ESG and Credit in Oil & Gas and Industrials

December 2021

Corporate ESG profiles are driving some key business decisions. ESG scores can be critical in choosing suppliers; and for listed firms it can determine their suitability as an investment and ultimately their funding costs. This paper looks at the link between ESG profiles and credit risk.

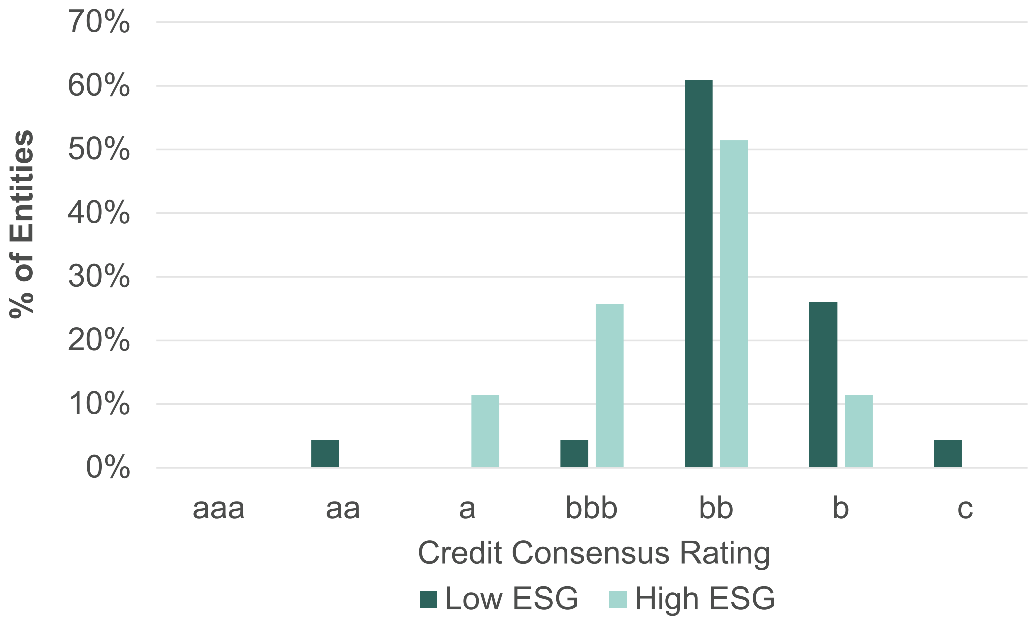
Moody's ESG scores and related analytics have up to 15 years of history with a core database covering more than 100,000 companies. Credit Benchmark have been providing consensus credit ratings since 2015, covering around 30,000 corporates and financials globally.

This preliminary study looks at a sample of global corporate issuers: 58 in the Oil & Gas sector and 56 in the Industrials sector. The selection criteria for this sample are as follows:

- Issuer unrated by major agencies
- Consensus rating based on 3 or more bank contributions
- Issuers are Ultimate Parents (i.e. not subsidiaries)
- Issuer size is large or medium, or more than 5 bank contributions
- Issuers are domiciled in developed markets in North America, Europe or Pacific

Figure 1 shows the credit distributions for Oil & Gas companies split by ESG score, with a score of 30 as the boundary. There are 23 companies in the Low Score category.

