the crisis;
2. Measures to boost private investment and support companies;
3. The reinforcement of key EU programmes (drawing lessons from the crisis) in order to build a more resilient economy and accelerate the twin green and digital transition.

The various programmes embedded in Next Generation EU will be composed of grants and loans. For more detail on these instruments as well as for the projected distribution of funds, please see Appendix 1.

**In terms of grants, Italy will receive Eu63,380mn (2018 prices) from the Recovery and Resilience Facility and Eu1,606mn (2018 prices) from the Just Transition Fund.** More details on the grant component per country under these two instruments are provided in Appendix 2.

### Recovery and Resilience Facility

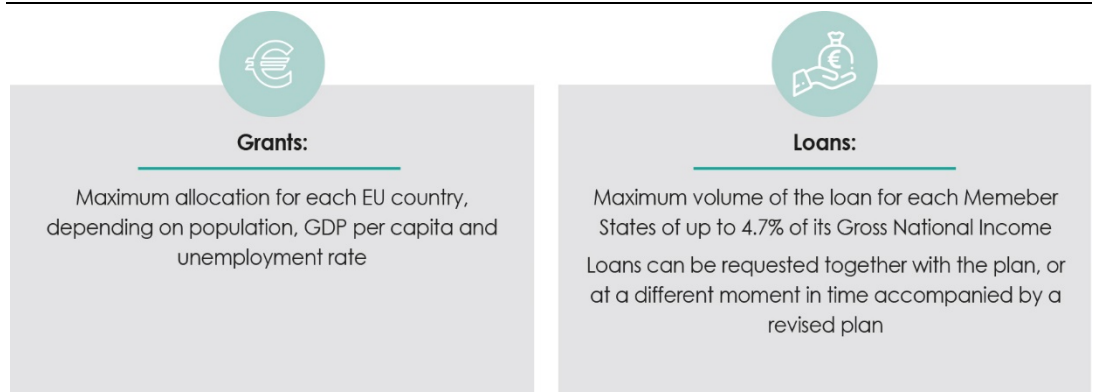
The star of Next Generation EU is the **Recovery and Resilience Facility**. This instrument will offer large-scale financial support for public investments and reforms, mainly in green and digital. The support will take the form of up to **Eu310bn in grants and up to Eu250bn in loans, for a total of Eu560bn.**

In order to access this instrument, Member States should prepare **Recovery and Resilience Plans**, taking into account the findings of the European Semester, as well as national energy and climate plans and, last but not least, measures that contribute to addressing the green and digital transitions. Recovery and Resilience Plans should be submitted to the Commission in April as an annex to Member State national reform programmes, or in October with national draft budgets.

Bearing in mind the emergency, the Commission proposed that **at least 60% of grants should be legally committed by end-2022, and the remainder by the end of 2024.** Loan support should be requested by the end of 2024 at the latest.

Once the Commission has verified that the criteria are fulfilled, it will decide what form the support will take for each member state (loan or grant) and the timetable for implementation. The loan will benefit from the long maturities and favourable interest rates in the Union. Additionally, the non-repayable support under the Facility will be particularly beneficial to those countries with lower per capita income and high unemployment rates (positive for the worst-hit countries). Member States can also request loans but the maximum volume of the loan is 4.7% of Gross National Income.

### How the Recovery and Resilience Facility works



Source: EU Commission

The grants and loans will be **repayable in instalments**, and Member States may also require assistance and technical support in preparing the Recovery and Resilience Plans, under the **Technical Support Instruments**.

## Size, timing and allocation of the Recovery Instruments

**Next Generation EU** is worth **Eu750bn** in total, and will be allocated across **four years, 2021-2024**. According to the preliminary simulation, this corresponds to around **5.4% of annual EU-27 GDP or 1.35% of 2019 GDP in each year**.

The funds will be allocated as follow:


- Eu451bn will go to boost public investments in the form of grants and loans;
- Eu250bn will be loans to Member States to finance public investment. These loans will be repaid gradually over 20 years by the Member State beneficiaries;
- The remainder of the package will be used as loss provisioning for the financing of private investments to InvestEU and ESFI.

According to the Commission proposal, the breakdown of distribution of the Recovery Instruments among Member States (**allocation keys**) depends on GDP per capita and the impact of the crisis (the higher the impact, the greater the funding). The simulation is based on the following assumptions:

- The same allocation keys apply to all components of the package (grants, loans, additional provisioning to InvestEU);
- The group of Member States with above-average GDP per capita will receive 24.5% of the package; the below-average GDP (low debt) group will receive 25%; and the below-average GDP (high debt) group will receive c.50.6%;
- All Member States will contribute in proportion to their overall share of GDP.

In the Allocation Keys provided by the Commission, which we report below, Italy will enjoy the highest share of the recovery package at Eu153bn (20.4% of the total) in the context of a Eu96.3bn contribution, i.e. a net benefit of Eu56.7bn for Italy, but according to rumors in the media, Italy will receive Eu82bn in grants and Eu90bn in loans for a total amount of Eu172bn, broadly equal to 10% of Italian GDP.

### Allocation key per country

Country	Allocation Key	GDP (bn)	Share of EU 27 GDP	Recip. (bn)	Contribution (bn)	Net (bn)	Net (% GDP)
Belgium	1.6	474	3.4%	12	25.5	-13.5	-2.9%
Bulgaria	2	61	0.4%	15	3.3	11.7	19.3%
Czech Republic	1.5	220	1.6%	11.3	11.9	-0.6	-0.3%
Denmark	0.6	311	2.2%	4.5	16.7	-12.2	-3.9%
Germany	6.9	3436	24.7%	51.8	185.1	-133.3	-3.9%
Estonia	0.3	28	0.2%	2.3	1.5	0.7	2.6%
Ireland	0.4	347	2.5%	3	18.7	-15.7	-4.5%
Greece	5.8	187	1.3%	43.5	10.1	33.4	17.8%
Spain	19.9	1245	8.9%	149.3	67.1	82.2	6.6%
France	10.4	2419	17.4%	78	130.3	-52.3	-2.2%
Croatia	2	54	0.4%	15	2.9	12.1	22.4%
<b>Italy</b> 	<b>20.4</b>	<b>1788</b>	<b>12.8%</b>	<b>153</b>	<b>96.3</b>	<b>56.7</b>	<b>3.2%</b>
Cyprus	0.3	22	0.2%	2.3	1.2	1.1	4.9%
Latvia	0.7	30	0.2%	5.3	1.6	3.6	11.8%
Lithuania	0.9	48	0.3%	6.8	2.6	4.1	8.6%
Luxembourg	0	64	0.5%	0	3.4	-3.4	-5.4%
Hungary	2	144	1.0%	15	7.7	7.3	5.0%
Malta	0.1	13	0.1%	0.8	0.7	0	0.3%
Holland	1.7	812	5.8%	12.8	43.7	-31	-3.8%
Austria	1	399	2.9%	7.5	21.5	-14	-3.5%
Poland	8.6	529	3.8%	64.5	28.5	36	6.8%
Portugal	4.2	121	1.5%	31.5	11.4	20.1	9.5%
Romania	4.4	223	1.6%	33.5	12	21	9.4%
Slovenia	0.5	48	0.3%	3.8	2.6	1.2	2.4%
Slovakia	2	94	0.7%	15	5.1	9.9	10.5%
Finland	0.7	240	1.7%	5.3	12.9	-7.7	-3.2%
Sweden	1.2	475	3.4%	9	25.6	-16.6	-3.5%

Source: EU Commission and Intermonte SIM

### The investment needs

Here we show the basic investment needs estimated by the Commission. At this stage, only basic investment needs will be distributed; further work will be carried out for the green and digital transitions.

#### Basic investment needs by sector

<b>Basic Investment needs</b>	<b>bn</b>
Tourism	161
Mobility-Transport-Automotive	64
Aerospace & Defence	4
Construction	54
Agri-food	32
Energy Intensive Industries	88
Textiles	6
Creative & Cultural Industries	6
Digital	66
Renewable Energy	100
Electronics	18
Retail	115
Proximity & Social Economy	n.a.
Health	32
<b>Total</b>	<b>748</b>

Source: EU Commission

## Financing the Recovery Plan

To finance the necessary investments, the **Commission will issue bonds on the financial markets on behalf of the EU.**

As reported in the Commission Documents, in order to make borrowing possible, the Commission will amend the Own Resources Decision and increase the headroom (the difference between the Own Resources ceiling of the long-term budget and actual spending). With the headroom as a guarantee, the Commission will raise funds on the markets and channel them via Next Generation EU to programmes whose purpose is to repair the economic and social damage caused by the Covid-19 outbreak.

The timing, volume and maturity of bond issues will depend on the needs of the EU and its Member States. Newly issued bonds will range in maturity from 3 to 30 years.

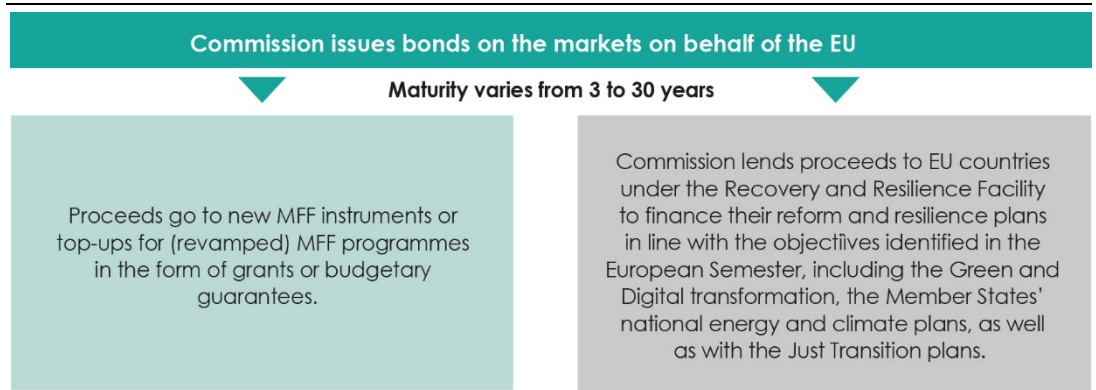
**The funds raised will be repaid after 2027 and by 2058 at the latest from future EU budgets.** The loans will be repaid by the borrowing Member States.

Thus the Commission will borrow up to Eu750bn, largely concentrated in the 2020-2024 period, and will have the option to:

1. channel the funds to one of the new or enhanced programmes or;
2. finance the grant component of the Recovery and Resilience Facility, or lend the money to Member States in need under the new Recovery and Resilience Facility under the terms of the original issue (same coupon, maturity and same nominal amount).

