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Second Party Opinion

Danfoss' Sustainability-Linked Bond Framework

May 17, 2023

Danfoss is a multinational headquartered in Nordborg, Denmark, with 41,928 employees globally. Founded in 1933, Danfoss has worldwide sales in more than 100 countries, with factories in more than 20 countries. The company provides engineering solutions, including electrical and mechanical components, and serves diversified industrial and construction end markets through three segments: Danfoss Power Solutions, Danfoss Climate Solutions, and Danfoss Power Electronics and Drives. In 2022, the company reported sales revenue of above €10 billion.

In our view, Danfoss' Sustainability-Linked Bond Framework, published May 2023, is aligned with:

-  Sustainability-Linked Bond Principles, ICMA, 2020

Issuer's Sustainability Objectives

Danfoss' sustainability strategy comprises three key pillars: Decarbonization; circularity; and diversity, equity, and inclusion. The company has set ambitious carbon reduction targets in line with the Paris Agreement's 1.5 degrees Celsius (C) pathway. Danfoss commits to reduce absolute scope 1 and 2 greenhouse gas (GHG) emissions 46.2% by 2030 from a 2019 base year. To achieve its overarching goal of becoming carbon neutral in all global operations by 2030, Danfoss' three-step approach includes installation of energy efficient solutions, recycling the energy that the company already has, phasing out fossil fuels, and procuring renewable energy. It also commits to reduce absolute scope 3 GHG emissions associated with the activities of its customers and suppliers by 15% within the same timeframe. This includes offering energy efficient, low emission products to the market and therefore supporting its clients' decarbonization efforts. In addition, the company factors circularity as a core element in its product design and production processes, while building on its diversity and inclusion policies to attract and retain top talent.

Danfoss has developed its own sustainability-linked bond framework to further align its climate and energy objectives with its funding strategy.

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

KPI	SPTs	Baseline	2022 performance
Absolute scope 1 and 2 GHG emissions	Reduce absolute scope 1 and 2 GHG emissions 75% by 2028 from a 2019 base year	419,116 MT CO ₂ e (2019)	395,604 MT CO ₂ e
(Metric tons [MT] of carbon dioxide equivalent [CO ₂ e])	Achieve carbon neutral operations (scope 1 and 2) by 2030, equivalent to a minimum of 90% absolute scope 1 and 2 GHG emissions reduction from a 2019 base year.		

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Second Party Opinion Summary

Selection of key performance indicators (KPIs)

Alignment	 Danfoss' Sustainability-Linked Bond Framework is aligned with this component of Sustainability-Linked Bond Principles, ICMA
KPI 1	Absolute scope 1 and 2 GHG emissions (MT of CO ₂ e)


Not aligned
Aligned
Strong
Advanced

Calibration of sustainability performance targets (SPTs)

Alignment	 Danfoss' Sustainability-Linked Bond Framework is aligned with this component of the Sustainability-Linked Bond Principles, ICMA
SPTs	Reduce absolute scope 1 and 2 GHG emissions 75% by 2028 from a 2019 base year. Achieve carbon neutral operations (scope 1 and 2) by 2030, equivalent to a minimum of 90% absolute scope 1 and 2 GHG emissions reduction from a 2019 base year.


Not aligned
Aligned
Strong
Advanced

Instrument characteristics

Alignment	 Danfoss' Sustainability-Linked Bond Framework is aligned with this component of the Sustainability-Linked Bond Principles, ICMA
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The instruments the company issues under this framework will be subject to either a coupon step-up or a premium payment if Danfoss does not achieve its SPT by the target observation date. Additionally, trigger events may occur if reporting is not completed in line with requirements, or verification is not provided and made publicly available as set out in the corresponding bond documentation. The framework includes a reference to the fallback mechanisms, including potential recalculation of the baseline or relevant SPT.

Reporting

Alignment	 Danfoss' Sustainability-Linked Bond Framework is aligned with this component of the Sustainability-Linked Bond Principles, ICMA
Score	<div style="display: flex; justify-content: space-around;"> Not aligned Aligned Strong Advanced </div>

Danfoss commits to publish the performance of the KPI against the SPT annually, as well as information about recalculations of the level of carbon emissions in the base year and any relevant updates to its sustainability strategy and/or governance that could potentially affect both the KPI and SPT. Where material and viable, the issuer will disclose how the main factors contribute, as well as any positive sustainability impact and updates regarding regulations from regulatory bodies deemed relevant to the KPI and the SPT(s).