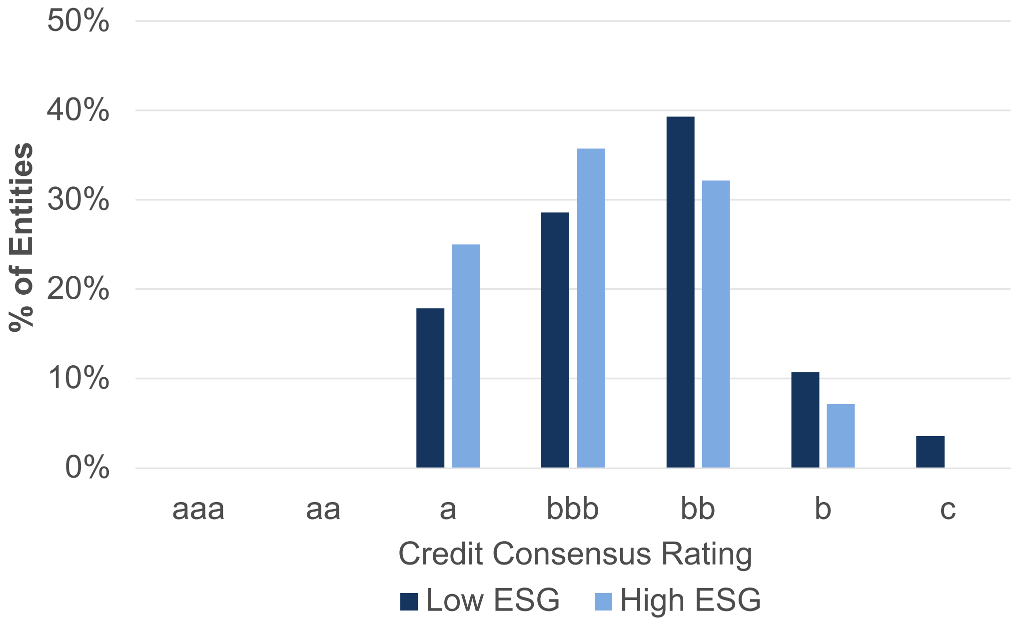
Figure 1: Credit Distributions, Oil & Gas, by ESG score



This suggests a significant credit difference between companies with a high (i.e. progressive) ESG score and those with a low score. In particular, those that score poorly have a higher proportion of companies in the **bb**, **b** and **c** credit categories; those with good scores have a much higher proportion in **a** and **bbb**. (The company in the aa category is Saskenergy Inc., which is owned by Saskatchewan state.)

Figure 2 shows the credit distribution for Industrials. There are 28 companies in the Low Score category.

Figure 2: Credit Distributions, Industrials, by ESG score



This suggests a moderate credit difference between High and Low ESG scores. Companies with scores of less than or equal to 30 have a higher proportion in the **bb**, **b** and **c** categories. Those above 30 have a higher proportion of companies in the **a** and **bbb** credit categories, with no companies in the **c** category.

These charts demonstrate the importance of controlling for sector bias when assessing the impact of ESG scores. It is clear that Oil & Gas companies – which tend to score poorly on Environmental factors – are dominated by the **bb** category; while Industrials are equally represented in the **bbb** and **bb** category. A sector-specific approach makes it much clearer that both sectors have a mix of High and Low ESG scores; but there are some significant differences in credit distributions both within and between these sectors.

One of the key links between credit quality and ESG score is investment: companies have to invest to achieve sustainability targets; while social and governance goals may require significant changes, with transition risks and costs.

This analysis suggests that the payoff for such investment is better credit quality, and by implication cheaper and easier access to funding.

The data for this sample suggests that ESG scores and credit rating levels are correlated. Figures 3 and 4 plot changes in credit risk for each sector for 2021 YTD, again split by ESG score.