In this way, Member States will indirectly borrow under very good conditions, benefitting from the EU's high credit rating and relatively low borrowing rates compared to those of several Member States. The timing, volume and maturity of the issues will be so arranged as to obtain the most advantageous terms possible for the EU and its Member States.

### How the Recovery Plan will be financed



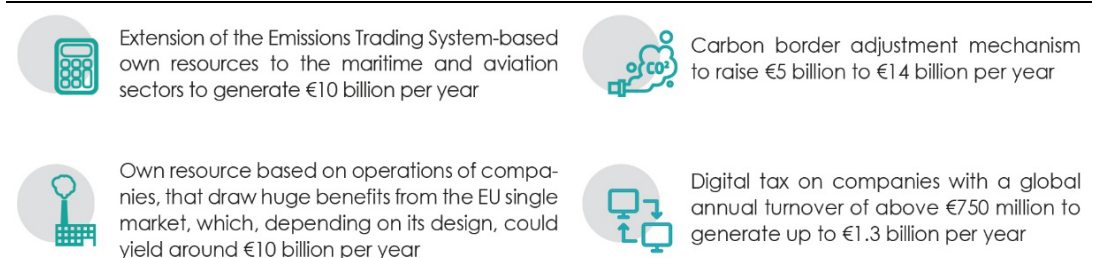
Source: EU Commission

In order to ensure sufficient headroom, the Commission proposes to amend the Own Resources Decision to allow borrowing and to increase the Own Resources ceiling on an exceptional and temporary basis by 0.6 percentage points.

The increased headroom will demonstrate to investors that the EU budget can fulfil its debt repayment obligation under any circumstances. Thus the EU will keep borrowing costs as low as possible without immediate additional contributions to the long-term budget by its Member States.

The revenue sources of the EU budget have remained more or less the same over the last few years: customs duties, contributions from the Member States based on VAT and those based on gross national income (GNI). Possible additional own resources to be added later during the 2021-2027 financial period are summarised thus:

### Additional revenue sources of the EU budget



Source: EU Commission

These new own resources could help finance the repayment of and the interest on the market financing raised under Next Generation EU. In view of the current circumstances, the Commission will work towards a more gradual elimination of the rebates than initially foreseen.

As regards the timing of the disbursement of funds, Commissioner **Gentiloni** said: "*Member States should submit recovery and resilience plans to the Commission in April, as an annex to their national reform programme – but if they wish, they can already submit a draft together with their national draft budget in October. That would certainly help us to provide support more quickly.*

*Given the obvious need to deploy these funds as swiftly as possible, our proposal specifies that at least 60% of grant money should be legally committed by the end of 2022, with the remainder by the end of 2024. Loan support should be requested by the end of 2024 at the latest. The Commission will assess the plans, on the basis of transparent criteria: we will look at:*

- whether they effectively address the relevant challenges identified in the European Semester – we presented them a couple of weeks ago in our spring package;
- whether they contribute to strengthening growth potential and resilience and to enhancing cohesion;
- and whether they contain measures that significantly contribute to addressing the green and the digital transitions.

*Provided that the assessment criteria are fulfilled, the Commission will adopt a decision setting out the financial contribution that the Member State will benefit from (a grant and, if so requested, loan), and the milestones and timetable for implementation."*

## The Green Recovery

As part of the EU Recovery Plan, the European Commission has also **adjusted its Work Programme for 2020** in response to the current Coronavirus pandemic.

The Commission remains committed to delivering on the **green and digital transitions**, which are key to relaunching the European economy. The **investment needed for delivering this twin green and digital transition is estimated to amount to at least Eu595bn** per year (Eu1,190bn over the next two years). As reported in the EU Commission documents, this amount includes the additional investments needed to reach the **EU's current 2030 climate and environmental policy goals**, which are around **Eu470bn** per year, and the EU's need to pursue **digital transformation**, which amounts to **Eu125bn** per year.

The investment needs to deliver the green transition shown in the table below are merely estimates, and possibly conservative ones, since at this stage it is not possible to quantify all the investment needs, and also because these numbers do not take into account all the environmental goals for climate change adaptation (and the other 4 under preparation).

### Investment needs for delivering green transformation

Sectoral breakdown of green transformation investment gaps (EUR bn, per year)				
Sectors		Climate mitigation and energy 2030 targets	Wider environmental objectives, beyond climate	Total green transformation
Renewable energy	Power grids	10	-	10
	Power plants	20	-	20
	<b>Total Renewable Energy</b>	<b>30</b>	-	<b>30</b>
Construction	Residential energy efficiency	115	-	115
	Business energy efficiency	70	-	70
	<b>Total Construction</b>	<b>185</b>	-	<b>185</b>
Industrial/other energy efficiency	<b>Industrial energy efficiency, new efficient boilers</b>	<b>5</b>	-	<b>5</b>
Transport	Vehicles, rolling stock, vessels and airplanes	20	-	20
	Infrastructure - Core TEN-T network	30	-	30
	Infrastructure - Other interurban infrastructures	35	-	35
	Infrastructure - Urban transport	35	-	35
	<b>Total Transport</b>	<b>120</b>	-	<b>120</b>
Environmental protection	Protection of ambient air and climate	-	40	40
	Wastewater management	-	15	15
	Waste management	-	10	10
	Protection of soil, ground-/surface water	-	1	1
	Noise and vibration abatement	-	1	1
	Biodiversity landscapes / Agri-food	-	4	4
	Protection against radiation	-	5	5
	Environmental R&D	-	2	2
<b>Total Environmental protection</b>	-	<b>77</b>	<b>77</b>	
Resource management (excluding energy)	Management of waters	-	20	20
	Management of forest resources	-	2	2
	Management of wild flora and fauna	-	1	1
	Management of materials and efficiencies	-	10	10
	Resource management R&D	-	5	5
	<b>Total Resource management (excl. energy)</b>	-	<b>38</b>	<b>38</b>
Circular economy (beyond needs already included)	Additional potential (based on EMF papers) in 3 sectors (food, mobility and built environment), informal expert view	-	15	15
		<b>340</b>	<b>130</b>	<b>470</b>

Source: Commission services; Estimate for additional investments needs in the power, construction, industrial and transport (vehicles and rolling stock, excluding infrastructure) sector based on EUCO32-32.5 scenario, <https://ec.europa.eu/energy/en/data-analysis/energy-modelling/euco-scenarios>. Estimates of additional investment per year over the period 2021-2030 are relative to 2016 Reference, estimates per sector rounded to the nearest € 5 bn. Estimates not yet updated to include raising the ambition of GHG emission reductions to 50-55%. Climate change adaptation is not yet assessed and incorporated in climate figures. The European Green Deal initiatives, being rolled out currently, are only partly addressed yet. Environmental figures do not comprehensively cover marine issues. For the water domain, the Water Framework Directive and the Floods Directive still to be added to the assessment, as well as the most recent OECD-ENV water study results (not fully captured yet).

Source: EU Commission

## Green investments direction

In the 27 May announcements, the Commission released details regarding the sectors that will benefit the most from the “new green funds”: **construction, mobility, renewables and hydrogen**.

**Buildings** represent **40% of energy consumption**, so building renovation is a must in order to help people cut their energy bills and energy use. A “Renovation wave” in the buildings sector will be unveiled in 3Q20, as reported in the Commission Adjusted Work Programme (please see the Appendix 3). Currently, only around 1% of buildings in the EU are renovated each year, hence a faster renovation rate is necessary to improve energy efficiency and reduce GHG emissions.

**Energy** production and use represents more than **75%** of the EU's GHG emissions. The Commission has highlighted the urgency of several measures to decarbonise this sector, by means of rolling out renewable energy projects (wind and solar) and kick-starting a clean hydrogen economy in Europe. Although renewable energies have proven more resilient than fossil fuels during the Covid-19 crisis, supply chains have been seriously affected, with solar and wind markets expected to shrink by 20-33% this year, the Commission says.

Hydrogen is a key solution for cutting greenhouse gas emissions in sectors that are hard to decarbonise and where electrification is difficult or impossible. This is the case for industrial sectors such as steel production, or heavy-duty transport. As a carbon-free energy carrier, hydrogen would also enable transport of renewable energy over long distances and the storage of large volumes of energy.

On **8 July 2020**, the Commission unveiled **two strategies to further boost the transition to a climate-neutral economy: the EU Strategy for Energy System Integration and the EU Hydrogen Strategy**. Those strategies are fully in line with the EU Green Deal Agenda and Next Generation EU.

The **EU Strategy for Energy System Integration** sets out 38 actions to create a connected and integrated energy system, linking different energy carriers, infrastructure and consumption sectors.

It is founded on three main pillars:

- A more circular energy system leveraging on energy efficiency, e.g. reuse of waste heat from industrial sites, energy production from bio-waste;
- Greater direct electrification of end-use sectors;
- Clean fuels (renewable hydrogen, sustainable biofuels, and biogas) for those sectors where electrification is difficult.

Energy system integration means having a connected and more efficient energy system: for example, the electricity that powers Europe's cars could come from solar panels on our roofs, buildings kept warm using heat from factories, and factories powered by clean hydrogen produced using off-shore wind energy.

**Hydrogen is a priority** for achieving the European Green Deal targets and climate neutrality by 2050. It can be used as a feedstock, a fuel, and an energy carrier, and has several applications across the manufacturing, transport, power and building sectors. Additionally, hydrogen could replace fossil fuels in some carbon-intensive industrial processes (steel and chemicals) thus lowering GHG emissions and aiding the decarbonisation process.

Hydrogen's current share of the European energy mix is modest (**less than 2%**) and still largely produced from fossil fuels (with the release of 70 to 100 million tons CO<sub>2</sub> annually in the EU), hence in order to contribute to climate neutrality it must be produced on a larger scale, and output must be fully decarbonised. According to the EU's strategic vision for a climate neutral EU published in November 2018, **hydrogen's share of the European energy mix is expected to reach 13-14% by 2050**.

The new strategy for hydrogen is in line with the Green Deal Agenda and the Recovery Plan. The Commission stresses the fact that clean hydrogen is one of main ingredients of the green transition, and investments in hydrogen could foster growth and jobs, which will be critical in light of the covid-19 crisis. **'Renewable or clean hydrogen'** (so called **green hydrogen**) is hydrogen produced through the electrolysis of water (in an electric-powered electrolyser), using power from renewable sources, while **'Low-carbon hydrogen'** (so called **blue hydrogen**) covers fossil-based hydrogen with carbon capture as well as electricity-based hydrogen.

Renewable hydrogen is the focus of the strategy, as it has the greatest decarbonisation potential and is therefore the most compatible option for the EU's climate neutrality goal. The strategy also recognises the role of other low-carbon hydrogen production processes in a transitional phase, e.g. through the use of carbon capture and storage or other forms of low-carbon electricity in order to clean up existing hydrogen production, reduce emissions in the short term, and scale up the market.

