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Second Party Opinion

IHO Verwaltungs GmbH's Sustainability-Linked Financing Framework

March 23, 2023

IHO Verwaltungs GmbH (IHO) is a Germany-based holding and finance company wholly owned by IHO Beteiligungs GmbH. Its portfolio comprises three main companies in the automotive and industrial sectors: Schaeffler AG, of which IHO owns 75%; Continental AG (36%); and Vitesco Technologies Group AG (Vitesco; 39.9%). They are all global manufacturing companies headquartered in Germany and listed on the Frankfurt Stock Exchange.

In our view, IHO's Sustainability-Linked Financing Framework, published on March 23, 2023, is aligned with:

-  Sustainability-Linked Bond Principles, ICMA, 2020
-  Sustainability-Linked Loan Principles, LMA/LSTA/APLMA, 2023

Issuer's Sustainability Objectives

IHO seeks to provide solutions that can assist with the transition to a low-carbon and more-sustainable economy. Currently, IHO's sustainability strategy is characterized by the respective strategies of its portfolio companies, primarily Schaeffler, the main company over which IHO has full control.

Schaeffler's sustainability strategy focuses on 10 key environmental, social, and governance (ESG) action fields. These include the goal of achieving climate neutrality in the company's own operations by 2030, and throughout its entire supply chain by 2040, by targeting a reduction in carbon dioxide emissions (scopes 1, 2, and 3) and offsetting residual emissions that cannot be reduced.

IHO has developed a sustainability-linked financing framework to link its financing with its sustainability objectives. These include a commitment to a decarbonization pathway for Schaeffler, of which IHO holds all outstanding shares with voting rights, measured by a reduction in direct greenhouse gas (GHG) emissions. IHO further intends this commitment to provide guidance for other companies in its portfolio for which it does not own a majority of shares.

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

KPI	SPTs	Baseline (2019)	2022 Performance
GHG emissions from Schaeffler's own operations (scope 1 and 2)	Reduction of absolute (gross) scope 1 and 2 GHG emissions by 75% to 260,800 tons of carbon dioxide equivalent (tCO _{2e}) or	1,043,000 tCO _{2e}	488,000 tCO _{2e}

Primary Analyst

Maria Ortiz de Mendivil
Madrid
+34-687-007-348
maria.omendivil@spglobal.com

Secondary Analyst

Dennis Sugrue
London
+44-20-7176-7056
dennis.sugrue@spglobal.com

Luisina Berberian
Madrid
+34-91-788-7200
luisina.berberian@spglobal.com


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below observed by year-end 2025, and by 90% to 104,300 tCO₂e or below observed by year-end 2030


GHG emissions from Schaeffler's upstream supply chain (scope 3 upstream)	Reduction of absolute (gross) scope 3 upstream GHG emissions by 25% to 4,603,500 tCO ₂ e or below observed by year-end 2030	6,138,000 tCO ₂ e	6,234,000 tCO ₂ e
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Second Party Opinion Summary

Selection of key performance indicators (KPIs)

Alignment	 IHO's Sustainability-Linked Financing Framework is aligned with this component of the Sustainability-Linked Bond and Loan Principles.				
KPI 1	GHG emissions from Schaeffler's own operations (scope 1 and 2)	Not aligned	Aligned	Strong	Advanced
KPI 2	GHG emissions from Schaeffler's upstream supply chain (scope 3 upstream)	Not aligned	Aligned	Strong	Advanced

Calibration of sustainability performance targets (SPTs)

Alignment	 IHO's Sustainability-Linked Financing Framework is aligned with this component of the Sustainability-Linked Bond and Loan Principles.				
SPT 1	Reduction of absolute (gross) scope 1 and 2 GHG emissions by 75% to 260,800 ton of carbon dioxide equivalent (tCO _{2e}) or below observed by year-end 2025, and by 90% to 104,300 tCO _{2e} or below observed by year-end 2030	Not aligned	Aligned	Strong	Advanced
SPT 2	Reduction of absolute (gross) scope 3 upstream GHG emissions by 25% to 4,603,500 tCO _{2e} or below observed by year-end 2030	Not aligned	Aligned	Strong	Advanced

Instrument characteristics

Alignment  IHO's Sustainability-Linked Financing Framework is aligned with this component of the Sustainability-Linked Bond and Loan Principles.