Figure 3: Credit Change, Oil & Gas, by ESG

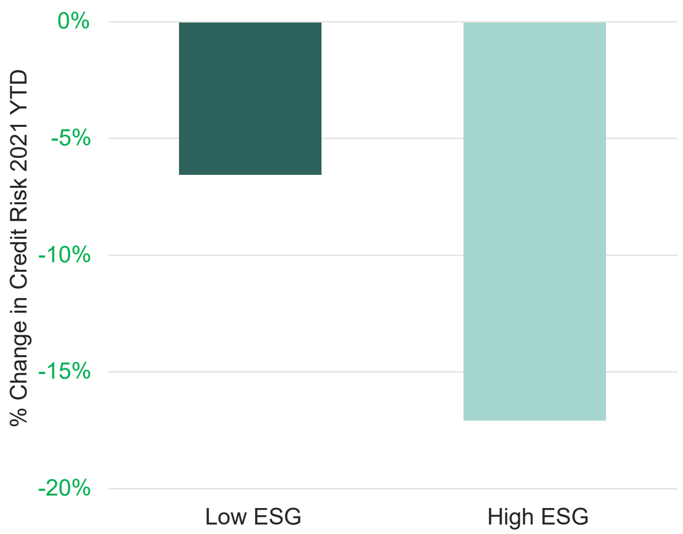
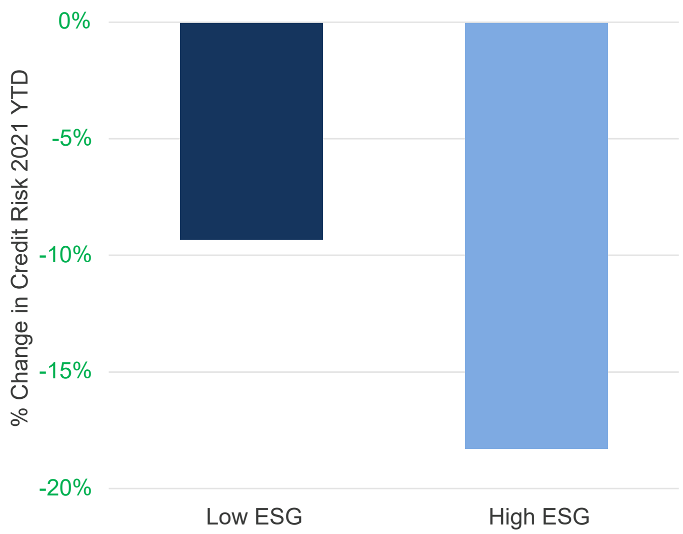


Figure 4: Credit Change, Industrials, by ESG



Credit risk has fallen across the sample this year. But in both sectors, there is a notable difference between the Low and High ESG score groups. Oil & Gas companies with a High ESG score show a fall of 17% in credit risk during 2021, against 7% for Low ESG scores. For Industrials, the pattern is similar: a fall of 18% for High ESG scores and 9% for Low ESG scores.

These credit improvements are a partial rebound from major declines in 2020 when credit risk in most sectors soared across the globe. It should be noted that, in the sample of 114 companies surveyed here, the largest decline and subsequent recovery has been in High ESG score companies.

It is possible that businesses in this sample that promote good citizenship and sustainability have also been most vulnerable to the consequences of lockdowns; but they have also benefited more as restrictions are eased. Bringing the pandemic under control may also be good for the progressive ESG agenda.

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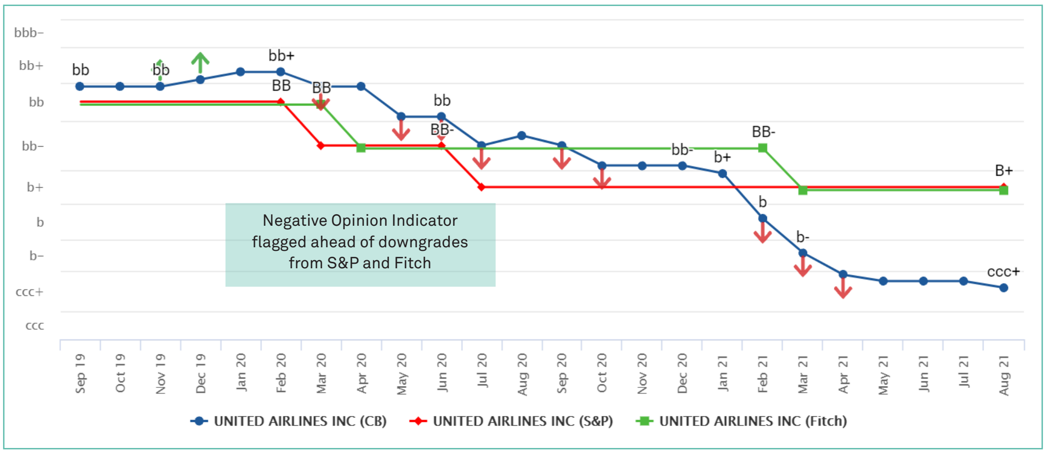