According to EU official documents **cumulative investments in renewable hydrogen in Europe** could be up to **Eu180-470bn by 2050** and in the range of **Eu3-18bn for low-carbon fossil-based hydrogen**. The strategy outlines a comprehensive investment agenda, including investments for electrolysers, but also for the renewable power production capacity required to produce clean hydrogen, transport and storage, retrofitting of existing gas infrastructure, and carbon capture and storage.

Current renewable and low-carbon hydrogen is not cost competitive compared to fossil-based hydrogen. Estimated costs today for fossil-based hydrogen are around 1.5 Eu/kg for the EU: this is highly dependent on

natural gas prices, and disregards the cost of CO<sub>2</sub>. Current estimated costs for fossil-based hydrogen with carbon capture and storage are around 2 Eu/kg, and renewable hydrogen 2.5-5.5 Eu/kg. To bridge this gap, the EU has drawn up a hydrogen roll-out plan:

**Phase 1** – from 2020 to 2024. The objective is to decarbonise existing hydrogen production for current uses such as the chemical sector, and promote it for new applications. This phase relies on the installation of at least 6 Gigawatts of renewable hydrogen electrolyzers in the EU by 2024 and aims to produce up to one million tonnes of renewable hydrogen. By way of comparison, the current installed base amounts to approximately 1 Gigawatt of electrolyzers in the EU.

**Phase 2** – from 2025 to 2030. Hydrogen needs to become an intrinsic part of an integrated energy system with the strategic objective of installing at least 40 Gigawatt of renewable hydrogen electrolyzers by 2030 and the production of up to ten million tonnes of renewable hydrogen in the EU. Hydrogen use will gradually be expanded to new sectors including steel-making, trucks, rail and some maritime transport applications. It will still mainly be produced close to the user or close to renewable energy sources, in local ecosystems.

**Phase 3** – from 2030 to 2050. Renewable hydrogen technologies should reach maturity and be deployed on a large scale to reach all hard-to-decarbonise sectors. In particular, hydrogen and hydrogen-derived synthetic fuels, based on carbon neutral CO<sub>2</sub>, are expected to achieve deeper penetration across a wider range of economic sectors, from aviation and shipping to hard-to-decarbonise industrial and commercial buildings.

To support the large-scale deployment of renewable hydrogen the Commission estimates that major investments will be needed:

- From now to 2030, investments in electrolyzers could be in the Eu24-42bn range. Additional investments are required: (i) ca.Eu220-340bn to connect 80-120 GW of solar and wind energy production capacity in order to power electrolyzers; (ii) Eu11bn in investments to retrofit half of existing plants with carbon capture and storage; (iii) Eu65bn in investments for hydrogen transport, distribution, and storage;
- From now to 2050: investment in production capacity would amount to Eu180-470bn in the EU.

It is also estimated that ca. Eu160-200mn would be required to convert a typical EU steel installation reaching its end-of-life to hydrogen, while in the road transport sector the rolling-out of an additional 400 small-scale hydrogen refuelling stations (there are currently 100) could require Eu850-1000mn.

To support these investments, on 8 July 2020 the Commission announced the launch of the European Clean Hydrogen Alliance, with the aim of drawing up a clear pipeline of viable investment projects.

The EU Taxonomy will play a key role in driving investments in hydrogen across key economic sectors.

Several Member States have identified renewable and low-carbon hydrogen as part of their National Energy and Climate Plans. The Commission will compare and contrast Member States' hydrogen plans through the Hydrogen Energy Network. Member States will need to draw up these plans in line with the priorities identified in the context of the European Semester, and their national recovery and resilience plans in the context of the Recovery and Resilience Facility.

**Transport** represents **25% of emissions**, thus it is necessary to roll out cleaner, cheaper and healthier forms of private and public transport. **A strategy for “Sustainable and Smart Mobility” will be unveiled in 4Q20** according to the official **Adjusted Work Programme**. The only detail to emerge during the speech accompanying the presentation of the Recovery Plan on 27 May 2020 is that **one million electric vehicle charging points will be installed in Europe**.

### What's next

Ahead of the European Council (17-18 July), on July European Council President Charles Michel presented his proposal for the MFF and the Recovery Plan.

Based on discussions with EU leaders, Pres Michel has identified the six 'building blocks' for a possible agreement:

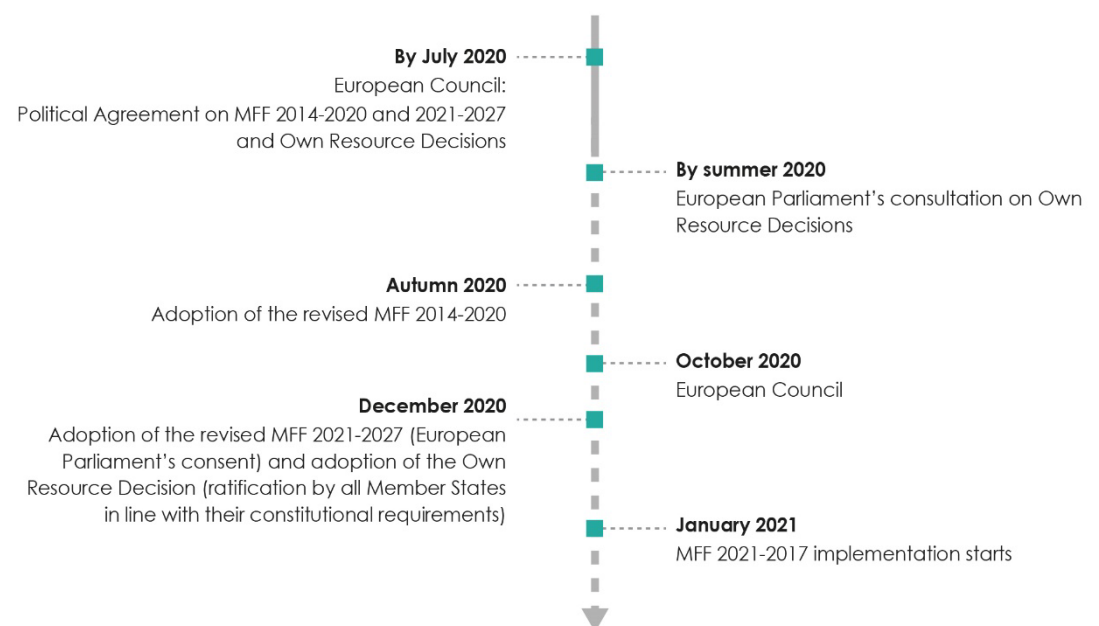
1. **Size of the MFF:** President Michel has proposed Eu1,074bn for the 2021-2027 MFF (vs the proposed Eu1,100bn).
2. **Rebates:** Lump sum rebates would be maintained for Denmark, Germany, the Netherlands, Austria and Sweden.
3. **Size of the recovery fund:** The Commission would be empowered to borrow up to Eu750 billion through an own-resource decision. These funds may be used for back-to-back loans and for expenditure channelled through the MFF programmes.
4. **Loans and grants:** President Michel has proposed preserving the balance between loans, guarantees and grants in order to avoid over-burdening member states with high levels of debt.
5. **Allocation of the Recovery and Resilience Facility (RRF):** This proposal ensures the money goes to the countries and sectors most affected by the crisis: 70% of the Recovery and Resilience Facility would be committed in 2021 and 2022, according to the Commission's allocation criteria; 30% would be committed in 2023, taking into account the drop in GDP in 2020 and 2021. The total envelope should be disbursed by 2026.  
Secondly, 30% of funding will target climate-related projects. Expenses under the MFF and Next Generation EU will comply with the EU's objective of climate neutrality by 2050, the EU's 2030 climate targets, and the Paris Agreement.

The third conditionality proposed by the President is linked to the rule of law and European values.

### Repayments and own resources

According to the President's proposal, repayments would start in 2026, and this commitment enhances the pressure on introducing new own resources. There would be a new own resource related to the use of plastic waste starting in 2021. The Commission would put forward a proposal in the first half of 2021 on a carbon adjustment measure and a digital levy would be introduced by the end of 2021.

### Time line on EU agenda



Source: Intermonte SIM and EU Commission

## Green Deal

***"The European Green Deal is our new growth strategy... on the one hand [it is] about cutting emissions, but on the other hand it is about creating jobs"*** - Ursula von der Leyen, president of the European Commission

On **11 December 2019** the European Commission presented the **European Green Deal**, a detailed roadmap of actions to promote the efficient use of resources by transitioning to a resilient circular economy, restoring biodiversity, and reducing pollution. **The ultimate objective is to turn Europe into the first climate-neutral bloc by 2050.** In order to transform this political commitment into a legal one and an incentive for investments, a proposal was made on 4 March 2020 for a **European Climate Law** (consultation period until 17 June 2020).

To achieve the ambitious climate targets set in the Green Deal, action will be needed in all economic sectors:

- **Energy sector** - the production and use of energy represents more than 75% of the EU's GHG emissions, so decarbonisation of the sector and promotion of the use of renewable energy sources is needed;
- **Buildings** – account for 40% of energy consumption, so it is necessary to renovate buildings, and cut energy bills and energy use;
- **Industry** – only 12% of the materials used by European manufacturing are recycled, so support is needed in order to make it the world leader in the green economy;
- **Mobility** – transport represents 25% of emissions, thus it is necessary to roll out cleaner, cheaper and healthier forms of private and public transport.

On **14 January 2020** the Commission presented the **European Green Deal Investment Plan and the Just Transition Mechanism**, i.e. an instrument that will help reduce the socio-economic impact due to the green transition in the worst-affected regions where the economy depends to a large degree on the use of fossil fuels.

### The European Green Deal Investment Plan

The goal of the plan is to mobilise **Eu1,000bn in investments into climate and environmental projects**, broken down as follows:

- Eu503bn from the EU budget, which in turn will stimulate additional co-financing for c.Eu114bn to go into climate and environmental projects;
- InvestEU will mobilise Eu279bn in public and private investments in the climate and environment sectors for the 2021-2030 period. It will also provide an EU budget guarantee to enable the EIB and other executive partners to increase the number of projects in which they invest and allow them to invest in higher-risk projects, which should help attract private capital;
- The Just Transition Mechanism (JTM), which according to the initial proposal on 14 January 2020 is intended to mobilise at least Eu100bn in investments in the 2021-2027 period thanks to resources from the EU budget, co-financing by Member States, and contributions from InvestEU and the EIB. Nevertheless, in light of the Covid-19 crisis, the Commission has decided to bolster this mechanism: the total budget for the Just Transition Fund will be increased by Eu40bn and the Just Transition Scheme under InvestEU will be strengthened, thus the JTM will mobilise c.Eu150bn in public and private investments;
- The Innovation and Modernisation Fund (EU Emissions Trading System Funds) will mobilise c.Eu25bn for EU transition to climate neutrality. These funds are not part of the EU budget but are financed by some of the income from EU Emissions Trading.