Post-issuance review

Alignment



Danfoss' Sustainability-Linked Bond Framework is aligned with this component of the Sustainability-Linked Bond Principles, ICMA

Danfoss commits to have the KPI performance against the SPT verified annually by one or more qualified external and independent reviewers with relevant expertise. The verification will be publicly available together with Danfoss' sustainability-linked progress report.

Framework Assessment

Selection of key performance indicators (KPIs)

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

 Danfoss' Sustainability-Linked Bond Framework is aligned with this component of the Sustainability-Linked Bond Principles, ICMA

KPI 1	Absolute scope 1 and 2 GHG emissions (MT of CO ₂ e)	Not aligned	Aligned	Strong	Advanced
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We believe the selected KPI is aligned with the principles, given that the scope, objective, and calculation methodology are clearly articulated in the framework. The KPI, aimed at an absolute reduction in scope 1 and 2 emissions, contributes to the global effort to combat climate change, which is a topic we consider important for the capital goods sector. Although scope 1 and 2 emissions are material to the industry, the KPI does not cover scope 3 emissions, which account for the vast majority of the issuer’s carbon footprint and, in our view, are the most material to the business.

We view positively that Danfoss calculates its absolute scope 1 and 2 GHG emissions (MT of CO₂e) in accordance with the GHG protocol. To reflect the energy procured for each location, the company uses market-based approach for scope 2 accounting in the framework. Scope 1 emissions are a result of direct activities at Danfoss' facilities, while indirect scope 2 emissions stem from the use of purchased electricity, heating, and cooling. We assess favorably that the KPI is expressed as a sustainability outcome rather than a financial proxy and covers all global facilities under Danfoss' operational control.

We acknowledge that reducing absolute scope 1 and 2 emissions is necessary for Danfoss to achieve climate neutrality in its global operations and this is an integral part of its sustainability strategy. The selected KPI is relevant to the capital goods sector given the energy-intensive nature of manufacturing power products (see "[Key Sustainability Factors: Capital Goods](#)"). This is particularly relevant given Danfoss' large global presence. However, we view the selection of only this KPI as a weaker practice because scope 3 emissions account for 98% of Danfoss' GHG inventory. Most of its scope 3 emissions are related to customers' use of its sold products, among other sources. We note that while Danfoss' products are energy efficient and help customers to reduce their emissions, inclusion of scope 3 into the KPI would have a greater impact on the company's and the sector's decarbonization efforts.

To reflect considerable changes related to merger and acquisition (M&A) activities, as well as to enhance data accuracy, the baseline emissions and historical performance have been recalculated. The updated baseline has been verified with a limited assurance performed by a third party.

Calibration of sustainability performance targets (SPTs)

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

Second Party Opinion



Danfoss' Sustainability-Linked Bond Framework is aligned with this component of the Sustainability-Linked Bond Principles, ICMA

SPTs	Reduce absolute scope 1 and 2 GHG emissions 75% by 2028 from a 2019 base year.	Not aligned	Aligned	Strong	Advanced
	Achieve carbon neutral operations (scope 1 and 2) by 2030, equivalent to a minimum of 90% absolute scope 1 and 2 GHG emissions reduction from a 2019 base year.				

We believe the ambition, clarity, and characteristics of the issuer's SPT(s) are strong. Specifically, the framework outlines the strategy to reach the targets, providing relevant information on past and expected future performance.

The framework lays out the expected observation date, and the trigger events. The first target observation date is Dec. 31, 2028, while carbon neutrality will be observed on Dec. 31, 2030.

Danfoss has benchmarked the SPT against three years of its historical performance (2019-2022) and provided the projected target achievement until 2030. It commits to reduce CO₂e emissions by a minimum of 8.2% on average per year, faster than its historical pace of 1.9%. Additionally, we view positively that Danfoss' SPTs under the framework are more ambitious compared to its GHG emission reduction targets that have been already validated by the Science Based Targets initiative (SBTi), such as a reduction of absolute scope 1 and 2 GHG emissions of 46.2% by 2030 from a 2019 base year, and a 15% reduction in absolute scope 3 GHG emissions within the same timeframe.

When setting the SPT, the company also conducted a peer benchmarking exercise by comparing its reduction target with those of its global industry peers, considering their local context. The outcome of the benchmark illustrates that Danfoss' targets are more ambitious than most of the peers selected by the issuer and go beyond the minimum SBTi requirement.