If an SPT is not met by the target observation date, a trigger event will take place leading to a change in the financial characteristics of the relevant sustainability-linked instrument. This could occur through, for example, a revision of the interest rate, either up or down, for periods commencing after the relevant observation date (referred to as coupon or margin step-ups or step-downs). It could also occur through the payment of a higher or lower amount upon redemption of the instrument. Furthermore, the issuer defines a fallback mechanism in the event that the performance against the SPT for each KPI cannot be calculated or observed in a satisfactory manner.

Reporting

Alignment  IHO's Sustainability-Linked Financing Framework is aligned with this component of the Sustainability-Linked Bond and Loan Principles

Score Not aligned Aligned Strong **Advanced**

IHO will publish relevant information on the performance against the SPT annually on its corporate website, or on another website that it designates. The issuer commits to disclose any reassessments of the KPIs or SPTs due to changes or adjustments to the baseline or scope, if applicable, as well as information on any drivers that affect performance against the SPTs. Progress

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against the SPTs, as well as the positive impact achieved, will also be published in Schaeffler's annual sustainability report. The report will be subject to and include a verification assurance statement (limited assurance), and IHO will make it available to lenders, investors, and any other interested party via a link at the IHO Section of the homepage.

Post-issuance review

Alignment




IHO's Sustainability-Linked Financing Framework is aligned with this component of the Sustainability-Linked Bond and Loan Principles.

IHO commits to have the performance against the SPT verified annually at the portfolio company level through the verification of Schaeffler's sustainability report. The issuer commits to make Schaeffler's sustainability report, including the limited assurance statement, readily available to lenders, investors, and any other interested party.

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.

-  IHO's Sustainability-Linked Financing Framework is aligned with this component of the Sustainability-Linked and Loan Bond Principles.

IHO has selected two KPIs, one related to scope 1 and 2 emissions from Schaeffler's own operations, as defined in its sustainability report, and the other related to Schaeffler’s upstream scope 3 emissions. We view favorably the inclusion of a specific KPI to address upstream scope 3 emissions as it addresses the most material source of emissions for both the industry and the group. As part of our assessment, we acknowledge that these KPIs leave out of scope emissions generated by other companies within IHO’s portfolio (namely Vitesco and Continental). However, we understand that this is because Schaeffler is the only company within IHO's portfolio for which it has 100% voting rights and therefore full control over. Finally, we note that there is no certainty that instruments issued under the framework will be linked to both KPIs.

KPI 1	GHG emissions from Schaeffler's own operations (scope 1 and 2).	Not aligned	Aligned	Strong	Advanced
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We consider that the first KPI that IHO has selected is aligned with the Principles, given that the scope, objective, and calculation methodology are clearly articulated, and that it responds to a material topic for the capital goods and automotive sector.

The KPI's objective, baseline, and applicable scope are clearly stated in the framework: that is, to achieve climate neutrality in its own operations in 2030. It is one of the most used KPIs in the market, allowing for external benchmarking. Furthermore, it has been calculated following the GHG protocol, which represents the most widely used international standard globally. Through tracking and improving performance against this KPI, IHO intends to tackle decarbonization, which links to its sustainability strategy, focused on promoting sustainability and environmental responsibility to its portfolio companies. We believe it is linked to one of the most relevant and pressing sustainability issues facing the capital goods and automotive equipment and machinery sectors, climate-change mitigation (see "Key Sustainability Factors: Capital Goods," published May 11, 2021, on RatingsDirect).

We regard it as positive that the KPI is expressed as a sustainability outcome rather than a financial proxy. We also acknowledge that reducing Schaeffler’s scope 1 and 2 emissions is necessary for IHO to achieve its sustainability objectives; however, we view this KPI as weaker than KPI 2, because tackling scope 3 emissions, which account for the lion's share of the holding company's total measured carbon footprint, would have a greater impact on its and the sector's decarbonization efforts.