### The Reinforced Just Transition Mechanism

The JTM has been created to help the most vulnerable regions, especially those with economies dependent in large part on fossil fuels, to alleviate the socio-economic impact of the energy transition. In January 2020 the Commission proposed a Eu100bn package for the JTM consisting of 3 pillars: a Just Transition Fund, a Just Transition Scheme under InvestEU, and a public sector facility. The mechanism was part of the Eu1tn package of investments under the European Green Deal Investment Plan (EGDIP). In light of Covid-19, the green recovery has become not only more urgent, but greater support for the most vulnerable regions has also become more necessary. In its presentation on 27 May the Commission announced it intended to strengthen the JTM: the overall budget will be increased to Eu40bn and the Just Transition Scheme under InvestEU will be beefed up.

On top of the initial Eu7.5bn, the Commission has proposed additional funds:

- Eu2.5bn from the long-term European budget;
- Eu30bn from Next Generation EU.

This takes **the total Just Transition Fund to Eu40bn**. The funds will be used to alleviate the socio-economic impact of the green transition in the worst-affected regions, e.g. through retraining workers, assistance for SMEs to create new business opportunities, and in general for the diversification of economic activity. According to initial estimates, Italy will receive Eu2,141mn.

The second pillar of the JTM is the Just Transition Scheme under InvestEU, which will be strengthened as a consequence of the increase in guarantees under InvestEU.

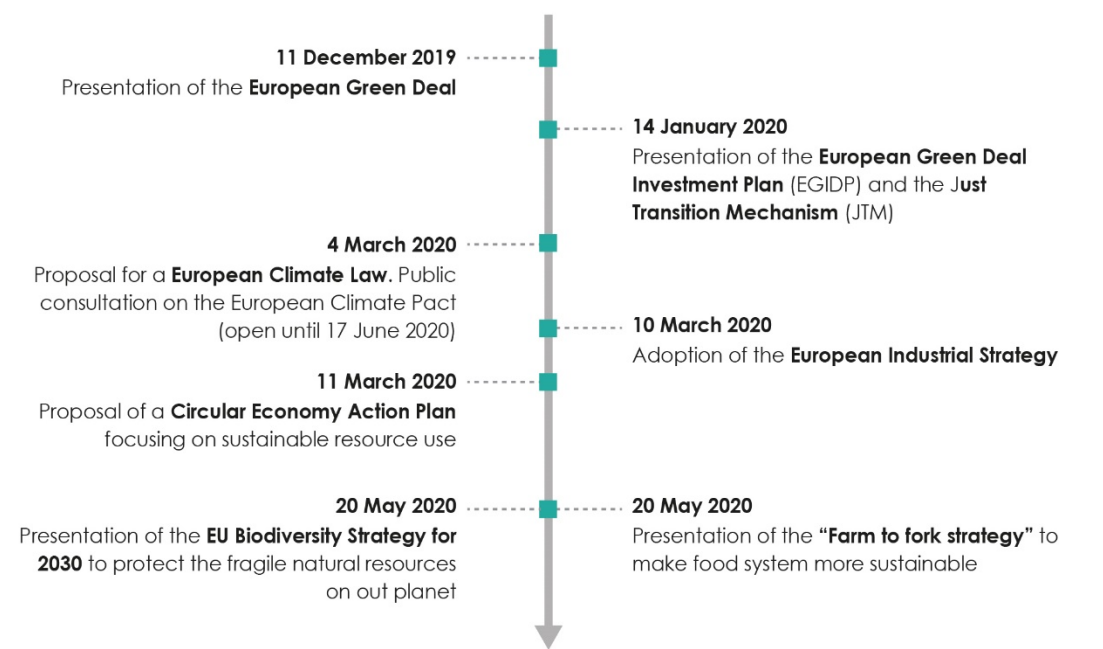
The third pillar is the public sector loan facility, presented on 27 May by the Commission and the EIB. This instrument consists of grants worth Eu1.5bn from the EU budget and loans for c.Eu10bn from EIB resources. In total, the instrument intends to mobilise Eu20-25bn in public investments into the following areas: the energy and transport sectors, measures for enhancing energy efficiency, building renovation, and social infrastructure.

### Accessing JTM funds

To access JTM funds, Member States must draw up territorial **Just Transition Plans** that take account of the Commission's priorities as laid down in the European Semester 2020 and also provide a framework for energy transition to 2030. These plans must also be in line with National Energy and Climate Plans and the transition to a climate-neutral economy. The territorial Just Transition Plans will identify the worst-affected regions that should receive support in the various Member States. Once the territorial Just Transition Plans are approved, access to the three pillars of the JTM will be granted.

Grant management falls to the Commission, while loans will be provided by the EIB. To ensure access to instruments, grants will be available for eligible projects in Member States through national grants that will be allocated until December 2024. Beyond this date, calls will be launched at EU level, to ensure the full implementation of the facility. The facility will become effective after an Administrative Agreement is signed between the Commission and the EIB.

### Time line on EU agenda – Green Deal



Source: Intermonte SIM and EU Commission

## Action Plan

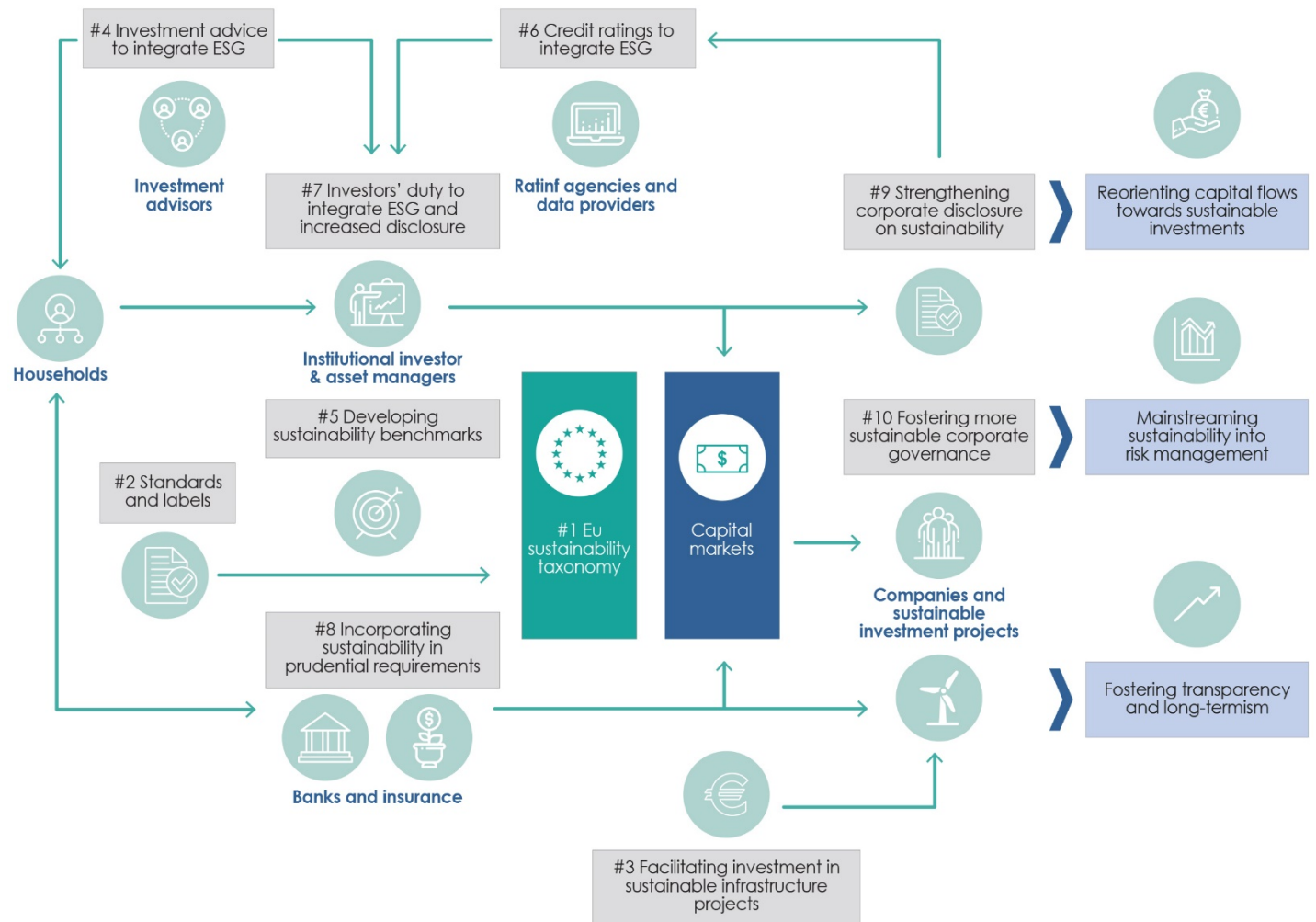
The **Action Plan on Financing Sustainable Growth** was announced by the European Commission in **March 2018** with the aim of reforming the financial system for a **greener and more sustainable economy**. At the end of 2016, the Commission appointed a **High Level Expert Group** on sustainable finance, in charge of elaborating a sustainable strategy for Europe. **Two imperatives** of the HLEG:

1. **Improving the contribution of finance to sustainable and inclusive growth by funding society's long-term needs;**
2. **Incorporating ESG factors into investment decisions.**

The Action Plan is expressed in **10 points across three main macro-areas:**

1. **Reorienting capital flows towards sustainable investments;**
2. **Mainstreaming sustainability into risk management;**
3. **Fostering transparency and long-termism.**

### Action Plan at a glance



Source: EU Commission and Intermonte SIM

In the following section we analyse some of the relevant points of the Action Plan and its implications for financial markets.

## EU Sustainable Taxonomy (Action 1)

The Taxonomy is a **classification system** for economic activities that contribute to **the transition toward a low-carbon and resilient economy**.

An economic activity is taxonomy-aligned if it satisfies three conditions:

1. **Substantially contributes to at least one of the six environmental objectives** defined in the Regulation;
2. **Does no significant harm** to any of the other five environmental objectives (DNSH Criteria);
3. **Complies with social minimum safeguards** such as the OECD Guidelines on Multinational Enterprises and the UN Guiding Principles on Business and Human Rights.