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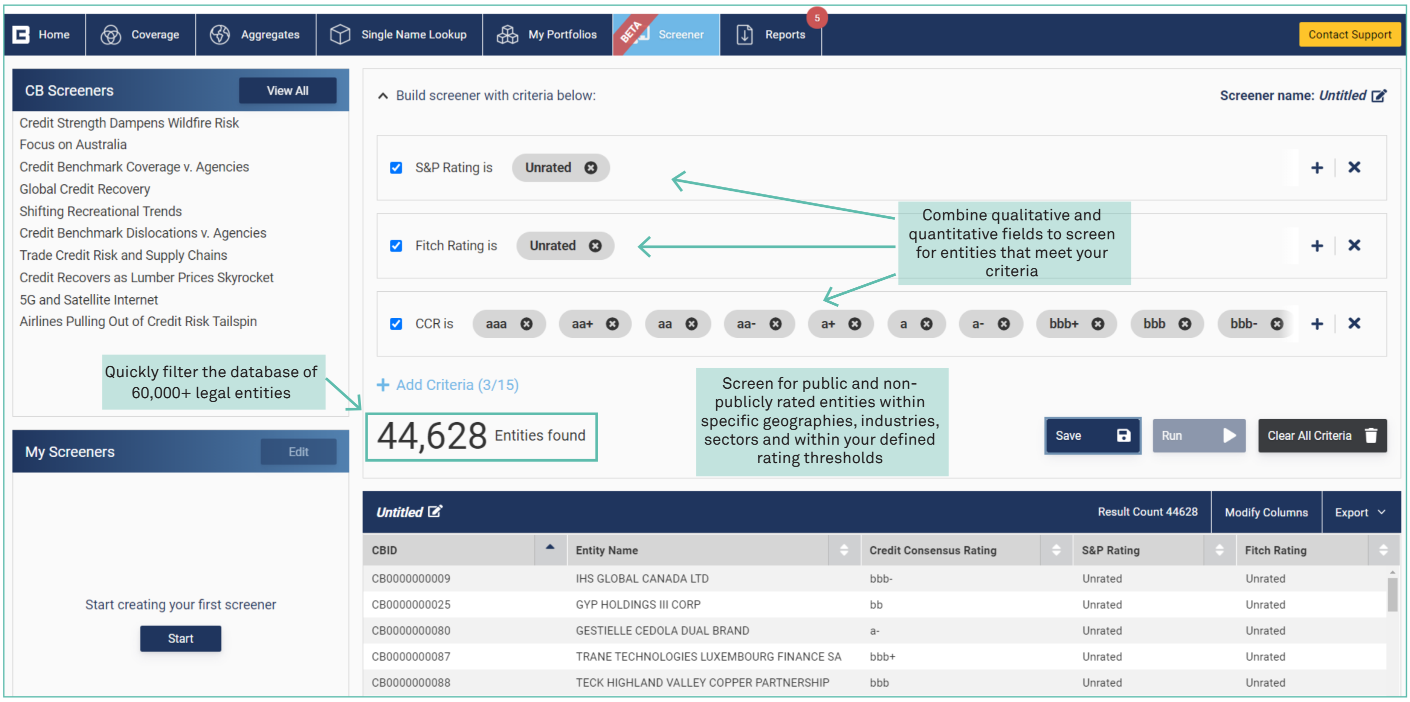
Credit Benchmark Web App: Entity-Level Data Sample



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