In addition, the KPI only focuses on Schaeffler's emissions, which limits our opinion of its materiality. While we acknowledge that Schaeffler is the only company in IHO's portfolio over which it has full control, the other companies, Continental and Vitesco, still contribute a significant amount to IHO's reported carbon footprint. For example, in 2021, Continental and Vitesco’s scope 1 and 2 emissions were approximately 1.08 million tCO₂e. Based on IHO's 36% and 39.9% share of these companies respectively, we estimate that its share of their emissions is approximately 0.39 million tCO₂e, lower than the 0.91 million tons attributed to IHO from Schaeffler's (75% ownership). As such, we estimate that Schaeffler represents close to 57% of the holding company's scope 1 and 2 emissions.

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KPI 2	GHG emissions from Schaeffler's upstream supply chain (scope 3 upstream)	Not aligned	Aligned	Strong	Advanced
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We consider the second KPI selected by IHO to be strong, given that the scope, objective, and calculation methodology are clearly articulated, and that the KPI responds to a very material topic for the capital goods and automotive sector.


The KPI's objective, baseline, and applicable scope are clearly stated in the framework: to reduce Schaeffler's absolute scope 3 emissions from purchased goods and services, fuel, and energy-related GHG emissions and transport and distribution by 25% by year-end 2030. The KPI is calculated following the GHG Protocol and the methodology for target validation by SBTi, both widely used international standards. In our view, tackling upstream scope 3 emissions is directly linked to climate-change mitigation, which is one of the most relevant and pressing sustainability issues facing the capital goods and automotive equipment and machinery sectors (see "Key Sustainability Factors: Capital Goods," published May 11, 2021, on RatingsDirect), as well as directly linked to IHO's sustainability strategy.

We view as a strength that the KPI covers Schaeffler's scope 3 emissions, because these represent over 90% of the company's reported carbon footprint in 2022. Also, we view favorably that IHO includes emissions related to the purchase of goods and services, which, according to the CDP's Technical Note on the relevance of Scope 3 Categories by sector published in 2022, account for the second-most-material scope 3 category (following the downstream category use of sold products) for both the capital goods sector and the transport original equipment manufacturer (OEM) sector. However, the KPI does not include downstream emissions, particularly those related to the use of sold products that, as stated, represent the most material category of scope 3 emissions (84% and 90% of the total carbon footprint for transport OEMS and capital goods companies respectively, according to the CDP.). This said, we appreciate the difficulty of measuring the emissions of the products sold, and acknowledge that it is a sector-wide issue.

As for the first KPI, the scope is limited to Schaeffler's scope 3 emissions, instead of including the other portfolio companies' emissions, which constrains our opinion of the materiality of the KPI for IHO. Finally, in this case, the 2019 figure (the baseline) has not been externally verified, now or in the past, because Schaeffler has only recently started measuring and tracking this KPI, and only data from 2020 has been externally assured, which in our view falls short of the market practice to have the baseline subject to external verification.

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.

 IHO's Sustainability-Linked Financing Framework is aligned with this component of the Sustainability-Linked Bond and Loan Principles.

SPT 1	Reduction of absolute (gross) scope 1 and 2 GHG emissions by 75% to 260,800 tons of carbon dioxide equivalent (tCO ₂ e) or below observed by year-end 2025, and by 90% to 104,300 tCO ₂ e or below observed by year-end 2030	Not aligned	Aligned	Strong	Advanced
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We believe the ambition, clarity, and characteristics of the SPTs linked to KPI 1 are strong. Furthermore, the framework provides externally verified information on Schaeffler's past emission performance and describes the strategy to achieve the targets by the observation dates.

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Schaeffler's historical performance for reducing GHG emissions has been externally verified and is part of Schaeffler's regular public sustainability reporting. The framework outlines the timeline for achieving the targets (expressed in absolute values) until the observation dates on Dec. 31, 2025, and 2030, as well as the relevant trigger events.