The **six environmental objectives** as defined in the regulations are:

### Environmental objectives according to the Taxonomy



\*already covered by the TEG

\*already covered by the TEG

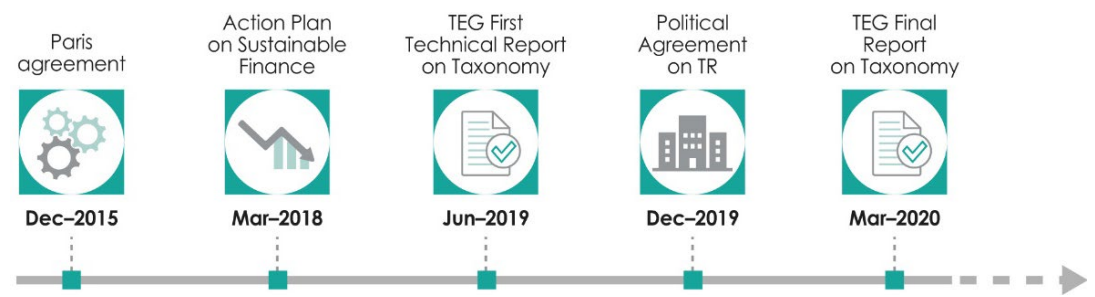
Source: TEG final report and Intermonte SIM

In March 2018, the Commission issued the Action Plan on Financing Sustainable Growth and set up a **technical expert group (TEG) on sustainable finance** to assist it in the development of a unified classification system for sustainable economic activities (first point of the Action Plan), an EU green bond standard, methodologies for low-carbon indices, and metrics for climate-related disclosures.

The **TEG is composed of 35 members** from the civil service, academia, business, finance, as well as additional members and observers from EU and international public bodies. It started its work in July 2018 and its mandate has been extended until 30 September 2020 in order to conclude technical work in February 2020. Following the end of its mandate, the TEG will be replaced by a permanent **Platform on Sustainable Finance**, an advisory body composed of experts from the private and public sector, which will assist the Commission on the further development of EU Taxonomy and sustainable finance more broadly.

The first TEG technical report on EU Taxonomy was issued in June 2019, and in December a political agreement on the proposed regulation was reached. Finally, **in March 2020 the final report on the Taxonomy, covering only the first two environmental objectives (climate change mitigation and adaptation), was released by the TEG.** Further development of the Taxonomy will be managed by the **Platform on Sustainable Finance**, which will continue the work of the TEG.

### From Paris Agreement to Taxonomy



Source: TEG Final report and Intermonte SIM

The European Parliament adopted **new legislation on the Taxonomy as of 18 June 2020**. The new law was published in the Official Journal of the European Union on 22 June 2020 and **will come into effect on 12 July 2020**.

**The next relevant steps** are highlighted below:

- Delegated acts for activities that substantially contribute to climate change mitigation and adaptation will be adopted by the end of 2020 and come into force by the end of 2021;
- Delegated acts for activities that substantially contribute to the remaining four environmental objectives will be adopted by the end of 2021 and come into force by the end of 2022.
- By 1 June 2021, the Commission will adopt a delegated act specifying how the corporate disclosure obligations should be applied in practice, taking into account the difference between financial and non-financial companies.

### Taxonomy Architecture

The final TEG report has developed **Technical Screening Criteria (TSC) and Do No Significant Harm Criteria for 70 activities that contribute substantially to climate change mitigation and 68 activities that contribute to climate change adaptation**.

Nuclear energy and natural gas are not explicitly excluded or included in the list of eligible environmentally sustainable economic activities. The Taxonomy Regulation leaves it to the delegated acts – to be based on the input of the stakeholders that make up the Platform on Sustainable Finance - to determine the role for nuclear energy and/or natural gas, if any, in the taxonomy.

### Sectors covered by the Taxonomy

70 Activities Climate Change Mitigation	68 Activities Climate Change Adaptation
Forestry	Forestry
Agriculture	Agriculture
Manufacturing	Manufacturing
Electricity, gas, steam and air conditioning supply	Electricity, gas, steam and air conditioning supply
Water, sewerage, waste and remediation	Water, sewerage, waste and remediation
Transportation and storage	Transportation and storage
Information and communications	Buildings
Construction and real estate activities	Financial and insurance activities
	Professional, scientific and technical activities




Source: TEG final report and Intermonte SIM

**In developing the TSC, the TEG prioritised those sectors that have a large impact** (for climate change mitigation, the activities covered are responsible for 93.5% of GHG emissions). The reason is that identifying the activities that make a substantial contribution to climate change mitigation in these high impact sectors will help the decarbonisation process.

**For companies that are engaged in activities that are not covered by the Taxonomy, the TEG encourages disclosures to reflect their current situation as clearly as possible.**

To capture all economic sectors covered by the Taxonomy, **NACE codes** are used and translation tables to other classification systems are provided by the TEG. For each environmental objective the TEG recognises **three types of activities that substantially contribute**, as highlighted in the table on the next page.

### Taxonomy-eligible economic activities

Type of activity	Description	Example
 <b>Own Performance</b>	Economic activities that make a substantial contribution based on their own performance. The activity is performed in a way that substantially contributes to environmental objectives	Energy efficient manufacturing processes, low carbon energy production
 <b>Enabling Activities</b>	Economic activities that through provision of their products or services enable a substantial contribution to be made to other activities	Manufacture of low carbon products, key components, equipment or machinery that improves the environmental performance of another activity
 <b>Transition Activities</b>	Activities that do not meet the TSC. The TEG recommends considering the financing of the improvement measures (capex and opex if relevant) as Taxonomy aligned if they are part of a plan to meet the activity threshold over a set period of time (limit of five years for these plans)	Energy efficiency measures, resilience measures, small scale renewables

Source: TEG final report and Intermonte SIM

We show a simple **example of a cement manufacturing company**, which is by definition a high emission activity.

**A cement manufacturing company has GHG emissions of 0.71CO<sub>2</sub>e/t of cement, thus it does not meet the TSC established by the Taxonomy, which is 0.4981CO<sub>2</sub>e/t of cement. As a consequence, the activities and the company cannot be considered taxonomy aligned. But if the company is intending to increase the environmental performance of its manufacturing facility and drafts a plan to do this, thus showing its commitment to meeting the performance criteria as established in the Regulation in the foreseeable future, the company can be considered taxonomy aligned as it is financing the transition.**

**Some TSC will be tightened over time, in particular for CO<sub>2</sub> metrics** (which are likely to trend toward zero over the period 2050) and for transition activities the Taxonomy Regulation requires the European Commission to review the performance threshold every three years. Additionally, the TEG recommends that the improvement plan for transition activities should satisfy the current criteria but should also be flexible enough to respond to future tightening of the criteria. Thus a three-year plan should consider some tightening of criteria within the next three years.

### Taxonomy users

The users of Taxonomy will be:

#### Taxonomy users



**1.** Financial market participants offering financial products in the EU, including occupational pension providers



**2.** Large companies who are already required to provide a non-financial statement under the Non-Financial Reporting Directive



**3.** The EU and Member States, when setting public measures, standards or labels for green financial products or green (corporate) bonds

Source: TEG Final report on taxonomy

### How companies would use the Taxonomy

Companies that are already required to provide a Non-Financial Statement under the NFRD (>500 employees) will also be required to provide new disclosures for the new Taxonomy regulation. These new disclosure requirements differ for financial and non-financial companies.

#### Non-financial companies are required to disclose:

- **the proportion (%) of turnover aligned with the Taxonomy;**
- **the CapEx and, if relevant, OpEx aligned with the Taxonomy.**

The **disclosures** should be made **as part of the non-financial statement and should be located in the annual report or sustainability report**. The new climate reporting guidelines developed by the Commission in 2019 recommended that companies disclose their degree of alignment with the taxonomy and by 1 June 2021 the Commission will adopt a delegated act that will give more indications on how these requirement obligations should be applied in practice, distinguishing between financial and non-financial companies.

The % of CapEx aligned with the Taxonomy provides investors with invaluable information for constructing green portfolios and for analysing companies' transition plans and environmental strategies.

When a company discloses the % of turnover or CapEx that is Taxonomy aligned, it must choose one of the two environmental objectives to which it contributes. In situations where an economic activity makes multiple substantial contributions, the company will normally choose the environmental objectives for which the % of alignment with the Taxonomy is higher, and the company is encouraged to disclose the fact that one or more activities contribute to multiple environmental objectives.

Once companies provide disclosures against the Taxonomy and after verifying that the economic activities substantially contribute to climate change mitigation and/or adaptation, companies should check compliance with the **Do No Significant Harm Criteria** and **with minimum social safeguards such as the OECD Guidelines on Multinational Enterprises and the UN Guiding Principles on Business and Human Rights**.

When a company files disclosures on economic activities there are a number of possible scenarios:

**Disclosure approach for companies with and without Taxonomy coverage**

Case	TEG Recommendation
The economic activity is covered by existing TSC	Disclose turnover, capex and opex if relevant
The economic activity may be able to make a substantial contribution to climate change mitigation or adaptation, but TSC have not been developed yet	Disclose that the economic activity does not yet have TSC. Inform the Platform on Sustainable Finance
The economic activity may be able to make a substantial contribution to climate change mitigation or adaptation, but TSC have not been developed yet. All disclosure of this kind is voluntary until the delegated acts enter into application	Disclose that the economic activity does not yet have TSC because the Taxonomy does not yet cover the environmental objective to which it contributes (3-6). Narrative disclosure about environmental performance is still possible using NFRD guidelines. Inform the Platform on Sustainable Finance.
The economic activity does not, in the opinion of the issuer or operator, have a significant impact on the Taxonomy's environmental objectives, and improved performance in its own operations is unlikely to make a substantial contribution to an environmental objective. This situation will not apply to climate change adaptation	Disclose that the economic activity is not addressed by the Taxonomy. Companies can and should disclose how they manage their environmental impacts. The fact that their activities do not make a substantial contribution to an environmental objective does not mean that the companies do not contribute positively to the environment by responsibly managing their environmental impacts, no matter how limited these are