The strategy to reach the SPT(s) is well articulated in the framework. Specifically, the issuer commits to install energy-efficient solutions and leverage excess heat from buildings, processes, and data centers in a bid to reduce, resource, and re-use energy. In addition, Danfoss will continue to purchase 100% renewable electricity by 2030 via power purchase agreements (PPAs) from the regions where it operates. We view this instrument as robust, because such PPAs seem likely to provide the additional sustainability benefit of helping drive expansion of renewable generation capacity. The current focus is to decarbonize electricity consumption in the EU and U.S., and the issuer plans to expand the scope of countries gradually. Danfoss considers compensation to address unavoidable residual emissions (10% or below) as a last resort, which we evaluate positively.

Furthermore, we view positively that the issuer has already identified external factors beyond its control that may affect the SPT(s), such as pandemics and natural disasters, market constraints, pricing of renewable energy, and regulatory uncertainties related to PPAs, as well as M&A activities and organic growth that could significantly affect its GHG emissions inventory.

Baseline	Reduce absolute scope 1 and 2 GHG emissions by 75% by 2028 from a 2019 base year				
	2019	2020	2021	2022	2028
419,116 MT CO ₂ e	378,076 MT CO ₂ e	404,305 MT CO ₂ e	395,604 MT CO ₂ e	104,779 MT CO ₂ e	41,912 MT CO ₂ e
Reduction from 2019 baseline	Equivalent to 10% reduction	Equivalent to 4% reduction	Equivalent to 6% reduction	Equivalent to 75% reduction	Equivalent to 90% reduction

Instrument characteristics

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

 Danfoss' Sustainability-Linked Bond Framework is aligned with this component of the Sustainability-Linked Bond Principles, ICMA

Danfoss can issue bonds under the framework for both targets (to reduce absolute scope 1 and 2 GHG emissions 75% by 2028 or achieve carbon neutral operations [scope 1 and 2] by 2030 from a 2019 base year). In its sustainability-linked bond framework, the company discloses that if the trigger event occurs, the bond issued under this framework will be subject to either a premium payment or coupon step-up. The trigger event takes place, if: 1) the KPI has not achieved the SPT(s) at the relevant target observation date(s); 2) the reporting has not been completed in line with the requirements set out in the relevant bond documentation; or 3) the verification has not been provided and made publicly available as set out in the relevant bond documentation.

The characteristics of any bond issued under this framework may change, leading to a financial impact in the form of either a premium payment or coupon step-up, in case a trigger event occurs.

The framework includes a fallback mechanism whereby the issuer will recalculate the GHG emissions baseline figures, and the corresponding SPT, if there is a significant change of 5% due to either alterations in the issuer's organizational structure, improved data availability, or a changed calculation methodology.

Danfoss commits to report any readjustment to the baseline or SPT in its sustainability-linked progress report and obtain verification by a qualified external reviewer. The third party will confirm its alignment with the issuer's sustainability strategy and materiality.

Reporting

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

 Danfoss' Sustainability-Linked Bond Framework is aligned with this component of the Sustainability-Linked Bond Principles, ICMA

Disclosure score

Not aligned

Aligned

Strong

Advanced

We consider Danfoss' overall reporting practices to be strong.

Danfoss will disclose the performance of the KPI against the SPTs in its sustainability-linked progress report annually. It might be either incorporated into the integrated annual report or a stand-alone report. Additionally, the progress report will include the information regarding any recalculations of the level of carbon emissions in the base year and any relevant updates to Danfoss' sustainability strategy and/or governance with a potential impact on the KPI and SPT(s).

Furthermore, where relevant and feasible, the issuer will annually disclose how the main factors, such as M&A activities, contribute to KPI performance, and illustrate the positive sustainability impacts of the performance improvement or any updates on new or proposed regulations from regulatory bodies deemed relevant to the KPI and the SPT(s).

We assess positively that a qualified external reviewer with the relevant expertise will verify the performance level of the KPI against SPT(s).

Post-issuance review

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



Danfoss' Sustainability-Linked Bond Framework is aligned with this component of the Sustainability-Linked Bond Principles, ICMA

The issuer commits to externally verify KPI performance against the SPT(s) by one or more independent and qualified third-party reviewers annually. When choosing an external reviewer, the issuer will ensure the selection process is aligned with the voluntary guidelines for green, social, sustainability, and sustainability-linked bonds.

Danfoss will publish the verification and sustainability-linked progress report on its website, as set out in the sustainability-linked bond framework and in related bond documentation.

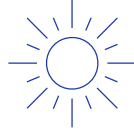
Mapping To The U.N.'s Sustainable Development Goals

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

Danfoss' sustainability-linked bond framework intends to contribute to the following SDGs:

KPI

Absolute scope 1 and 2 GHG emissions MT CO₂e



13. Climate action* **7. Affordable and clean energy***

*The KPI is likely to contribute to the SDGs

Second Party Opinion

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