The SPT is benchmarked against Schaeffler's past performance. Schaeffler has been able to reduce its scope 1 and 2 emissions by 53% in 2022 since 2019. It achieved the bulk of this (29%) in 2020, when the effects of pandemic-related lockdowns contributed to the accelerated reduction in emissions, and in 2022 (30%), a year in which it achieved its goal to ensure 100% of its sites in Europe and China purchased green power exclusively. To achieve the targets, the company must reduce emissions by an additional 37% (over 7% per year until 2025 and 3% per year until 2030) compared with the baseline. While this trajectory represents a slowdown in the necessary reductions to achieve the first target on the first observation date, we believe that residual emissions are the most difficult to remove. The absolute level of the reduction in emissions to be achieved (a 90% reduction) demonstrates a material improvement in GHG emissions compared with the baseline and peers' emissions.

We view as a strength that in December 2022, the target to 2030 was validated by SBTi as being in line with the 1.5°C scenario. While the target to 2025 was itself not validated, it was considered an intermediary milestone in achieving the long-term target. Additionally, IHO has carried out a benchmarking exercise to show that the expected trajectory is in line with that of most advanced peers in the automotive sector. We consider that the selected peers represent a good and diverse group for comparison, because they are all in the same sector and include the other IHO portfolio companies, Vitesco and Continental. We also think that the trajectory compares favorably with the peer group's ambitions.

The framework includes substantial information on the strategy to achieve the targets, which primarily incorporates an increase in the use of renewable energy through the surge of on-site renewable generation. Schaeffler aims to ensure 10% of its global energy requirements in 2025 and 25% in 2030 are covered by self-generated renewable energy (mainly from solar photovoltaics). Also, it has signed a power purchase agreement (PPA) in Germany to supply 60,000 megawatt-hours (MWh) of green electricity to its sites in the country as of 2023. Although we acknowledge that the company currently relies heavily on energy attributed certificates (EACs) to reduce its scope 2 emissions, we view favorably its aim to focus on other mechanisms, such as on-site generation and PPAs. These strategies are more robust, in our view, because they provide the additional sustainability benefit of helping drive the expansion of renewable generation capacity.

Baseline	Reduction of absolute scope 1 and 2 GHG emissions by 75% or below by 2025, and by 90% or below by 2030				
2019	2020	2021	2022	2025	2030
1,043,000 tCO ₂ e	744,000 tCO ₂ e	699,000 tCO ₂ e	488,000 tCO ₂ e	260,800 tCO ₂ e	104,300 tCO ₂ e
	Equivalent to 29% reduction from the baseline	Equivalent to 33% reduction from the baseline	Equivalent to 53% reduction from the baseline	Equivalent to 75% reduction from the baseline	Equivalent to 90% reduction from the baseline

SPT 2	Reduction of absolute (gross) scope 3 upstream GHG emissions by 25% to 4,603,500 tCO ₂ e or below observed by year-end 2030	Not aligned	Aligned	Strong	Advanced

We believe the ambition, clarity, and characteristics of the SPT 2 are in line with the Principles. Furthermore, the framework provides externally verified information on Schaeffler's past emission performance and describes the strategy to achieve the target. It outlines the timeline for achieving the targets (expressed in absolute values) until the observation date on Dec. 31, 2030, as well as the relevant trigger events.

The SPT is benchmarked against Schaeffler's past performance, which shows it increased its upstream scope 3 emissions by 2% in 2022 compared with 2019 data. In this regard, the company needs to achieve a 27% reduction by 2030 to meet its target (approximately a 3.4% annual reduction), which demonstrates an improvement compared with its business-as-usual trajectory, in our view indicating the target's ambition.

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We view as a strength that in December 2022, SBTi validated the target as being in line with the 1.5°C scenario. Additionally, as part of the process to set the target, IHO carried out benchmarking against peers in the automotive sector. We consider that the selected peers represent a good and diverse group for comparison because they are all in the same sector and include the other IHO portfolio companies: Vitesco and Continental. The trajectory compares favorably with the peer group's ambitions and, according to SBTi as of March 2023, of 141 companies in the sector that have a public commitment to set science-based targets, only 70 have approved targets; and of these, only 48 (including Schaeffler) have targets in line with the 1.5°C scenario.