Source: TEG final report and Intermonte SIM

**Application of Taxonomy for a company step-by-step**

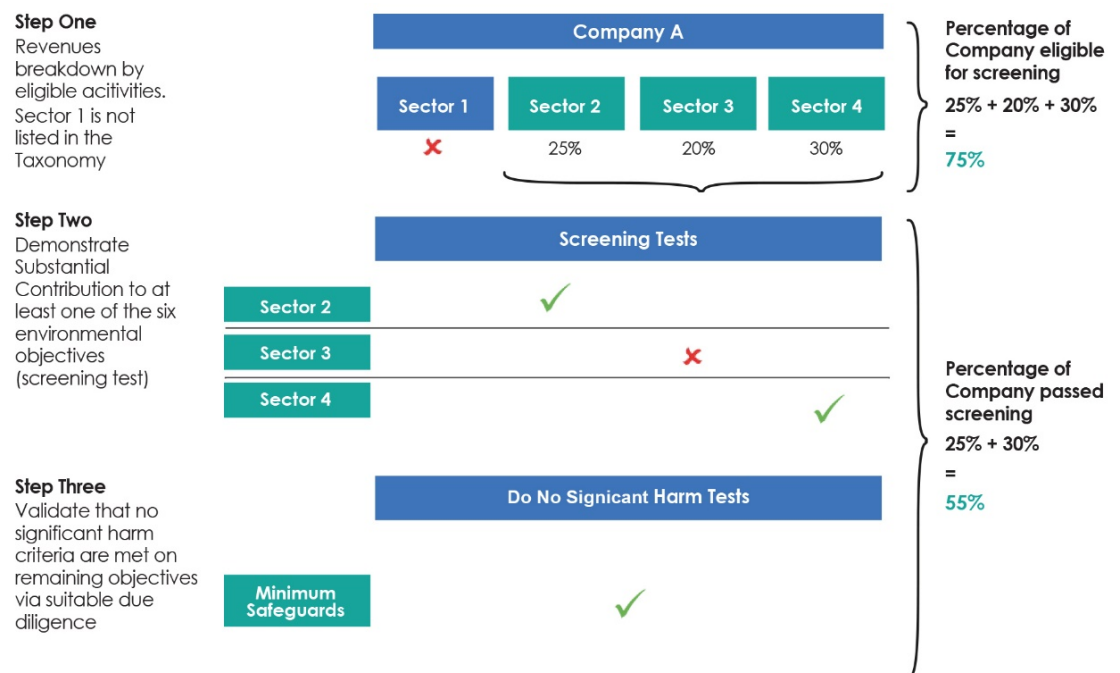
We show a simple example taken from the final TEG report (please refer to the graph below) in order to set out in greater detail how a company can assess its taxonomy compliance step by step.

In the first step, the company needs to break down its revenues or CapEx (if relevant OpEx) by eligible taxonomy activities. In this example, Company A has activities split across four sectors: based on the TEG report, TSC have been developed for Sectors 2, 3 and 4 only, hence the percentage of company-eligible taxonomy activities up to this stage is 75%.

In the second step, the company should demonstrate a substantial contribution to at least one of the six environmental objectives. In this case, only Sectors 2 and 4 pass the screening test and as a result the percentage of company alignment at this step is 55%.

In the final step, the company should verify the Do No Significant Harm criteria with regard to the remaining environmental objectives and compliance with Minimum Social Safeguards. In this example, the company passes step three and its final taxonomy alignment percentage is 55%.

**Assessing an individual company for Taxonomy alignment**



Source: Intermonte SIM elaboration on TEG Final report on taxonomy

### Final verification

The Taxonomy Regulation does not require any formal verification of Taxonomy-related disclosures, although the TEG considers it good practice for issuers to seek external assurance on their Taxonomy-related disclosures.

### Financial market participants

Financial market participants offering financial products in the European Union, as illustrated in the table below, are required to perform Taxonomy Disclosure:

#### Financial market participants required to make Taxonomy disclosure

Market segment	In scope for Taxonomy disclosure
Pension and Asset Management	<u>UCITS funds:</u> - equity funds - Exchange-traded funds (ETFs) - bond funds <u>Alternative Investment Funds (AIFs):</u> - fund of funds - real estate funds - private equity or SME loan funds - venture capital funds - infrastructure funds Portfolio management (under Article 4(1) of MIFID II) <u>Pensions:</u> - pension products - pension schemes (defined with reference to IORP II) - pan-European personal pension products
Insurance	Insurance-based Investment products (IBIPs)
Corporate & Investment Banking	Securitisation funds Venture capital and private equity focus Portfolio management Index funds

Source: TEG Final Report on taxonomy

#### Financial market participants are required to disclose:

- **the proportion of underlying investments that are Taxonomy aligned as a percentage of the investment, fund or portfolio;**
- **the distinction between transition and enabling activities;**
- **to what environmental objectives they contribute.**

These disclosures must be provided as part of the existing pre-contractual and periodical disclosure obligations and on relevant websites.

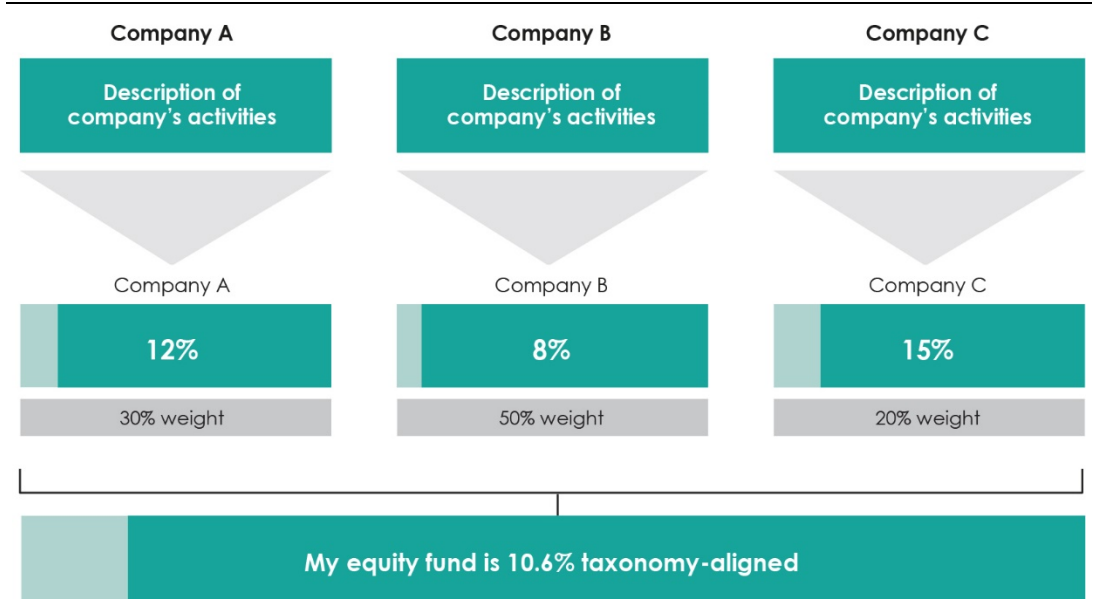
As it stands, the Taxonomy Regulation does not require investors to seek external verification of their disclosures, but the Commission plans to review this by 2022.

Investors should follow a **five-step process** in using the Taxonomy:

1. Identify the activities conducted by the company, issuer or covered by the financial product that could be Taxonomy-eligible, indicating for which specific environmental objectives;
2. For each activity identified in the first step, verify if the TSC are met;
3. Verify that the DNSH criteria are met by the issuer;
4. Conduct due diligence to avoid any violation of the social minimum safeguards stipulated in the Taxonomy;
5. Finally, calculate alignment of investments with the Taxonomy and prepare the necessary disclosures.

The following diagram provides a simple example of how to calculate Taxonomy alignment.

**How to apply Taxonomy to an equity portfolio**

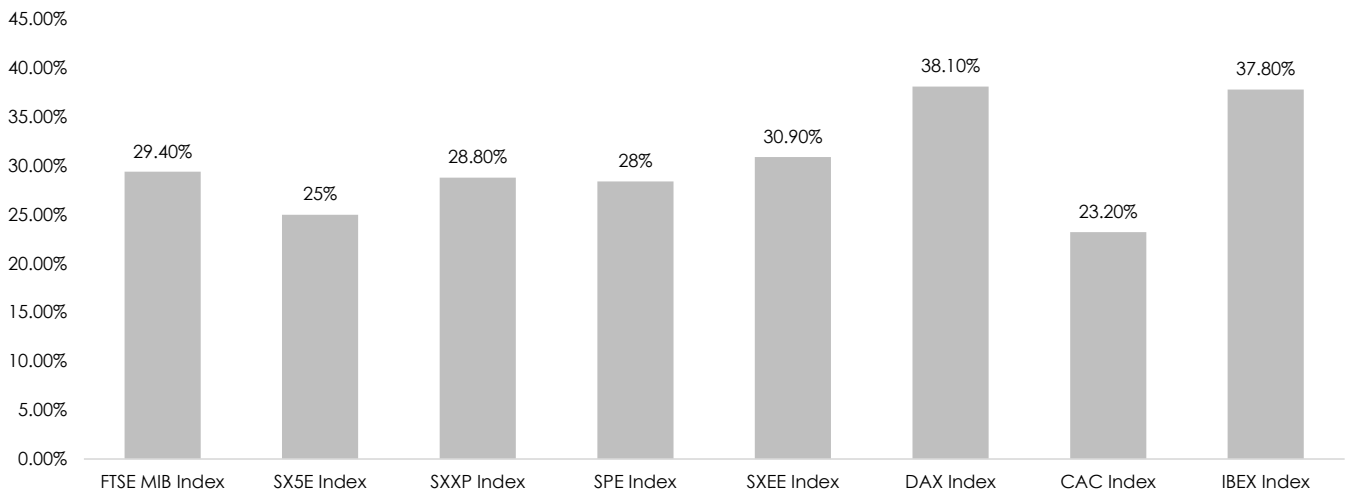


Source: TEG Final Report on Taxonomy

**Taxonomy-eligibility of indices**

We have looked at Taxonomy-eligibility percentages for a number of European Indices using Bloomberg. Making the running are the IBEX Index (c.37.80% Taxonomy-eligible) and the DAX Index (c.38.10%). The FTSE MIB is about 29.40% Taxonomy-eligible. These figures express the percentage of revenue of underlying assets that sit within a Taxonomy-eligible activity (definition provided by Bloomberg) with reference to the first two environmental objectives (climate change mitigation and adaptation).

**Percentage Taxonomy-eligibility of selected European indices**



Source: Bloomberg

## Creating standards for green financial product labels (Action 2)

Building on the EU Taxonomy, EU standards and labels for sustainable financial products would facilitate trust in the sustainable financial market, avoid green-washing, and ease access for investors seeking these products. A labelling scheme will be of particular interest to retail investors who wish to express their investment preferences in sustainable activities.

In Action 2 of the Action Plan, the Commission asked the TEG to prepare a report on an EU Green Bond Standard (EU-GBS), building on current best practices; the Commission will explore the use of the EU Ecolabel framework for financial products, to be applied only after the EU Taxonomy Regulation is adopted.

On 18 June 2019, the TEG published its Report on the EU Green Bond Standard and on 9 March 2020 published a usability guide for the EU Green Bond Standard. In the near future, the Commission will also explore the possibility of a legislative initiative for the EU Green Bond Standard.

