Nordic Credit Rating

SECTOR COMMENT

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ESG factors in corporate ratings

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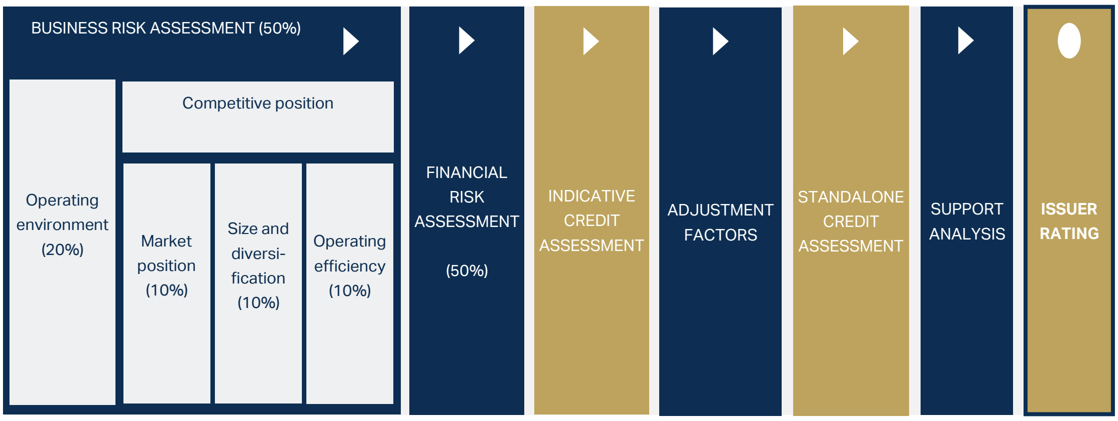
Nordic Credit Rating (NCR) is committed to increasing transparency into how environmental, social and governance (ESG) factors can impact creditworthiness. These factors will be considered and highlighted in our credit ratings if we believe they are material and relevant to the creditworthiness of an issuer. ESG factors can influence ratings, outlooks and headroom within ratings. The potential influence of ESG factors on our credit ratings depends on the financial impact they have on an entity's creditworthiness, whether positive or negative. We consider each entity's public disclosures on ESG factors and engage in a dialogue with management on the issuer's exposure to and management of risks relating to ESG factors in all facets of its business.

Our rating methodology for non-financial corporate entities incorporates important factors as which we deem to be relevant for assessing their creditworthiness. It takes into account each issuer's exposure to its operating environment, its competitive position, and financial risk factors.

NCR corporate rating framework



Our analysis of an issuer's exposure to ESG factors is integrated, where relevant, throughout the methodology. The factors included in the assessment represent tangible issues with a potential direct impact on the issuer's operating environment, competitive position, and financial assessment. In addition, an adjustment factor can be applied which can result in a negative adjustment to the rating if we consider that the issuer's exposure to ESG-related risk has not been fully captured elsewhere in the methodology.

OPERATING ENVIRONMENT

Our assessment of an issuer's exposure to its operating environment includes our view of its exposure to industry and country risk. Industry exposure can be inherently associated with risk arising from environmental or social conditions as well as governance issues. If we consider that such risks could cause an industry's fundamental dynamics to deteriorate, or growth trends or profit margins to weaken, we would adjust our view of industry risk accordingly. Industry specific issues for a given issuer are covered in this assessment.

COMPETITIVE POSITION

Our view of an issuer's competitive position reflects how efficiently it utilises its assets to gain market traction. It further reflects the issuer's overall vulnerability and ability to maintain, or increase, its competitive position.

Problems in the operating environment can sometimes be mitigated by the issuer itself. Exposure to environmental and social risk can affect an issuer's competitive position in relation to suppliers, customers and partnerships. This can affect the issuer's ability to maintain or increase its revenues as well as keep its cost base at competitive levels and in turn reduce its ability to service its debt obligations. An issuer could respond, for example, by improving its competitive position through increased market share, diversification or increased operating efficiency with an appropriate response to ESG issues.

Conversely, an issuer could face issues not typical for the industry or fail to respond in line with its competitors, thus weakening its competitive position. Typical examples could include companies operating in stable industries but with a history of excess pollution above the levels of their competitors, or companies that have not adapted their operations to industry standards or regulations.

FINANCIAL RISK

In our financial risk assessment, we analyse an issuer's financial statements and forecast how its financial position will develop. Importantly, we also analyse closely its risk appetite and financial policy as we consider that these factors dictate future financial performance.

Financial risk for an issuer can be negatively impacted by environmental, social or governance factors. This can affect estimated revenues, cost of goods sold, and capital expenditure. Further, it can cause untimely depreciation of assets or stranded assets, while loss of business license or opportunities can lead to loss of investments resulting in weakening cash flows. Positively, companies that can maintain the value of their properties, factories, and operations due to significant avoidance of risk, including ESG risk, could support their credit metrics by ensuring potential second-hand value. An above-average ESG assessment does not mitigate structural weaknesses in a business or financial assessment, but it can contribute to the protection of an already strong credit profile.

We think that an entity's financial risk is inherently impacted by factors relating to corporate governance. In our assessment of financial risk appetite, we consider the degree to which risk culture is embedded in a company, and this in turn affects our assessment of the company's ESG policies and compliance with these. An historically weak governance structure and weak execution of financial plans will result in lower confidence from investors, regulators, and suppliers, which could lead to an erosion of the issuer's financial position over time.

ADJUSTMENT FACTORS

Apart from incorporating the above-mentioned ESG factors into our overall credit analysis, we also identify any significant deficiencies not otherwise considered, and apply a negative adjustment to the rating if we deem it necessary. Our assessment of whether a rating warrants such an adjustment is based on whether we can assess with confidence that the issuer is negatively exposed to ESG issues not captured in the initial analysis. We compare an entity's exposure to, and management of, ESG matters with those of its closest peers to take into account industry standards and to avoid double-counting any factors that have already been considered in our business risk assessment. We would therefore not automatically apply a negative ESG assessment to entities operating within industries that emit high levels of greenhouse gases, as this would have already been factored into our initial analysis.

DISCLAIMER

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