The framework includes some information on the strategy to achieve the target, which primarily focuses on improving its procurement criteria to favor the purchase of “low-emission materials and services” including low emissions steel, aluminum, plastics, electronic components, and logistics. In this regard, the framework states that Schaeffler has entered into an agreement with a Swedish start-up to purchase 100,000 tons per year of green steel from 2027, which we view favorably.

Baseline **Reduction of absolute (gross) scope 3 upstream GHG emissions by 25% to 4,603,500 tCO₂e or below observed by year-end 2030**

2019	2020	2021	2022	2030
6,138,000 tCO ₂ e	5,499,000 tCO ₂ e	6,176,000 tCO ₂ e	6,234,000 tCO ₂ e	4,603,500 tCO ₂ e
	Equivalent to 10% reduction from the baseline	Equivalent to 1% increase from the baseline	Equivalent to 2% increase from the baseline	Equivalent to 25% reduction from the baseline

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.

- ✓ IHO's Sustainability-Linked Financing Framework is aligned with this component of the Sustainability-Linked Bond and Loan Principles.

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

Following a trigger event, the financial characteristics of the relevant sustainability-linked instrument will change. This could occur through, for example, a revision of the interest rate, either up or down, for periods commencing after the relevant observation date (referred to as coupon or margin step-ups or step-downs). It could also occur through the payment of a higher or lower amount upon redemption of the sustainability-linked instrument. The possible changes occurring upon a trigger event will be specified within the final terms and conditions of each bond issued.


The Framework includes two target observation dates linked to the first KPI (Dec. 31, 2025, and 2030 respectively) and one target observation date relevant to the second KPI. Also, it includes a commitment to have annual observation dates based on the expected SPT trajectories linked to any loans issued under the framework, in line with the Sustainability-Linked Loan Principles and with market practice.

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

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funding, or the sustainability performance of the financed projects over the lifetime of any dedicated funding, including any commitments to post-issuance reporting.

 IHO's Sustainability-Linked Financing Framework is aligned with this component of the Sustainability-Linked Bond and Loan Principles

Disclosure score

Not aligned

Aligned

Strong

Advanced


We consider IHO's overall reporting practices to be advanced compared with market practices.

IHO will publish relevant information on the performance against the SPTs for both KPIs annually on its corporate website, or on another website that it designates, to enable investors, lenders, and other relevant stakeholders to monitor Schaeffler's progress against its sustainability commitments. Furthermore, the holding company commits to disclose the related impact and timing of such impact on the instrument's economic characteristics, and any reassessments of the KPI or SPTs due to changes or adjustments to the baseline or scope, if applicable, as well as information on any drivers that affect performance against the SPT, including but not limited to technological advancements, mergers and acquisitions, or events with a global impact such as the COVID-19 pandemic. The issuer commits to make the external verification report (limited assurance), as part of Schaeffler's sustainability report, publicly available.

Finally, progress against the SPTs, as well as illustrations of the positive impact achieved--namely, descriptions of how the decarbonization measures contribute to overarching goals, including the U.N.'s Sustainable Development Goal 13 on climate action--will be published at the portfolio company level through Schaeffler's annual sustainability report.

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.

 IHO's Sustainability-Linked Financing Framework is aligned with this component of the Sustainability-Linked Bond and Loan Principles.

IHO commits to have the performance against all SPTs verified annually at the portfolio company level through the verification of Schaeffler's sustainability report. The issuer commits to make the assurance statement readily available to investors. In this regard, Schaeffler's sustainability report will be verified annually, including the performance against the SPTs for each KPI in the framework, by a qualified external auditor at a limited assurance standard. The verification report will be published annually as part of the sustainability report on Schaeffler's website and include a description of the procedures conducted and any inherent limitations, the standards used to assess conformance, and a confirmation of the practitioners' independence.

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.

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

KPI

GHG emissions from Schaeffler's own operations (scope 1 and 2).



***13. Climate action**

GHG emissions from Schaeffler's upstream supply chain (scope 3 upstream)



***13. Climate action**

*The KPI is likely to contribute to the SDGs.

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