The Green Bond market is on the rise and 2019 saw a new issuance record set of USD257.7bn (Source: 2019 Green Bond Market Summary, February 2020, Climate Bond Initiative), up 51% on 2018. Europe led on volumes in 2019 with 45% of bond issuance, followed by Asia-Pacific.

**The TEG proposed that an EU Green Bond could be any type of listed or unlisted bond or capital market debt instrument issued by a European or international issuer that is aligned with the EU Green Bond Standard.** Based on best market practices, the **EU Green Bond Standard** would have the following **four characteristics**:

1. Alignment with EU taxonomy: proceeds from the EU Green Bond should go to finance or refinance projects/activities that are taxonomy-aligned;
2. Publication of a Green Bond Framework, which confirms the voluntary alignment of green bonds issued under the EU GBS, and provides additional information, such as how the issuers' strategy is aligned with environmental objectives and the use of proceeds.
3. Mandatory reporting on the use of proceeds (allocation report) and on the environmental impact (impact report);
4. Mandatory verification of the Green Bond Framework and a final allocation report by an external reviewer. The TEG believes the most appropriate authority to perform external verification would be ESMA.

In the following table we compare the EU-GBS to the ICMA principles, which inspiration for the former.

### GBP vs GBS

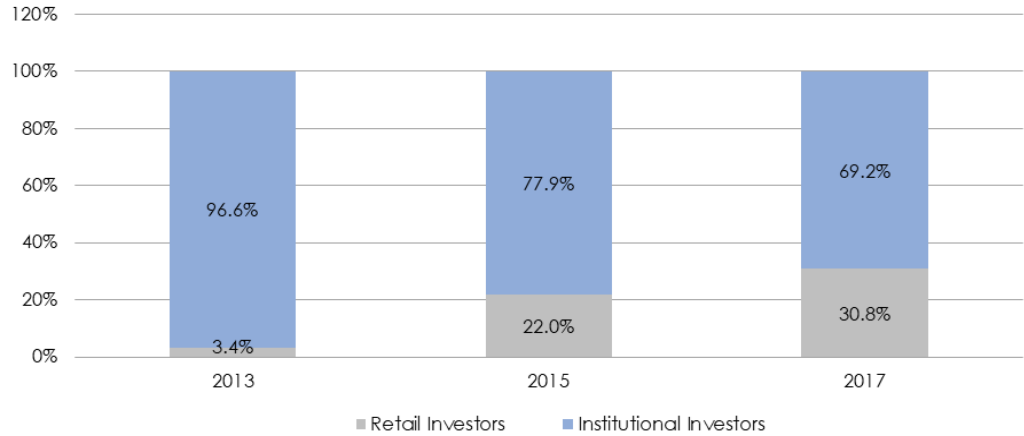
Topic	Green Bond Principles (ICMA)	Proposed EU Green Bond Standard (GBS)
Use of proceeds in legal documentation	Recommended	Required
Alignment with Taxonomy	Not required	Required alignment with the four criteria of EU Taxonomy: (1) substantial contribution to environmental objectives, (2) DNSH, (3) compliance with social minimum safeguards. Green Bond Framework (GBF) is required and a template is provided in the report of the EU-GBS. Specific requirements related to capital/operating expenditures and look-back periods are provided in the EU-GBS report
Disclosures of proportion of proceeds used for	Required	Required
Impact monitoring and reporting	Required to report whether issuer is monitoring impact or not, and if so, to disclose estimated/actual impact	Required. A reporting template is provided
External review requirements	Required. External review must confirm, as a minimum, alignment on issuance of the EU green bond with all four core components of the EU-GBS, or, alternatively, confirm alignment of the EU Green Bond programme as a whole	Required. Verification of the Green Bond Framework and the Final Allocation Report by an accredited verifier to confirm conformity with the EU-GBS
Publication of external verification	Required	Required
Accreditation of external reviewers	Sets out accreditation requirements for external verifiers	A centralised scheme of accredited verifiers operated by ESMA. Voluntary interim registration scheme for an estimated transition period of up to three years

Source: EU Commission and Intermonte SIM

## Incorporating sustainability when providing financial advice (Action 4)

According to the European SRI Study 2018, the number of retail investors interested in incorporating sustainability themes in their investment strategies has increased markedly. Eurosif investigated the evolution of the SRI asset breakdown by investor type, and observed an increase in the retail sector: the SRI asset breakdown for retail investors grew from 3.40% in 2013 to 30.77% in 2017.

### SRI asset breakdown by retail and institutional investors



Source: European SRI Study 2018

According to Global Sustainable Investment Alliance data, at the start of 2018, global sustainable investments reached \$30.7 trillion in the five major markets, a 34% rise in two years:

### Global sustainable investment assets at a glance - USDbn

Macro-area	2016	2018
Europe	\$ 12,040	\$ 14,075
United States	\$ 8,723	\$ 11,995
Japan	\$ 474	\$ 2,180
Canada	\$ 1,086	\$ 1,699
Australia/New Zealand	\$ 516	\$ 734
<b>Total</b>	<b>\$ 22,839</b>	<b>\$ 30,683</b>

Source: Global Sustainable Investment Alliance 2018

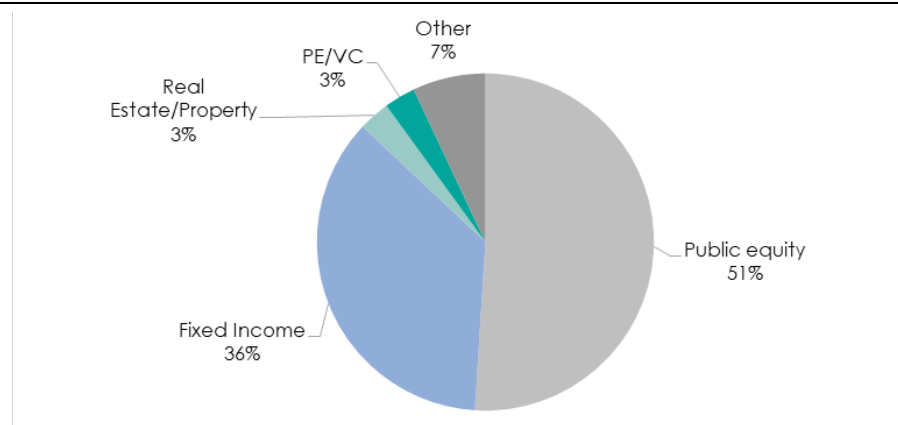
### Percentage of global sustainable investment assets

% of AUM per Macro-area	2016	2018
Europe	52.7%	45.9%
United States	38.2%	39.1%
Japan	2.1%	7.1%
Canada	4.8%	5.5%
Australia/New Zealand	2.3%	2.4%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>

Source: Global Sustainable Investment Alliance 2018

Sustainable investments now cover a wide range of asset classes, as shown in the pie chart below, which illustrates sustainable investing asset allocation in Europe, the United States, Japan and Canada in 2018 (Source: Global Sustainable Investment Alliance 2018). In these territories, public equity took the lion's share of asset allocation with 51%, above the total at the beginning of 2018; the second largest allocation was in fixed income, at 36%. The 'other' category, on 7%, includes sustainable investments in hedge funds, cash, depository vehicles, commodities and infrastructure.

### Global sustainable investment asset allocation 2018



Source: Global Sustainable Investments Alliance 2018

Hence sustainable finance is increasingly becoming mainstream, although savers and small investors need to be provided with clear information on green themes. Action 4 of the Action Plan addresses this: it lays down that sustainability be added to financial consultancy through changes to MiFID II and the IDD directives.

Between May and June 2018, the European Commission held a public consultation to assess the opinions of parties interested in amending the MiFID II and the IDD directives to supplement consultancy with ESG themes. In July 2018, the Commission asked ESMA and EIOPA to provide their technical views on incorporating ESG factors into the regulation in question.

In April 2019, ESMA and EIOPA published their technical views on the consultation and submitted them to the Commission.

In early January 2020, the Commission published proposed amendments to the IDD and MiFID II delegated acts. These acts are subject to examination by the Commission for 3 months (6 if necessary). Once completed and barring objections, the delegated acts are officially published in the Official Journal of the European Union. The changes to the MiFID II Directive that should be introduced according to ESMA are as follows:

**Proposed amendments to MIFID II**

<b>Organisational Requirements</b>	Companies must take account of ESG factors and integrate them in their organisation, processes, systems and internal controls
<b>Risk management</b>	ESG factors must be borne in mind in the risk management process. It is also expected that compliance and internal audit departments should perform analysis on sustainability questions, since both functions are responsible for monitoring the suitability and effectiveness of the firm's risk management policies and procedures
<b>Conflicts of interest</b>	Companies must indicate how conflicts of interest related to distribution of securities that are relevant for ESG purposes are identified and managed
<b>Product governance</b>	The ESG preferences that a specific product aims to satisfy must be identified and set out point by point. Companies to use the Taxonomy being drawn up by the European Commission to inform the identification process.

Source: ESMA – Consultation Paper on integrating sustainability risks and factor in MIFID II

## Clarifying institutional investors' and asset managers' duties (Action 7)

The Commission intends to clarify the obligations of institutional investors and asset managers on considerations inherent to sustainability. The aim is to oblige investors and managers to supplement their investment decision process with sustainability themes and to increase transparency in regard to final investors on how to integrate sustainability factors in their investment decisions and also in regard to their exposure to sustainability risks.

Regarding ESG reporting by institutional investors, the reference regulations are contained in EU Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORP II).

This EU directive was transposed into Italian law via Legislative Decree 147/2018, in force since 1 February 2019.

It is clearly stated that the environmental, social and governance factors referred to in the principles of responsible investment supported by the United Nations are important for investment policies and management systems at pension providers, and thus such institutions are required to state:

- whether they bear ESG factors in mind in investment choices;
- how such factors are integrated in risk management.

If ESG criteria are not adopted, reasons must be given for this choice (comply or explain rule).

Amendments to IORP II introduced the following main updates :

### Amendments in force to IORP II

Article	Section	Description
19	Investment rules	Pension IORPs shall take account of the potential long-term impact of investment decisions on ESG factors
21	Investment rules	IORPs shall adopt an effective system of governance that takes into account ESG factors related to investment activities
25	Risk management	The risk management system shall cover ESG risks related to the investment portfolio and the management thereof in a manner that is proportionate to the size, nature, scale and complexity of the IORP's assets
28	Own-risk assessment	If IORPs take ESG factors into consideration in investment decisions, at least every three years or following any significant change in the risk profile a risk assessment shall be performed of new or emerging risks
30	Statement of investment policy principles	Every 3 years, IORPs shall draw up a document stating how ESG factors are integrated in investment policies. This statement is to be revised without delay after any significant change in the investment policy and shall be accessible to the public
41	Information to be given to prospective members	Member States shall require IORPs to ensure that prospective members who are not automatically enrolled in a pension scheme are informed, before they join that pension scheme, about whether and how environmental, climate, social and corporate governance factors are considered in the investment strategy; Member States shall require IORPs to ensure that prospective members who are automatically enrolled in a pension scheme are promptly informed after their enrolment on whether and how environmental, climate, social and corporate governance factors are considered in the investment strategy

Source: EU Directive (EU) 2016/2341 and Legislative Decree 147/2018

## How Could These Plans Affect Banks: Incorporating Sustainability in prudential requirements (Action 8)

Banks, insurance companies and pension funds could play a critical role in financing the transition towards a more sustainable economy, but could be exposed to risks related to unsustainable economic development, since the current prudential framework does not make a distinction between green and brown investments. Building on the development of the EU Taxonomy, the Commission will explore the possibility of including risks associated with climate and other environmental issues in institutions' risk management policies and the potential calibration of banks' capital requirements as part of the Capital Requirement Regulation and Directive (Action 8, Action plan). In the third quarter of 2018 the Commission invited the European Insurance and Occupational Pensions Authority (EIOPA) to provide an opinion on the impact of prudential rules for insurance companies on sustainable investments, with a particular focus on climate change mitigation. The Commission will take this opinion into account in the report to be submitted to the European Parliament and Council by 1 January 2021 under the Solvency II Directive.

The rationale behind the proposed changes to prudential requirements is based on the assumption that ignoring risks associated with climate change and environmental factors can expose financial institutions to long-term financial risks. The purpose is to encourage banks and insurers to invest in sustainable assets.

A BIS paper published in 2020, entitled "The Green Swan – Central banking and financial stability in the age of climate change", reports the discussions that have emerged with regard to how the three pillars of the Basel framework could integrate climate risks:

**Pillar 1 on minimum capital requirements:** since the exposure to climate-related risks could lead to financial risks, it may be appropriate to consider capital requirements to reflect such risks. There are two proposals on the table: the first in favour of a green supporting factor, which would reduce capital requirements for banks with lower exposure to climate-related risks; the second proposal is on a brown penalising factor, which would increase capital requirements for banks with higher exposures to climate-related risks. Even if the discussions are still ongoing, the inclination seems to be toward a brown penalising factor. The thinking behind this is that exposure to brown assets can clearly increase financial risks, whereas it is not obvious why being exposed to green assets would automatically reduce non-climate related financial risks and hence justify lower capital requirements.

**Pillar 2 on the supervisions of institutions' risk management:** regulators could prescribe additional capital on a case-by-case basis, for instance if a financial institution does not adequately monitor and manage climate-related risks.

**Pillar 3 on disclosure requirements:** a more systematic, consistent and transparent disclosure of climate-related risks is encouraged by regulators and supervisors, since it should help improve the pricing of climate-related risks and lead to more efficient capital allocation.

The potential impact of climate-related prudential regulation at this current stage remains unclear, and discussions are still ongoing.

On 20 May 2020, the European Central Bank launched a public consultation on its Guide to climate-related environmental risks. The consultation will end on 25 September 2020.

The Guide highlighted the importance of safe and prudent management of climate-related and environmental risks under the current prudential framework, and set guidelines on:

- how institutions should consider climate-related and environmental risks when designing their business strategy, their governance and their risk management framework;
- how to effectively communicate exposure to climate-related risks by enhancing climate-related disclosure.

Climate-related risks for banks are divided into:

- Physical risks, which refer to the financial impact of: (i) a changing climate, including more frequent extreme weather events and gradual changes in climate; and (ii) environmental degradation, such as air, water and land pollution, water stress, biodiversity loss and deforestation. These changes can directly result in, for example, damage to property or reduced productivity. Indirectly, they can lead to issues such as the disruption of supply chains.
- Transition risks, which refer to financial losses that can result, directly or indirectly, from the process of adjustment towards a lower-carbon and more sustainable economy. These risks can arise as a result of, for example, relatively abrupt adoption of climate and environmental policies, technological progress or changes in market sentiment and preferences.

Both of these risks can have an impact on economic activity, which in turn affect the financial system. This impact can occur directly through, for example, lower corporate profitability or asset devaluation, or indirectly through macro-financial changes. In addition, physical and transition risks can trigger further losses stemming

directly or indirectly from legal claims on the bank (commonly referred to as "liability risk") and reputational loss for failing to adequately manage climate-related and environmental risks.

Physical and transition risks are therefore drivers and potentially aggravating factors of prudential risk categories, in particular credit risk, operational risk, market risk and liquidity risk.

The Guide intends to increase awareness of climate-related and environmental risks and to improve the management of such risks, and does not conflict with European and national law.

After the consultation period ends, the ECB will publish the comments received and a feedback statement.

### **CCR quick fix: revised rules**

On 19 June the European Parliament approved CRR "quick fix", a package of new rules to encourage banks to lend to companies and households in order to mitigate the impact of the Covid-19 pandemic. Temporary changes have been made to Regulation (EU) 575/2013 (CRR, capital requirements regulation) and Regulation 2019/876 (CRR2, Capital Requirement Regulation 2). Banks will have to monitor the effect of the pandemic on their balance sheets, pay close attention to non-performing loans and apply know-your-customer standards.

Among the various adopted changes we signal the one according to which Banks will no longer be required to deduct certain software assets from their capital, with the aim of accelerating the digitalisation of the banking sector. This change is consistent with the digital transition that the EU Commission is committed to achieving.

### **ECB against climate change**

In January 2020 the Governing Council of the European Central Bank (ECB) launched a review of its monetary policy strategy, the so-called strategic review, expected to be concluded by mid-2021.

ECB President Christine Lagarde declared: "Through our strategic review, we will determine where and how the issue of climate change and the fight against climate change can actually have an impact on our policies".

ECB is working on how it can fight climate change and take action in four main areas:

1. Economic analysis: ECB staff ensure that climate change is taken into account in the ECB's macroeconomic models, forecasting methods and risk assessments,
2. Banking supervision: supervisors engage with banks to raise awareness of risk emerging from climate change. The aim is to ensure that banks are able to manage these risks properly;
3. Monetary policy and investment portfolios: ECB, as part of the ECB's asset purchase programme, has invested in green bonds, taking into account the need to avoid market distortion;
4. Financial stability: experts measure and assess the risks posed to the financial system by climate change. Their findings are communicated to the public, to market participants and to policymakers.

## Appendix 1


### Pillars of Next Generation EU

	Programme	Description	Budget
First Pillar	Recovery and Resilience Facility	Grants and loans for implementing Member States' national recovery and resilience plans defined in line with the objectives of the European Semester, including in relation to the green and digital transitions and the resilience of national economies	Eu560bn, of which Eu310bn for grants and Eu250bn in loans
	REACT-EU	Flexible cohesion policy grants for municipalities, hospitals, and companies via Member States' managing authorities. No national co-financing required	Eu55bn of additional cohesion policy funding between 2020 and 2022
	Reinforced Just Transition Fund	A proposal to strengthen the Just Transition Fund to Eu40bn in order to assist Member States in accelerating the transition towards climate neutrality	Eu40bn
	Reinforced Agricultural Fund	A Eu15bn reinforcement for the European Agricultural Fund for Rural Development in order to support rural areas in making the structural changes necessary in line with the European Green Deal and achieving the ambitious targets in line with the new Biodiversity and Farm to Fork strategies	Eu15bn
Second Pillar	Enhanced InvestEU	Provisioning of an EU budget guarantee to finance investment projects via the EIB group and national promotional banks	Eu15.3bn for InvestEU. Additionally, a new Strategic Investment Facility to be endowed with Eu15bn in provisioning from Next Generation EU
	New Solvency Support Instrument	Provisioning of an EU budget guarantee to finance investment projects via the EIB group and national promotional banks	Provisioning of an EU budget guarantee for the EIB in order to mobilise private capital
Third Pillar	EU4Health	A new Health Programme, EU4Health, to strengthen health security and prepare for future health crises	Grant and loans for Eu9.4bn
	RescEU	Reinforcement of the EU's Civil Protection Mechanism in order to strengthen health security and prepare for future health crises	Grants and procurement for Eu3.1bn

Source: Intermonte SIM and EU Commission

## Appendix 2

### Breakdown of grants components per country for the Recovery and Resilience Facility and for Just Transition Fund

Country	Recovery and Resilience Facility	Just Transition Fund
	National Allocations (Eumn 2018 - prices)	National Allocations (Eu mn - 2018 prices)
Austria	2,950	212
Belgium	4,821	285
Bulgaria	6,131	2,020
Croatia	6,125	290
Cyprus	1,082	158
Czech Rep.	4,678	2,560
Denmark	1,723	139
Estonia	1,004	552
Finland	2,196	726
France	32,167	1,606
Germany	21,545	3,864
Greece	17,874	1,294
Hungary	6,136	407
Ireland	1,209	132
<b>Italy</b> 	<b>63,380</b>	<b>1,606</b>
Latvia	2,170	299
Lithuania	2,766	426
Luxembourg	101	14
Malta	226	36
Netherlands	5,197	972
Poland	26,808	6,000
Portugal	12,905	349
Romania	13,505	3,337
Slovenia	1,693	403
Slovakia	6,140	716
Spain	61,618	1,355
Sweden	3,849	243
<b>TOTAL</b>	<b>310,000</b>	<b>30,000</b>

Source: Intermonte SIM and EU Commission

### \*\*\*\*\* Glossary \*\*\*\*\*

<b>TR</b> Taxonomy Regulation	<b>HLEG</b> High Level Expert Group	<b>TEG</b> Technical Expert Group
<b>NFRD</b> Non-Financial Reporting Directive	<b>TSC</b> Technical Screening Criteria	<b>DNSH</b> Do No Significant Harm Criteria
<b>JTF</b> Taxonomy Regulation	<b>EGDIP</b> European Green Deal Investment Plan	<b>JTM</b> Just Transition Mechanism
<b>EIB</b> High Level Expert Group	<b>GBS</b> Technical Expert Group	<b>GBP</b> Technical Screening Criteria

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UNDERPERFORM: stock expected to underperform the market by between -10% and -25% over a 12 month period;

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NEUTRAL:	36,80 %
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NEUTRAL:	20,84 %
UNDERPERFORM	00,00 %
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OLIDATA	0,74	SHORT
SPACTV	1,08	LONG
THESPAC	0,89	LONG
VEI 1	0,87	LONG

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